



Point of View

EU Corporate Sustainability Due
Diligence Directive

June 2024

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Regulators around the world are incorporating environmental and social principles into formal policy frameworks. Novel legislation has emerged to address multiple sustainability megatrends, such as the imperatives to combat climate change, improve supply chain human rights, and ensure sustainable resource consumption. Moreover, policy makers are focusing on increasing the accountability of businesses to ensure their sustainability impacts are properly managed.

The European Union's forthcoming Corporate Sustainability Due Diligence Directive is one such example, requiring firms to integrate their human rights and environmental impacts into business management systems. Certain companies with economic nexus in the European Union (EU) will need to navigate and prepare for these new regulatory requirements, ensuring that they develop or incorporate the appropriate risk identification and management mechanisms necessary to comply and achieve intended outcomes.

This publication serves as a valuable reference guide for companies to understand the forthcoming regulatory requirements. We sincerely hope you find the enclosed publication informative. We would be happy to participate in any discussions required to provide clarifications on our views captured in the pages that follow. We look forward to hearing from you.

Thank you,

For Uniquus Consultech



Anu Chaudhary
Partner, Global Head of
ESG Consulting



Overview: Corporate Sustainability Due Diligence Directive (CS3D)

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2. Overview: Corporate Sustainability Due Diligence Directive (CS3D)

In March 2024, the European Council achieved consensus on a final version of the Corporate Sustainability Due Diligence Directive (CSDDD or CS3D), culminating two years of negotiations and changes since the Directive was originally proposed. In late April, the European Parliament approved the Directive, representing a pivotal piece of legislation in Europe's fight against climate change while integrating risk-based due diligence into corporate operations. Finally, the Directive was approved by member state representatives and adopted by the European Council this May. EU member states must proceed with formal adoption over the next two years.

3. What are the requirements of the CS3D?

The CS3D requires companies to identify adverse impacts of their business on human rights and the environment, and it obliges companies to establish formal mechanisms for remediating these impacts. This Directive is applicable across in-scope companies' value chains, including upstream and downstream activities relating to production, supply, transportation, storage, design, and distribution.

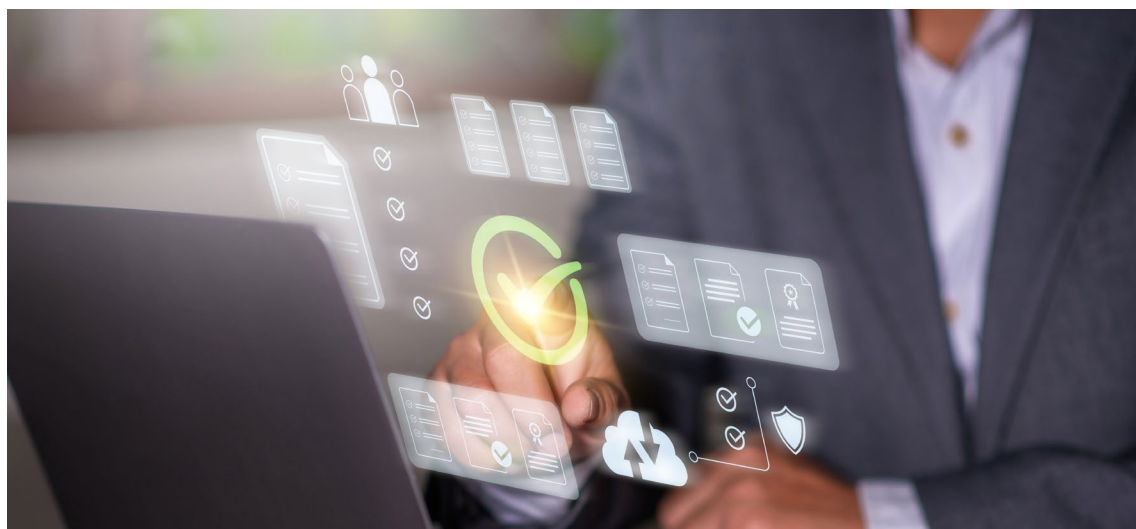
4. To whom does the CS3D apply?

