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Proposed EU Corporate Sustainability Due Diligence Directive: Update on Developments

Briefing Note No. 3

Introduction

A leap forward has been made in the journey of the proposed EU Corporate Sustainability Due Diligence Directive (CSDDD). In 2022, the European Commission and Council published their approaches on the CSDDD, and in June 2023, the Parliament adopted its position. The so-called 'trilogues' negotiations have started, and a final CSDDD text is anticipated in late 2023 or early 2024, meaning the Directive would be transposed into national law in EU Member States in 2025/26. In this Briefing Note No.3, we outline common themes and divergences across the three EU institutions' positions on the CSDDD, assisting our clients to stay up to date as this key framework evolves.[1]

Common Themes and Significant Divergences

Amongst the major themes to be reconciled across the three institutions' positions during the negotiations are broadening of the scope to bring more companies within the Directive, the inclusion and role of ultimate parent companies, and a return to the familiar concept of risk-based due diligence consistent with the UN Guiding Principles on Business and Human Rights (UNGPs). The span of due diligence is also at issue, as the Commission proposes that due diligence in value chains is limited to within 'established business relationships', whereas the Parliament version would require due diligence across value chains, in keeping with the UNGPs. A key aspect where the institutions' positions on due diligence vary is regarding downstream 'use' and 'users' of products and services. In addition, companies at group level may be able to support the fulfilment of due diligence obligations by their subsidiaries, as this is provided for in both the Council and Parliament texts, but not the Commission version. Civil liability, broadly for failure to comply with CSDDD obligations such that an adverse impact leads to damage, is included in all three versions. However, only the Parliament introduces much needed provisions to support those adversely affected to access remedy. While sanctions are included in all three versions, the Parliament text widens potential penalties, and sets a limit on fines based on worldwide net turnover.

Ongoing negotiations include these aspects, as well as the applicability of the CSDDD to the financial sector, and whether Directors' will have duties to oversee the implementation of due diligence. When the CSDDD will apply to companies is an open question, with both Parliament and Council proposing

[1] In our Briefing Notes No's 1 and 2 we outlined previous developments and key steps to prepare for mandatory human rights due diligence.

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staggered application over 3-5 years after the CSDDD comes into force, based on a company's size and activity. Below we review the major themes to be reconciled and compare the different draft versions of the CSDDD.

Scope

Applicability: As outlined in the table below, in all versions, the CSDDD includes both EU and non-EU companies in scope, based on thresholds of activity. The criteria are based on the number of employees and the net worldwide turnover for EU companies, and on the net turnover generated in the Union for non-EU companies. The Parliament version would bring more companies into scope, as it sets a lower company size threshold compared to the Commission and Council and aligns more closely with the related EU Corporate Sustainability Reporting Directive (CSRD).[2] In addition, in the Parliament text companies may meet the threshold of activity and come within the CSDDD individually, and may also come within it as the 'ultimate parent company' of a group meeting threshold levels.[3] The Parliament adopts a cross-sectoral approach, in contrast to the Commission and Council which segment into a 'Group 1' of large companies, and a 'Group 2' of smaller companies which operate in 'Higher Risk Sectors' of textiles, agri-food and the extraction of minerals.[4]

Controversially, in all three texts there is a special regime for the financial sector, which would have lesser due diligence obligations than other economic actors. For the financial sector, both the Commission and Council limit due diligence to identifying the adverse impacts of business partners before providing financial services,[5] while the Parliament limits their due diligence obligations to entities directly receiving financial services.[6] Further, the Council leaves whether to include financial institutions to the discretion of Member States.[7]

Value Chain - Upstream and Downstream: On the 'value chain', there are notably different positions taken by the three institutions. The Commission definition of value chain covers upstream supply chain and downstream, but with due diligence limited to within 'established business relationships' in the value chain.[8] The Council takes another approach and replaces 'value chain' with a new concept of a 'chain of activities'[9], reflecting divergent views amongst Member States as to whether the Directive should

