

June 7, 2024

EU Adopts Corporate Sustainability Due Diligence Directive

Directive Imposes Human Rights, Environmental and Climate Transition Plan Obligations on EU and Non-EU Companies

SUMMARY

On May 24, 2024, after intense negotiations among EU Member States and following approval by the European Parliament, the Council of the EU formally [adopted](#) the Corporate Sustainability Due Diligence Directive (the “CSDDD”). The [CSDDD](#) introduces requirements for in-scope companies to identify, assess, prevent and mitigate adverse human rights and environmental impacts in their own operations, subsidiaries and value chains. The CSDDD also requires in-scope EU and non-EU companies to adopt transition plans to align their business model and strategy with the Paris Agreement’s goal of limiting global warming to 1.5°C. EU Member States are required to empower supervisory authorities to investigate and impose penalties on companies that fail to comply.

The CSDDD will enter into force on the 20th day after its publication in the Official Journal of the EU. EU Member States will have two years to implement the regulations and administrative procedures to comply with the CSDDD. The directive will begin to apply on a phased-in basis between 2027 and 2029 depending on company turnover and, for EU companies, employee thresholds.

The CSDDD is part of the EU’s Green Deal, a set of policy initiatives developed to align the EU’s climate, energy, transport and taxation policies with its ambition to become the first climate-neutral continent by 2050. Other significant regulatory efforts under the EU Green Deal include the [EU Taxonomy Regulation](#), the [Sustainable Finance Disclosure Regulation](#) and the [Corporate Sustainability Reporting Directive](#) (the “CSRD”).

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IN-SCOPE COMPANIES AND COMPLIANCE TIMELINE

The obligations under the CSDDD apply to EU companies that have met certain worldwide employee and net turnover thresholds for each of the last two financial years. The CSDDD also applies extraterritorially to non-EU companies—even ones without a physical presence in the EU—so long as they have met certain net turnover thresholds in the EU in two consecutive years. Non-EU companies that are in-scope will have to appoint an authorized representative who must inform the competent supervisory authority that the company is in-scope.

Turnover and employee thresholds. In-scope companies are:

- **EU companies:** companies formed under the laws of an EU Member State that have over 1,000 employees on average during the course of a financial year and an annual net worldwide turnover exceeding €450 million.
- **Non-EU companies:** companies formed outside the EU that have an annual net turnover exceeding €450 million in the EU.
- **EU franchisors and licensors:** EU companies that have entered into certain types of franchising or licensing agreements in the EU in return for royalties, if (1) those annual royalties amount to more than €22.5 million and (2) the company has an annual net worldwide turnover exceeding €80 million.
- **Non-EU franchisors and licensors:** non-EU companies that have entered into certain types of franchising or licensing agreements in the EU in return for royalties, if (1) those annual royalties amount to more than €22.5 million and (2) the company has an annual net turnover exceeding €80 million, in each case, in the EU (together with EU franchisors and licensors, “In-Scope Franchisors and Licensors”).

Indirect effects. In addition, a large number of entities worldwide is expected to be affected indirectly by the CSDDD as upstream or downstream business partners of in-scope entities.

Financial institutions. In-scope regulated financial institutions and their upstream business partners (such as investors) will be covered by the CSDDD, but the CSDDD will not cover the activities of downstream business partners, such as investees or borrowers. However, the CSDDD provides that as early as possible but no later than two years after it enters into force, the European Commission (the “Commission”) must assess and report on the necessity of adopting additional sustainability due diligence requirements related to the financial services and investment activities of regulated financial institutions and the options for such due diligence requirements. The final text also specifically exempts alternative investment funds (“AIFs”) and undertakings for collective investment in transferable securities (“UCITSs”); however AIF managers and UCITS management companies are in scope of CSDDD.

Phased-in application timeline. Compliance under the CSDDD will begin in:

- **2027** (three years after entry into force) for (1) EU companies with more than 5,000 employees and an annual net worldwide turnover exceeding €1,500 million and (2) non-EU companies with an

annual net EU turnover exceeding the same amount, in each case with initial reporting beginning with respect to financial year 2028.