The CS3D complements the existing suite of sustainable policy initiatives from the EU. For example, it serves as an extension of the European Green Deal, which aims to transition the EU to a climate-neutral, green economy. The CS3D will also complement the corporate reporting requirements of the Corporate Sustainability Reporting Directive (CSRD), as well as inform investor obligations and decisions under the SFDR and Taxonomy.

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Specifically, the CS3D is the first EU legislation which requires in-scope companies to enact a climate transition plan, which aligns with the CSRD's disclosure requirements around such a plan and enables the achievement of European Green Deal objectives. Furthermore, due diligence mechanisms and addressal of outcomes required under the CS3D can be utilized to fulfill disclosures around human rights and environmental impacts for EU-based companies under guidelines for the CSRD – namely the European Sustainability Reporting Standards (ESRS).



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Why

- Ensures EU companies take real actions to mitigate or prevent adverse business impacts
- Complements the EU's wider portfolio of sustainability regulations

What

- Outlines steps that in-scope companies must take to identify and address adverse business impacts within their operations and across their value chains
- Requires that in-scope companies develop and implement climate transition plans aligned with Paris Agreement targets

Where

- Nexus of EU member states and the business partners of in-scope companies, regardless of location

Who

- Directly impacts four categories of companies based on corporate domicile, business model, revenue, and employee size
- Indirectly impacts upstream and downstream value chain partners of in-scope companies

When

- The CS3D will be finalized in May 2024, transposed into national laws over the next two years, and phased in over 2027, 2028, and 2029

What are the requirements of the CS3D?

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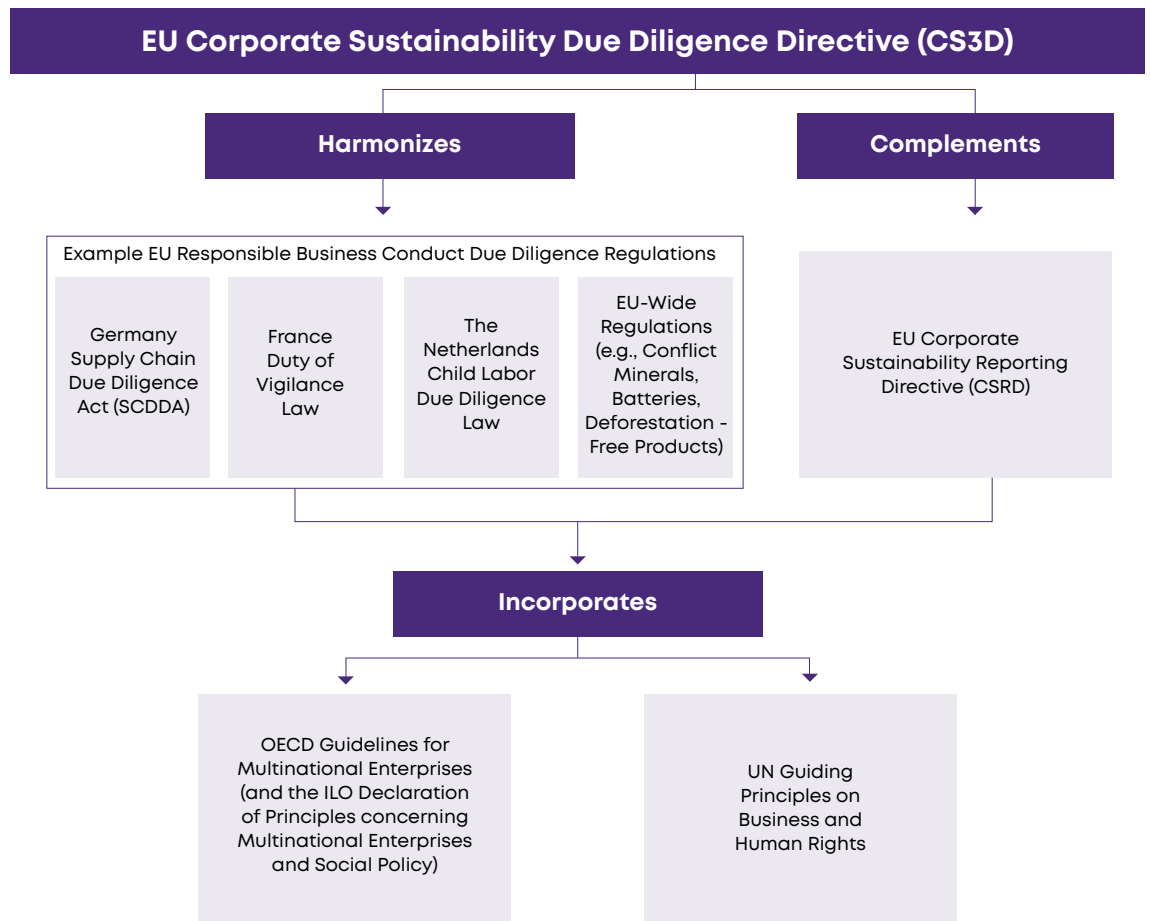
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01 Due Diligence: Identification of adverse human rights and environmental impacts