[2] Under the CSRD, EU Companies that exceed at least two of: Balance sheet total EUR 20m; net turnover EUR 40m; average employees during the financial year of 250; listed SMEs.
[3] See table below.
[4] Commission and Council Article 2(1)b and 2(2) b. Provided at least 50% of this turnover was generated in one or more defined 'high impact' sectors.
[5] Council Article 2(8). The Council compromise text leaves out of the scope financial products (i. e. alternative investment funds (AIFs) and undertakings for collective investment in transferable securities (UCITS)).
[6] See also Parliament new Article 8a, and Recital 19.
[7] Article 2(8).
[8] Article 3(1)(f) 'established business relationship' means a business relationship, whether direct or indirect, which is, or which is expected to be lasting, in view of its intensity or duration and which does not represent a negligible or merely ancillary part of the value chain;'
[9] Council Article 3(g) 'chain of activities' means: '(i) activities of a company's upstream business partners related to the production of goods or the provision of services by the company, including the design, extraction, manufacture, transport, storage and supply of raw materials, products or parts of the product or the service; and (ii) activities of a company's downstream business partners related to the distribution,

cover the whole 'value chain' or be limited to the 'supply chain'. Finally, the Parliament text returns to due diligence obligations spanning the 'value chain', broadly consistent with the UNGPs.[10] However, there are notable limitations on downstream span in the Parliament text. While it includes the 'sale' of products or services and consideration in their design and commercialization, the Parliament text does not include the 'use' or downstream users of products and services.[11] Similarly, the Council text does not include 'use' of products or provision of services in its definition of a 'chain of activities'.[12]

Return to Risk Based Due Diligence

Certain companies have long voluntarily conducted due diligence, in line with the UNGPs. With the arrival of the CSDDD, all companies within scope will have to identify and assess actual and potential adverse human rights and environmental impacts arising from their own operations, their subsidiaries, and those related to their value chains (to be defined), in order to surface adverse impacts which are most likely to occur, their potential severity, and which should be prioritised, taking into account relevant risk factors. A 'risk based' approach to due diligence is present in the Commission text but it is less central than in established international frameworks including the UNGPs.[13] The Council supports taking a risk based approach,[14] and we anticipate that companies will be relieved to see the Parliament text re-emphasise a familiar risk based approach to due diligence, which aligns more closely with existing international frameworks such as the UNGPs and updated OECD Guidelines for Multinational Enterprises.[15] Further, the Parliament helpfully defines 'risk factors' to be taken into account.[16]

Recalling, due diligence is an 'obligation of means', meaning to take appropriate steps within companies' means to set up and carry out due diligence measures.[17] In all three institutions' texts, companies should take 'appropriate measures', meaning measures which are capable of achieving the objectives of due diligence, having regard to the severity and likelihood of adverse impacts, the companies circumstances, and prioritizing action. It is welcome that the Parliament adds that 'appropriate measures' are those which effectively address the identified adverse impact, in a manner proportional to the company's

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transport, storage and disposal of the product, including the dismantling, recycling, composting or landfilling, where the business partners carry out those activities for the company or on behalf of the company, excluding the disposal of the product by consumers and distribution, transport, storage and disposal of the product being subject to the export control under [Regulations….].

[10] Article 3(1)(g). See also, for example, UNGP 13 and Commentary.

[11] Parliament Article 3(1)(g) defines value chain as including i) activities related to, and entities involved in, the production, the design, sourcing, extraction, manufacture, transport, storage and supply of raw materials, products or parts of a company's product and development of a company's product or the development or provision of a service, and ii) activities related to, and entities involved in, the sale, distribution, transport, storage, and waste management of a company's products or the provision of services, and excluding the waste management of the product by individual consumers.

[12] Council Article 3(q); Article 6.

[13] See for example UNGPs 13, 14, 17 and 18, and Commentaries.

[14] Council amendments to Article 6, and new 6a which emphasises prioritisation based on the severity and likelihood of the adverse impact, and sets down appropriate measures to prevent or mitigate potential adverse impacts and/or bring actual adverse impacts to an end.

[15] *inter alia*, Parliament Article 3(1)(qf); Article 5(2)(a).

[16] Parliament Article 3(1) (qf) Risk factors 'means company-level risk factors, business model risk factors, geographic risk factors, product and service risk factors and sectoral risk factors.' Parliament Article 3(1) (qg) 'means the scale, scope and irremediable character of the adverse impact, taking into account the gravity of an adverse impact, including the number of individuals that are or will be affected, the extent to which the environment is or may be damaged or otherwise affected, its irreversibility and the limits on the ability to restore affected individuals or the environment to a situation equivalent to their situation prior to the impact.'