- **2028** (four years after entry into force) for (1) EU companies with more than 3,000 and up to 5,000 employees and an annual worldwide net turnover of more than €900 million and up to €1,500 million and (2) non-EU companies with an annual net EU turnover in the same range, in each case with initial reporting beginning with respect to financial year 2029.
- **2029** (five years after entry into force) for (1) EU companies with more than 1,000 and up to 3,000 employees and an annual worldwide net turnover of more than €450 million and up to €900 million, (2) non-EU companies with an annual net EU turnover in the same range, and (3) In-Scope Franchisors and Licensors, in each case with initial reporting beginning with respect to financial year 2029.

DUE DILIGENCE OBLIGATIONS

The CSDDD requires in-scope companies to conduct appropriate human rights and environmental due diligence with respect to their and their subsidiaries' operations, as well as the operations of business partners in their "chain of activities". "Chain of activities" is defined to include the activities of a company's (1) upstream business partners related to both the services and products of the company (e.g., design, resource extraction, sourcing, manufacturing and development) and (2) downstream business partners related to the distribution, transport and storage of products of the company, but not those related to its services.¹

In-scope companies will be required to:

1. ***Integrate risk-based human rights and environmental due diligence into policies and risk management systems.*** Companies will need to develop a due diligence policy in consultation with employees and their representatives. The due diligence policy should contain (a) a description of the company's approach to due diligence, (b) a code of conduct describing rules and principles applicable to the company, its subsidiaries and, where relevant, direct or indirect business partners and (c) a description of the processes for integrating due diligence into the relevant policies and for carrying out due diligence, including measures taken to verify compliance with the code of conduct and to extend its application to business partners. This due diligence policy must be reviewed and updated at least every 24 months or whenever a significant change occurs.
2. ***Identify and assess actual or potential adverse human rights² and environmental³ impacts.*** Companies will need to take appropriate measures to map their own operations, as well those of their subsidiaries and business partners in their chains of activities, to identify general areas where adverse impacts are most likely to occur and to be most severe, and to carry out in-depth assessments in those areas.
3. ***Prevent or mitigate actual and potential adverse impacts.*** In-scope companies will need to take appropriate measures to prevent or adequately mitigate any adverse human rights or environmental impacts they have identified. "Appropriate measures" specified in the CSDDD include: (a) neutralizing the actual adverse impact or minimizing its extent; (b) developing and implementing a prevention or corrective action plan; (c) seeking contractual assurances from direct (and potentially indirect) business partners regarding compliance with the code of conduct and any prevention action plan, and adopting accompanying measures to verify business partners' compliance with these contractual assurances; (d) making financial or non-financial investments, adjustments or upgrades of, for example, facilities, production or other operational processes and infrastructure; (e) adapting business plans, strategies and operations (including purchasing practices) and developing and using purchasing policies that

contribute to living wages and incomes for their suppliers, and that do not encourage potential adverse impacts on human rights or the environment; and (f) as a last resort suspending or terminating the relevant business relationship. The CSDDD also contemplates that the Commission will provide guidance on model contractual clauses. Where it is not feasible to fully prevent, mitigate, bring to an end or minimize all identified adverse impacts at the same time, companies must prioritize adverse impacts identified.

4. ***Provide remediation for actual adverse impacts.*** The CSDDD stipulates that in-scope companies will provide remediation for an actual adverse impact, unless the adverse impact was caused solely by a business partner. The CSDDD defines “remediation” to mean “restoration of the affected person or persons, communities or environment to a situation equivalent or as close as possible to the situation they would have been in had an actual adverse impact not occurred, in proportion to the company’s implication in the adverse impact”. This may include financial or non-financial compensation and, where applicable, reimbursement of the costs incurred by public authorities for any necessary remedial measures.
5. ***Carry out meaningful engagement with stakeholders.*** In-scope companies must consult with employees, representatives of affected communities and other stakeholders, providing them with relevant and comprehensive information, and allowing for genuine interaction and dialogue. Companies may use industry or multi-stakeholder initiatives to comply with their obligations, except for the obligation to consult with a company’s own employees and their representatives.
6. ***Establish and maintain a notification mechanism and a complaints procedure.*** In-scope companies will need to provide affected persons as well as certain civil society organizations, human rights defenders and trade unions with the ability to submit complaints directly to the company in case of legitimate concerns regarding actual or potential adverse impacts with respect to the companies’ own operations, the operations of their subsidiaries or the operations of their business partners in the chains of activities of the companies.
7. ***Monitor the effectiveness of due diligence measures.*** In-scope companies must carry out periodic assessments of their and their subsidiaries’ operations, as well as the operations of business partners in their chain of activities. These verification assessments must be carried out at least every 12 months or whenever there are reasonable grounds to believe that new risks may arise.
8. ***Publicly communicate on due diligence.*** In-scope companies, other than those already subject to the CSRD, must publish annual statements on their websites describing their due diligence efforts. The Commission will adopt delegated acts specifying the content and criteria of the reporting. Companies subject to the CSRD are already required to include information on due diligence activities as part of their disclosure under that separate legislation.