The CS3D requires companies to implement and publicly communicate a comprehensive framework to identify adverse risks and impacts to human rights and the environment within their operations, the operations of their subsidiaries, and certain operations of their business partners. The CS3D includes adverse impact topics that are also referenced in other EU and EU-member regulations.

For example, the CS3D final text requires the identification and mitigation of the risks (i.e., due diligence) outlined by the OECD Guidelines and UN Guiding Principles. These are best practice, international sources of guidance on responsible business conduct that are also referenced in the guidelines of the CSRD (i.e., ESRS), which mandates reporting on many of the same sustainability-related topics covered under the CS3D. The CS3D is also expected to harmonize due diligence requirements around the EU, succeeding country-level regulations (e.g., Germany's 'Supply Chain Due Diligence Act', France's 'Duty of Vigilance' Law, the Netherlands' 'Child Labor Due Diligence Law'), complementing EU-wide regulations (e.g., Conflict Minerals Regulation, Batteries Regulation, Regulation on Deforestation-Free Products), and supporting EU policy initiatives (e.g., 2021 EU Action Plan Towards Zero Pollution for Air, Water, and Soil, the EU Action Plan on Human Rights and Democracy 2020-2024, the EU's 2030 Climate Target Plan, the UN Paris Agreement and the UN Sustainable Development Goals).





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Some specific adverse impacts and risks covered under the CS3D may include: child labor, slavery, labor exploitation (e.g., violations related to safety, freedom of association), discrimination, climate change, pollution, and damage to ecosystems.

Human rights and environmental risks

Example Adverse Human Rights Impacts	Child Labor	Forced Labor and Slavery	Labor Exploitation and Working Conditions	Discrimination, Harassment, and Equality
Example Adverse Environmental Impacts	Climate Change	Air, Land, and Water Pollution	Management of Waste and Hazardous Substances	Deforestation, Degradation of Ecosystems, and Biodiversity Loss

02 Risk Management Systems: Integration of due diligence, addressal, and remedial mechanisms

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Companies are obligated to establish a process for mitigating risks and eliminating violations, and they must create effective grievance, notification, and remediation mechanisms. Where not feasible to prevent or mitigate all identified adverse impacts, companies should prioritize adverse impacts based on severity and likelihood of the adverse impacts. Companies should also carry out meaningful engagement with relevant stakeholders – including those persons affected by identified adverse impacts and their legitimate representatives (e.g., civil society organizations, labor unions) – providing notification to them, answering their requests for information, and responding to their complaints. Furthermore, in-scope companies are obligated to provide remediation (e.g., financial or non-financial compensation, such as restitution) from actual adverse impacts on affected persons or the environment. In cases where adverse impacts include business partners, companies can temporarily or permanently suspend such business relationships, should the partners not take appropriate steps to address such impacts. These due diligence and remediation mechanisms must be translated into policies and integrated into enterprise risk management systems – a process that is required to be reviewed on an annual basis.