[17] See institutions' versions of Recital 15.

circumstances.[18] In addition, only the Parliament text includes an obligation to conduct heightened due diligence in circumstances where risks of adverse impacts are magnified, such as when companies operate in areas of conflict, occupation, or in failed states.[19]

Cause, Contribute, Directly Linked: In the UNGPs, the causal relationship of a company to an adverse impact is used to assess the scope of the company's responsibility for the impact.[20] While this familiar approach is integral to all three institutions' texts, the Parliament reinforces this approach and also adds clarity by defining what is 'to cause', 'contribute to', and to be 'directly linked' to an adverse impact.[21]

Adverse Impact: In the Commission text an 'adverse impact' is a 'violation' of one of the rights or prohibitions in the Annex and related international conventions.[22] However, the Parliament returns to a practicable formulation in line with the UNGPs, where an 'adverse human rights impact' results from an action which removes or reduces the ability of an individual or group to enjoy the rights, or to be protected by the prohibitions, enshrined in the Annex and related international conventions. Further, in its text, an 'adverse impact on environment' is a 'failure to comply' with the obligations listed in the Annex.[23]

Contractual Assurances: In all three institutions' texts, companies may seek contractual assurances from their suppliers that they will abide by the lead company's expectations such as in its supplier code of conduct, and also 'cascade' these by seeking corresponding contractual provisions with their suppliers in the value chain. The relationship of such assurances to potential civil liability of the company in scope is dealt with in the texts, but differs. The Commission and Council include a 'safe harbour' style provision from liability for damages caused by an adverse impact arising as a result of the activities of an indirect partner,[24] including where the lead company has taken actions such as obtaining contractual assurances.[25] However, in the Parliament version, companies can still be held liable, even if they seek contractual assurances and support the implementation of specific aspects of their due diligence with third-party verification.[26] Helpfully, the Parliament text explicitly states that contractual assurances 'shall

[18] Article 3(1) (q) 'appropriate measures' means measures that are capable of achieving the objectives of due diligence and effectively addressing the adverse impact identified […] in a manner proportionate and commensurate to the degree of severity and the likelihood of the adverse impact, and proportionate and commensurate to the size, resources and capacities of the company. This shall take into account the circumstances of the specific case, including the nature of the adverse impact, characteristics of the economic sector, the nature of the company's specific activities, products and services, the specific business relationship.

[19] Parliament new Article 5(2)(b) expands the definition of 'affected stakeholders; and introduces a definition of 'vulnerable stakeholders'. See also, for example, UNGP 12 and Commentary.

[20] UNGP 17.

[21] Article 3(1)(qb-d).

[22] '[…..] of one of the prohibitions and obligations in Annex Part I Section 1, as enshrined in the international conventions listed in the Annex Part I Section 2.'

[23] 'listed in the Annex, Part I, Section 1 and Annex, Part I, Section 2.' Further, ''adverse impact' means any potential or actual adverse human rights or adverse environmental impact'. See also, Recital 25(c). The Council version altered adverse human rights impact' from a 'violation' to an 'abuse' of one of the human rights listed in the Annex I, Part I Section 1, as those human rights are enshrined in the international instruments listed in the Annex I, Part I Section 2 […]. See also, UNGP 11.

[24] Council Article 22(1).

[25] Commission Article 22(2).

[26] Parliament Article 22(2)(b).

not result in the transfer of responsibility for carrying out due diligence under the Directive, and liability for failing to do so'.[27]

Parent Companies: A notable element in the Council and the Parliament versions, but not that of the Commission, is provision for companies to support and fulfil some due diligence obligations at group level. The Parliament text provides that parent companies may perform actions on behalf of their subsidiaries which are in the scope of the CSDDD.[28] These actions can contribute to their subsidiaries meeting their obligations of conducting due diligence, as well as documenting and reporting,[29] subject to certain conditions, and without prejudice to the civil liability of subsidiaries.[30] This means, for example, that a company can design and implement a global, corporate wide due diligence programme, which subsidiaries can apply to meet their due diligence obligations, while also taking subsidiary level actions such as integrating due diligence into the subsidiary's policies and risk management systems.[31]

Stakeholder Engagement and Heightened Protections

In the Commission and Council texts, stakeholder engagement is present, yet not positioned as a central and a consistent requirement. In comparison, the Parliament text requires and emphasises full, meaningful and safe consultation with 'affected stakeholders', and also specifically references vulnerable populations and those at increased risk such as migrant workers and women.[32] Further, recognising the real risks to rightsholders if business relationships are suspended or terminated, Parliament also sets down parameters for company conduct if this arises.[33] These, and other additional protections regarding responsible disengagement,[34] which are not as present in the Commission and Council texts, align with the UNGPs, international standards and best practice.