TRANSITION PLAN OBLIGATION

In addition to the due diligence obligations, the CSDDD will require in-scope companies to implement a climate transition plan to ensure, through best efforts, that their business model and strategy are compatible with the Paris Agreement’s goal of limiting global warming to 1.5°C and the EU’s own climate neutrality goals, including its intermediate and 2050 climate targets.

The CSDDD specifies that compliant transition plans should address, where relevant, the exposure of the company to coal-, oil- and gas-related activities. Transition plans should also include time-bound and science-based targets for 2030 and in five-year steps up to 2050, including a description of decarbonization levers identified and key actions planned to reach targets, and, where appropriate, absolute emission reduction targets for greenhouse gas for Scope 1, 2 and 3 emissions. Companies will need to develop

implementing actions to achieve such targets, and to update their transition plans every 12 months to assess progress made towards their targets.

Companies reporting a transition plan for climate change mitigation under the CSRD will be deemed to comply with the CSDDD transition plan obligation.

ENFORCEMENT MECHANISMS

The CSDDD, in the form of national implementation acts, will be enforced by the authorities of the EU Member States, including through imposing pecuniary and non-pecuniary penalties for non-compliance. Where pecuniary penalties are concerned, the CSDDD requires EU Member States to specify a maximum limit of no less than 5% of net worldwide turnover in the financial year preceding the decision. Compliance with CSDDD implementation acts may also be taken into account as part of the decision process for public support, public procurement and public concessions. To ensure coordinated enforcement, the Commission will set up a European network of supervisory authorities.

The CSDDD also requires EU Member States to ensure companies are liable for civil damages in circumstances where their failure to prevent potential or to end actual adverse impacts on rights, prohibitions or obligations aimed at protecting a natural or legal person caused damage of that person's legal interests that are protected under national law. However, companies will only be liable for their own actions and not the actions of their business partners, provided that the company has obtained the requisite assurance—and can reasonably expect compliance—from such business partner. This liability will entitle the natural or legal person to full compensation but may not lead to overcompensation, e.g., in the form of punitive damages. The final text of the CSDDD does not set forth any specific fiduciary duty obligations.

IMPLICATIONS

The CSDDD will require wide-ranging corporate sustainability due diligence from large EU and non-EU companies. Given the breadth of the new requirements, companies should begin to assess (1) whether they, their affiliates or their business partners will become subject to the CSDDD requirements, and (2) if so, gaps between their current policies, strategies and practices and those required to meet the CSDDD obligations.

Even entities that are not directly covered by the CSDDD will need to assess whether they are in the upstream or relevant downstream value chain of companies that are in-scope for the CSDDD. Such companies may be asked to collect and provide data on their human rights and environmental impacts to in-scope counterparties. They may also be asked to provide indemnities and certain other contractual assurances, or risk losing business.

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Companies subject to the CSDDD, as well as other companies with significant business relationships in the EU, should continue to monitor the development and implementation of the CSDDD requirements under national laws, as well as further guidance from the EU, including on financial institutions' obligations and model contracting clauses.

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ENDNOTES

- ¹ As noted above, for regulated financial institutions, the definition of “chain of activities” does not include downstream business partners that receive their services or products.
- ² Examples of adverse human rights impacts under the CSDDD include impacts on persons resulting from an abuse of one of certain human rights instruments (e.g., the right to life, the prohibition of torture and slavery, the right to enjoy just and favorable working conditions like fair wage, the prohibition of child and forced labor, the right to unionize and the prohibition of employment discrimination), and the abuse of certain human rights not listed in a specified human rights instrument but set forth in an international instrument, such as the core conventions of the International Labor Organization.
- ³ Examples of adverse environmental impacts under the CSDDD include those resulting from the breach of certain prohibitions and obligations under the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights, as well as impacts resulting from the breach of obligations listed in certain environmental instruments, such as the obligation to avoid or minimize adverse impacts on biological diversity or pollution of the marine environment, the prohibition on unlawful disposal of waste, or the import and export of certain chemicals.

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