Additionally, companies must continually monitor due diligence outcomes and their effectiveness. Companies are advised to reference international due diligence guidelines (e.g., OECD Guidance on Responsible Business Conduct) when setting out practical steps to prevent, mitigate, and account for how they address identified impacts. They must publicly report on due diligence issues, such as within CSRD reports where applicable.



03 Climate Transition Plan: Enactment of plans to reduce global warming to 1.5 degrees

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The CS3D is also the first EU law which mandates companies to adopt and implement a climate transition plan aligned with a 1.5-degree Celsius global warming scenario. The transition plan should ensure that companies' business models and strategies are compatible with the transition to a sustainable economy, limit global warming in line with the Paris Agreement, meet the objectives of the EU Climate Law, and address exposure to fossil fuel-related (i.e., coal, oil, and gas) activities. This agrees with the goals of the European Green Deal and supports fulfillment of reporting requirements for companies subject to the CSRD. Therefore, companies already reporting such a plan in accordance with the CSRD already comply with the CS3D's obligation to adopt such a plan and are exempted, although the CS3D also requires companies to implement the plan.

As per the CSRD guidelines (i.e., ESRS), the plan must include relevant targets, plans and other topics relevant to companies' business strategy and financial plans. These largely overlap with recommendations from the Taskforce for Climate-related Financial Disclosures (TCFD):

- **Climate reduction targets:**
Scope 1, 2, and 3 emissions targets every five years from 2030 to 2050, based on conclusive scientific evidence (i.e., independent scientific validation consistent with the limiting of global warming to 1.5 degrees).
- **Decarbonization plans:**
Key actions planned or undertaken for decarbonization to achieve set targets, including changes to company products or services and adoption of new technologies.
- **Financial plans:**
Qualitative and quantitative descriptions of investments and funding supporting transition plan implementation.
- **Accountability:**
Explanation of the roles and responsibilities among executive leadership and supervisory bodies of companies in overseeing and implementing transition plans.

The climate transition plan must be reviewed by in-scope companies every year to assess progress towards targets and update the plans accordingly. While the CS3D does not explicitly reference third-party assurance, independent attestation of such transition plans can support the development and annual review process for them.

04 Enforcement: Liability, penalties, and awards

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The Directive will be enforced through fines of at least up to 5 percent of a company's global net turnover at the consolidated level of the ultimate parent company, with EU member states permitted to set higher maximums, as well as public statements indicating company responsibility and the nature of infringements should the company fail to comply with the fine within applicable time limits. EU member states will develop national supervisors to monitor implementation of the CS3D and ensure that companies comply.

Additionally, when a company has directly or jointly caused an actual adverse impact, it should provide remediation (i.e., restitution of the affected person(s), communities, or environment and public authorities to a situation equivalent to, or as close as possible to, the situation they would be in had the actual adverse impact not occurred, proportionate to the company's implication in the adverse impact). In-scope companies would not be liable for damages only caused by business partners, but they would be held jointly liable for damages caused jointly by such companies, their subsidiaries, and indirect or direct business partners. However, when an adverse impact has been solely caused by an in-scope company's business partner, remediation is voluntary, and the company is recommended to influence its value chain partner to enable remediation.

A company could also face damages under civil liability – under the condition that they intentionally or negligently failed to prevent and mitigate potential adverse impacts or bring actual impacts to an end and minimize their extent under their due diligence obligations, and as a result a damage was caused to parties. Harmed parties will be granted a limitation period of at least five years to establish civil liability claims, with EU member states permitted to set lengthier national provisions for legal recourse. Furthermore, taking remedial action for adverse impacts would not preclude the possibilities of penalties or civil liability in the case of identified damages but could prevent future enforcement.