Access to Remedy

Civil liability, broadly for failure to comply with obligations in the Directive such that an adverse impact leads to damage, is included in all three versions of the CSDDD.[35] However, in all texts the decision on who holds the burden of proof is left to national law, potentially leading to a heavier burden on claimants in some jurisdictions.[36] Further, the Commission and Council fail to address existing barriers to remedy,

[27] Article 8(5)(2)(a).
[28] Parliament and Council Article 4a.
[29] Articles 5 to 11 and Article 15.
[30] Parliament 4(a); Council Article 4(2).
[31] Parliament 4(a).
[32] Article 3(1)(n) and 3(1)(n)(a). Also, Article 5(2)(b) and 8(d)(1-7). See also UNGP 12 and Commentary; UNGP 18 and Commentary.
[33] Parliament Article 7 and Recital 32. Noting that the Council also envisages the possibility for companies to not terminate a business relationship if there is a reasonable expectation that the termination would result in a more severe adverse impact
[34] Such as Article 8(6)(1); Article ((3)(c). See also UNGP 19 and Commentary.
[35] The Council clarifies four elements requires damage caused to a natural or legal person, a breach of duty, a causal link between the damage and the breach of the duty and fault (intention or negligence).
[36] Recital 58. The Commission and Council leave the question to national law. Further, the Council provides for individual Member States to choose whether only the victim, or other representative organisations on behalf of the victims. The Parliament includes similarly accords discretion to Member States, while indicating that these can reverse the burden of proof once the claimants have established a prima facie case of the likelihood of the defendant company's liability.

and only the Parliament includes much needed practical supports to improve access to justice for claimants.[37] Regarding remediation for those adversely impacted, the Commission refers only to financial compensation specifically, whereas the Council refers to full compensation for damages resulting from a company's failure to comply with the due diligence obligations. The Parliament widens remediation to include compensation, restitution, rehabilitation, public apologies, reinstatement or a contribution to investigations, and non-repetition, which is more consistent with international standards, such as the UNGPs.[38]

Directors' Responsibilities

For EU companies coming within the CSDDD only, a Directors' duty of care, as well as separate Directors' responsibilities for oversight of the implementation of due diligence obligations were introduced in the Commission text.[39] The Council did not include a Directors' duty of care, and integrated a company, rather than Directors', responsibility to put in place and oversee due diligence.[40] The Parliament included a Directors' duty of care but not the responsibility of oversight of implementation.[41] While the intuitions' positions differ, a Directors' oversight duty will be part of the trilogues negotiations.

Sanctions

All three institutions' texts provide for penalties, including fines, and allow for consideration of remedial and other supportive actions taken by a company. Fines are included by the Commission and Council, and while both provide that fines should be commensurate with a company's worldwide net turnover, no levels are specified, with the potential for divergence across Member States. By contrast, the Parliament text sets down defined limits on monetary fines, which shall be based on the company's net worldwide turnover, with the maximum limit of not less than 5% of the net worldwide turnover of the company in the business year preceding the fining decision.[42]

Climate

All three institutions texts provide for large companies EU and non-EU companies within scope adopting plans compatible with the transition to a sustainable economy and limiting global warming.[43] In addition, the Parliament text both specifically aligns with the CSRD, and sets down parameters on the content of such plans, such as to include time bound targets for climate change and emission reduction.[44]

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[37] Article 22(2)(a).
[38] Parliament Article 8(c)(2). See also UNGP 25 and Commentary.
[39] Articles 25 and 26 respectively.
[40] Article 5(3).
[41] Deleted during amendments of the agreed position.
[42] See Article 20. Parliament Article 20(3), and 20(2) including other sanctions such as a ban from public procurement.
[43] Article 15.
[44] Parliament Article 15: Develop and implement a transition plan in line with the reporting requirements in Article 19a of Regulation (EU) 2021/0104 (CSRD), to ensure that the business model and strategy of the company are aligned with the objectives of the transition to a

Staggered Application and Harmonisation

As outlined in the table below, the Commission and Council envisage application of the CSDDD to a Group 1 of large EU and non-EU companies, and to a Group 2 of smaller companies operating within high risk sectors two years later. The Parliament includes EU and non-EU companies across sectors based on activity. In addition, both the Council and Parliament propose staggered application, starting with the largest companies, once the CSDDD enters into force. Notably, in the Parliament text, companies may meet the threshold (individually), and as the 'ultimate parent company' of a group.