Finally, compliance could be leveraged as a criterion for the award of public contracts and concessions.

Enforcement Channels

State sanctions of up at least 5% of global turnover

Tort law from affected parties

Criterion for public contracts and concessions

To whom does the CS3D apply?

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01 Overview of CS3D Applicability: Four categories of companies

The CS3D will apply to four types of companies, based on firm characteristics including corporate domicile, business model, revenue, and employee size in the prior financial year. Broadly speaking, the CS3D applies to EU companies employing more than 1,000 individuals with a global turnover greater than EUR 450M. Non-EU companies do not have an employee threshold and will be affected as long as they generate turnover of at least EUR 450M within the EU. Franchisees or licensees whose royalties exceed EUR 22.5 million and meet a revenue threshold of EUR 80 million in the prior financial year would also be subject.

The graphic below defines these four categories for applicability of the Directive's requirements. The requirements of the CS3D will phase in across 3 years starting in 2027 (see next section: 'When will the CS3D apply?'):

01. EU Companies

Very large EU companies, or the ultimate parents of EU groups on a consolidated basis, reaching the below thresholds

Employees:
1000+ employees on average

Revenue:
EUR 450M+ net turnover worldwide

02. Non-EU Companies

Very large non-EU companies, or the ultimate parents of groups on a consolidated basis, reaching the below thresholds

Employees:
Not Applicable

Revenue:
EUR 450M+ net turnover within the EU

03. EU Franchisees

EU companies with a franchising or licensing business model (ensuring a common identity and business concept), or the ultimate parents of groups entering into such agreements on a consolidated basis, reaching the below thresholds

Employees:
Not Applicable

Revenue:

- EUR 22.5M+ royalties worldwide
- EUR 80M+ net turnover worldwide

04. Non-EU Franchisees

Non-EU companies with a franchising or licensing business model (ensuring a common identity and business concept), or the ultimate parents of groups entering into such agreements on a consolidated basis, reaching the below thresholds

Employees:
Not Applicable

Revenue:

- EUR 22.5M+ royalties within the EU
- EUR 80M+ net turnover within the EU

For ultimate parent companies of subsidiaries which, taken together on a consolidated basis, fulfill these employee and revenue thresholds, the CS3D should be met by the parent company. Or, should the parent company not engage in taking management, operations, or financial decisions on behalf of such subsidiaries, the CS3D obligations should be met by the closest operational subsidiaries to the parent company for those local operations which meet the applicability of the CS3D.

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Should parent companies be subject to the CS3D but its subsidiaries are not, then all their operational subsidiaries shall be included under parent company obligations, regardless of whether its subsidiaries are obligated to carry out the Directive's obligations on a standalone basis. Should parent companies be not subject to the CS3D but have operational subsidiaries which meet the applicability requirements under the Directive, all in-scope subsidiaries should meet the obligations of the CS3D. However, parent companies are allowed to fulfill due diligence and climate transition planning obligations on behalf of their in-scope subsidiaries, provided they ensure effective compliance for such subsidiaries.

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02 Financial Services: Limited scope of CS3D obligations

Companies operating within the financial services sector, which is considered high risk by best practice guidance such as the OECD Guidelines, will have only be subject to CS3D obligations for their direct operations and upstream business partners. Instead, for downstream activities, financial services firms are expected to consider adverse impacts and use their leverage (e.g., shareholders' rights) to influence companies where possible, as recommended by the OECD Guidelines.

The CS3D will exclude their downstream (i.e., investment) activities, which may make up most of the emissions, human rights, and environmental impacts within their value chains. For example, financial services firms will still be required to develop climate transition plans under the CS3D, but they will not be obligated to consider financed emissions in their strategies. The CS3D shall also not impose additional reporting obligations for in-scope financial services firms, including under the CSRD and SFDR.

Within two years of the CS3D coming into force, the European Commission is required to provide to the European Parliament and Council a report analyzing the necessity of additional sustainability-related due diligence requirements, tailored to financial services firms, which may include a legislative proposal for downstream activities to be included in the future. It should be noted, however, that EU member states are only required to comply with the Directive, at the latest, two years from the date of the CS3D coming into force, which makes unclear the possible substance of the report.

03 Knock-on Effects: Companies indirectly impacted by the CS3D

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The CS3D may also have knock-on effects for businesses worldwide with strong existing commercial relationships with in-scope companies. Specifically, the operations of upstream and certain downstream business partners of in-scope companies will be covered by CS3D requirements, on a risk-based and proportionate manner. The direct and indirect business partners of in-scope companies include those with whom the in-scope companies maintain:

3. What are the requirements of the CS3D?

- A commercial agreement related to the operations, products, or services of in-scope companies.
- No commercial agreement, but still carries out business operations related to the operations, products, or services of in-scope companies.

4. To whom does the CS3D apply?

Such partners may be obliged to disclose to in-scope companies non-trade secret information necessary for the companies to identify potential or actual adverse impacts, where necessary and duly justified for their compliance with due diligence obligations.

The following business partners within companies' value chains may be subject:

5. When will the CS3D apply?

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- The upstream value chain, including the production of goods or provision of services provided by the company (e.g., design, extraction, sourcing, manufacture, transport, storage, and supply of raw materials or products).
- The downstream value chain, including the distribution, transportation, and storage of products on behalf of the company. Disposal of products and downstream activities for products subject to export controls (e.g., weapons) are exempted.

For example, a large mining supplier in Africa for an EU-based aluminum smelting company may be requested to provide their Scope 1 and 2 GHG emissions, describe their own risk management system and processes, and disclose their social and environmental outcomes, to help the in-scope company fulfill their obligations under the CS3D. The supplier may also be asked by the in-scope company to remediate any reported incidents, improve their own risk management system, or develop a climate transition plan to reduce emissions in pursuit of the in-scope company's objectives under the CS3D. Else, their clients may be able to suspend or terminate the business relationship.

When will the CS3D apply?

The Directive was approved by the EU Parliament on April 24, 2024 and has received final approval by EU ministerial vote in May 2024, after which the CS3D will have come into force following publication in the Official Journal. Member states will have two years (i.e., by 2026) to transpose the provisions into national law. The CS3D will then begin applying on a phased approach dependent on firm size and turnover, starting in 2027, with additional in-scope companies subject over the subsequent two years. This means that all in-scope companies should prepare to meet the requirements of the CS3D before the end of this decade. The phased implementation approach applies to firms as set out below:

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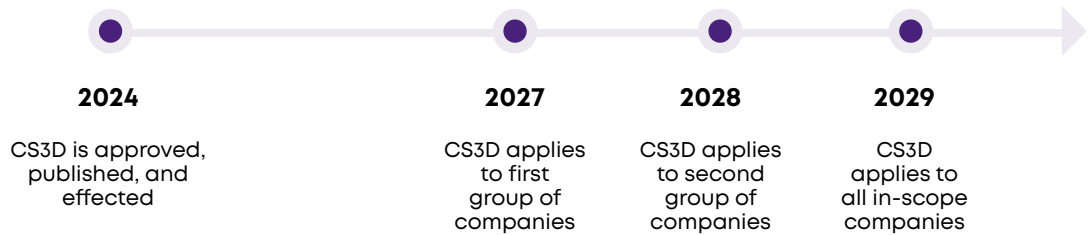
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2027

- EU companies with a net turnover over EUR 1.5B worldwide in the prior financial year and an average workforce greater than 5,000 employees.
- Non-EU companies with a net turnover over EUR 1.5B within the EU in the prior financial year.

2028

- EU companies with a net turnover over EUR 900M worldwide in the prior financial year and an average workforce greater than 3,000 employees.
- Non-EU companies with a net turnover over EUR 900M within the EU in the prior financial year.