> Staggered application would mean the CSDDD would apply up to 3 to 5 years after entry into force

Under staggered application in the Parliament text, three years after its entry into force, the CSDDD would apply to EU companies with over 1000 employees on average *and* net worldwide turnover of more than EUR150m in the last financial year, and to the ultimate parent of a group with such; and to non-EU companies, which generated a net turnover of more than EUR150m in the Union or are the ultimate parent of a group generating such a turnover.[45] The Council also adopts a phased approach, with the CSDDD applying three years after entry into force to companies with over 1000 employees and EUR300m net worldwide turnover, and for non-EU companies, over EUR300m net turnover generated in the Union. Staggered application is also provided in the CSRD, which phases in reporting under the general scope over four years. Recognising the possibility of differing standards when the Directive is transposed across Member States, leading to fragmentation and challenges for companies operating across different countries, Parliament and Council include to review harmonisation after 6 and 7 years.

How can Article One help to prepare?

We translate these complex requirements for business and perform gap analysis to benchmark policies and processes against the CSDDD and existing due diligence laws. In this way, we assist our clients to develop a roadmap for alignment and adopt robust approaches reflecting their values and goals.

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sustainable economy and with the limiting of global warming to 1.5°C in line with the Paris Agreement and the objective of achieving climate neutrality as established in Regulation (EU) 2021/1119 (European Climate Law) as regards its operations in the Union, including its 2050 climate neutrality target and the 2030 climate target.

[45] Article 30.

Summary of EU Institutions’ Positions on the CSDDD

	Commission 2022	Council 2022	Parliament 2023
EU Companies	Companies with: 1) Have >500 employees and net worldwide turnover >EUR150m in the last FY*; and 2) Two years later, those operating in ‘high risk’ sectors with >250 employees on average and >EUR40m. net worldwide turnover in the last FY, provided at least 50% of this turnover was generated in one or more defined ‘high risk’ sectors	Thresholds as Commission, but threshold of employees and net worldwide turnover for two consecutive financial years	Companies with: 1) Have >250 employees on average and net worldwide turnover of >EUR40m in the last FY […]; 2) Did not reach the thresholds under (1) but is the ultimate parent company of a group that had 500 employees and net worldwide turnover of >EUR150m the last FY […]
Non-EU Companies	Companies with: 1) Net turnover of >EUR150m generated in the EU in the last FY; and 2) Two years later those operating in ‘high risk sectors’ with >EUR40m EU wide net turnover in the last FY, as above	As above	Companies with: 1) Net worldwide turnover >EUR150m, provided at least EUR40m was generated in the Union in the FY preceding the last, including royalties; 2) Did not reach the thresholds under (1) but is the ultimate parent of a group that had 500 employees and net worldwide turnover >EUR150m and at least EUR40m generated in the Union in the FY preceding the last, including royalties
Complaints Procedure	A complaints procedure for potential or actual adverse impacts, including in value chains	As Commission, including in chain of activities	Notification and non-judicial grievance mechanisms, built out in line with UNGP criteria
Public Reporting	• Annual statement on website • Companies not subject to reporting under the CSRD shall publish an annual report on their website by 30th April each year	For companies not subject to the CSRD, annual statement on website, no later than 12 months after the balance sheet date of the FY for which the statement is drawn up	For companies not subject to the CSRD, annual statement on website, no later than 12 months after the balance sheet date of the FY for which the statement is drawn up
Staggered Application	1) Two years after entry into force to ‘Group 1’, EU and non-EU companies; 2) Four years after entry into force to ‘Group 2’, Companies in ‘high risk sectors’	1) Three years from entry into force to: - EU companies with companies with >1,000 employees on average and net worldwide turnover of >EUR300m in the last FY - Non-EU companies that generated a turnover in the Union of >EUR300m in the last FY 2) Four years from entry into force to: - EU Companies with >500 employees and net worldwide turnover >EUR150m in the last FY - Non-EU companies with net turnover of >EUR150m generated in the Union in the last FY 3) Five years from entry into force to: - Companies referred to in Article 2(1), point (b), and Article 2(2), point (b)	1) Three years from entry into force to: - EU companies with >1,000 employees on average and net worldwide turnover of >EUR150m in the last FY, or were the ultimate parent company of a group with such a number of employees and generating such a turnover; and - Non-EU companies which generated >EUR150m in the Union in the FY preceding the last FY, or were the ultimate parent of a group generating such a turnover 2) Four years from the entry into force to: - EU companies with >500 employees on average and a net worldwide turnover of more than EUR150m in the last FY, or were the ultimate parent of a group with such a number of employees and generating such turnover, […] - EU companies which had more than 250 employees on average and had a net worldwide turnover of more than EUR40m (can defer to five years after entry into force) - Non-EU companies which generated a net turnover of more than EUR40m in the Union and EUR150m worldwide in FY preceding the last FY, or were the ultimate parent company of a group generating such a turnover