2029

- All other EU and non-EU companies in scope of the CS3D.

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01 How does the CS3D fit within the EU's suite of various sustainability initiatives?

CS3D and European Green Deal

The CS3D supports the objectives of the European Green Deal, an overarching initiative which aims to transition the EU to a climate-neutral, green economy. The European Green Deal is a set of policies aimed at mitigating environmental degradation and reducing Europe's net GHG emissions by at least 55% by 2030, compared to 1990 levels, a target which aligns with the goals set by the Paris Agreement. In pursuit of these targets, the CS3D requires in-scope companies to mitigate their environmental business impacts and reduce their emissions according to Paris Agreement-aligned transition plans.

CS3D and CSRD

The CS3D complements the CSRD, which requires all large and listed companies in the EU to report on standardized and audited corporate sustainability information, in accordance with the European Sustainability Reporting Standards (ESRS) starting in 2024. Many in-scope companies under the CSRD will also be covered by the requirements of the CS3D.

The CS3D complements the CSRD by stipulating many of the same companies to perform social and environmental due diligence across their operations and value chains. Many of the reportable social and environmental risks referenced by the ESRS (i.e., those from the OECD Guidelines and UN Guiding Principles) will also be reflected in the CS3D's finalized due diligence requirements.

Under the CS3D, companies can identify their adverse impacts in accordance with their due diligence duties and prioritize areas to establish information collection and reporting processes accordingly under the CSRD. These adverse sustainability impacts, and any actions taken by companies to address them, can be reported upon under the ESRS, which fulfills the final reporting stage of companies' due diligence duty under the CS3D.

Finally, the CSRD mandates disclosure of climate transition plans on a comply or explain basis, which the CS3D mandates on a compliance basis for in-scope companies. The CS3D will therefore lead to more complete and effective reporting by companies also subject to the CSRD.

CS3D and SFDR

The CS3D can also be understood in the context of the already in-force Sustainable Finance Disclosure Regulation (SFDR), a law which stipulates requirements around how financial market participants (e.g., asset managers) market investment products and communicate sustainability-related fund and firm-level information to investors in the EU. Specifically, in-scope financial market participants must make statements on the due diligence policies guiding their investment decisions around social and environmental factors, and these investment decisions can be informed by the actions of investee companies subject to the CS3D.

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CS3D and EU Taxonomy

The CS3D is related to the EU Taxonomy, a classification system which establishes clear definitions of sustainable business activities. The Taxonomy supplements the reporting requirements of the CSRD and SFDR, and it allows investors and companies to make informed decisions when understanding the sustainability of investment and business activities.

Taxonomy-alignment for companies may be beneficial when attracting capital. The CS3D, which requires in-scope companies to establish risk management systems to identify and address their adverse social and environmental impacts, may allow such companies' activities to align with the 'Do No Significant Harm' principle, one of the criteria under the Taxonomy.

02 How can companies prepare for the CS3D?

While companies are not obligated to adhere to the Directive until at least 2027, they can begin aligning their organization today with several preparatory steps. Uniquis recommends the following to guide companies in preparing for the CS3D:

01. Understand Applicability:

Companies could conduct an impact assessment to evaluate whether their business will be covered under the obligations of the CS3D, based on projected business performance, size, and operations. Many companies may also be indirectly impacted by the requirements of the CS3D through their customers, and these businesses can also take steps to ensure they have CS3D-aligned policies and systems in place over the next few years.

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02. Conduct a Baseline and Gap Analysis:

Once determined to be in-scope under the CS3D, companies should identify which entities will be subject and which business lines and services will most likely be affected before developing an implementation plan. Companies can assess the information already available (i.e., internally or publicly), assess their abilities to obtain relevant information, and determine which steps need to be undertaken to obtain missing information. Companies can conduct similar assessments regarding their current capabilities to meet due diligence and remediation obligations.

03. Prepare an Implementation Plan:

Companies should develop an implementation plan to fulfill their CS3D obligations, including the identification of leadership and employees responsible for implementation. Companies should outline actions to develop or amend formal human rights and environmental policies and align them to CS3D requirements. In particular, companies should consider aligning their policies and risk management systems to best practice guidance, including the UN Guiding Principles and OECD Guidelines. Companies should also ensure that their human rights and environmental stipulations are incorporated into supplier selection and review processes.

04. Build Internal and External Capacity:

Companies can also implement training programs for relevant employees and establish internal reporting lines to prepare for CS3D requirements. If companies lack internal expertise, they may also identify third-party consultancies such as Uniqus to support with CS3D readiness and implementation.

05. Communicate with Internal and External Stakeholders:

Companies can communicate internally to raise awareness around their potential CS3D obligations and organizational needs from internal stakeholders. They can also begin engaging internal and external stakeholders to conduct impact assessments, identifying existing and potential risks across their value chains, and working to mitigate these risks. This will inform the development of formal grievance and remediation processes within their own operations and value chain. The figure below demonstrates how companies may identify and address such adverse risks and impacts. Finally, companies can begin designing formal processes for tracking the effectiveness of their implemented programs and consider their public communication plan.

06. Monitor Regulatory Developments:

Companies should ensure that they are monitoring the legislative transposition of the CS3D by EU member states, where relevant, for nuances in implementation, along with further clarifications or changes in interpretation of the CS3D. Financial services firms, for example, should track any future proposals regarding impacts on their downstream activities. Companies can also assess any overlap with other due diligence requirements from the legislation of other jurisdictions.

07. Leverage Technology:

Technology tools, whether internally developed or identified through third-party providers, such as Uniquis' ESG UniVerse, can support with implementing the CS3D obligations of companies. Technology tools can assist with processes, such as tracking and reporting of social and environmental due diligence outcomes, supplier engagement and outreach, calculating GHG emissions to track progress against climate transition targets, and more.

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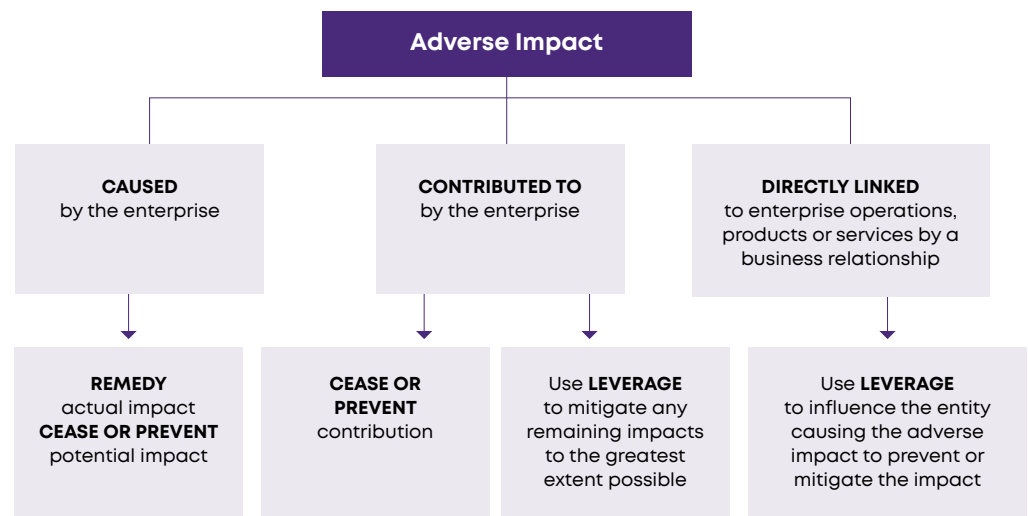
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Note: More specific guidelines for addressing human rights adverse impacts are listed in OECD (2011), Chapter IV

Source: OECD Due Diligence Guidance for RBC (2018)



Contact Uniquis Consultech today to learn more about how we can support your business with CS3D readiness and implementation.

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