

# The EU's Corporate Sustainability Due Diligence Directive – Obligations for Companies

The CSDDD will impose rigorous sustainability and human rights due diligence obligations on a broad scope of companies operating within the EU.





## Introduction

On 5 July 2024, the final text of the Corporate Sustainability Due Diligence Directive (CSDDD) was entered into the Official Journal of the EU. The CSDDD will enter force on 25 July 2024. This marks the final key step in the legislative process and a significant milestone in the implementation of the requirement for companies to embed responsible business conduct into due diligence processes and policies. The CSDDD is one of several legislative acts proposed by the EU under the [European Green Deal](#).

The CSDDD sets out corporate due diligence obligations. In particular, CSDDD requires relevant companies to identify, prevent, and mitigate potential or actual adverse human rights and environmental impacts connected with their operations, including both upstream and certain downstream impacts. It also seeks to provide access to grievance mechanisms and legal remedies for those affected by violations of CSDDD provisions.

This article discusses key aspects of the CSDDD and details high-level guidance on how potentially impacted companies can prepare.

1. Background on the CSDDD and an overview of the wider regulatory picture in the EU
2. The scope of the CSDDD, including extra-territorial impacts
3. A discussion of company obligations under the CSDDD
4. Penalties and enforcement mechanisms
5. Next steps, including the timeline for implementation

## Background

The CSDDD was initially proposed by the European Commission in February 2022, and was subject to a provisional agreement by the Council and European Parliament (Parliament) in December 2023. However, during subsequent negotiations between the negotiating parties, further amendments were made to accommodate the concerns of EU Member States and certain other stakeholders.

In particular, the extra-territorial implications of the CSDDD and extent to which it will impact global value chains have been key topics of negotiation throughout. Other important issues during the negotiation process included the extent to which financial institutions fall within the scope of the directive, the size thresholds for companies required to report, and the roles and duties of directors in the due diligence process.

## How Does the CSDDD Fit Into the Wider EU Regulatory Picture?

In recent years, several EU Member States have introduced due diligence legislation, such as the French Duty of Vigilance Law, the German Supply Chain Act, and the Norwegian Transparency Act. Additionally, other EU Member States held back on the introduction of such legislation, pending the progress of CSDDD. The CSDDD also complements and supplements an array of other human rights and value chain due diligence-related legislation in the EU, including the EU Deforestation Regulation, the EU Conflict Minerals Regulation, the EU Batteries Regulation, and upcoming regulation prohibiting products made with forced labour. Generally, the due diligence requirements in the aforementioned regulations have specific contexts or sector applications, and they differ in scope and specific obligations. By contrast, the CSDDD is broadly agnostic to sector and aims to create a common and comprehensive due diligence framework across the EU (as well as a broader extra-territorial impact).

The CSDDD will also complement the Corporate Sustainability Reporting Directive (CSRD), meaning certain companies will be required to comply with both directives. Whilst the CSDDD will focus on implementing due diligence measures, the CSRD will address the reporting of these measures and wider sustainability-related impacts, risks, and opportunities. Both the CSRD and CSDDD draw upon a number of internationally recognised frameworks, such as the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights. The CSDDD also contains disclosure requirements (see below in relation to Article 11), but companies that are already subject to reporting requirements under the CSRD will be exempted from reporting under both frameworks.

## Companies Subject to the CSDDD

The CSDDD captures a broad scope of companies, including those within the EU and those based outside the EU that have significant operations in the EU market. The final thresholds that companies must meet to ultimately be within scope of the CSDDD are as follows:

	Employee Threshold	Turnover Threshold
<b>EU Companies</b>	More than 1,000 employees average	More than €450 million turnover worldwide
<b>Non-EU Companies</b>	N/A	More than €450 million turnover in the EU
<b>Franchised Companies (EU)</b>	More than 1,000 employees average	More than €80 million net worldwide turnover, and generating royalties of more than €22.5 million
<b>Franchised Companies (Non-EU)</b>	N/A	More than €80 million net turnover in the EU, and generating royalties of more than €22.5 million in the EU

The CSDDD will also apply to companies that do not meet the size thresholds for large companies, but are the ultimate parent companies of a group that does reach the thresholds.

An exemption exists for ultimate parent companies that primarily hold shares in subsidiaries without engaging in management, operational, or financial decisions. The exemption is subject to the condition that one of the company's subsidiaries within the EU is designated to fulfil the CSDDD's obligations on behalf of the ultimate parent company. This subsidiary must be equipped with the necessary means and authority to comply effectively, and the ultimate parent company will remain jointly liable.

The CSDDD will only apply if the relevant conditions are met for two consecutive financial years, and ceases to apply if the relevant conditions are not met for two consecutive years.

For EU companies, the Member State of the company's registered office is the competent authority. For non-EU companies, the competent authority is the Member State in which the company has a branch or, if no branch exists, where the company generates its highest net turnover in the EU.

## Obligations Under the CSDDD

The due diligence process in the CSDDD draws from the six steps defined by the OECD Guidelines for Responsible Business Conduct, which include due diligence measures for companies to identify and address adverse human rights and environmental impacts.

Member States shall ensure that companies conduct risk-based human rights and environmental due diligence, by carrying out a number of actions, including to:

CSDDD Article Reference	Company Obligations	Key Provisions
<b>Article 5</b>	<b>Integrate due diligence into policies and risk management systems</b>	Companies will be required to establish and regularly update a due diligence policy, developed with employee input, that outlines their approach to risk management and adherence to a code of conduct across all operations and partnerships.
<b>Article 6</b>	<b>Identify and assess actual and potential adverse impacts</b>	Companies will be required to take suitable actions to identify and evaluate both actual and potential adverse impacts stemming from their operations, subsidiaries, and business partners, prioritising areas with the highest likelihood and severity of such impacts.



CSDDD Article Reference	Company Obligations	Key Provisions
<b>Article 7-8</b>	<b>Prevent and mitigate actual and potential adverse impacts, and bring actual adverse impacts to an end</b>	<p>Companies will be required to implement measures to prevent or adequately mitigate identified actual and potential adverse impacts from their operations, subsidiaries, and business partners. They should consider the nature of the impact, the company's influence, and the need for action plans, contractual assurances, investments, and collaborations. Companies should take appropriate measures to bring to an end actual adverse impacts that have been identified.</p> <p>Companies should include the option to suspend or terminate relationships as a last resort if impacts cannot be addressed.</p>
<b>Article 9</b>	<b>Establish and maintain a notification mechanism and complaints procedure</b>	<p>Companies will be required to establish accessible and transparent complaint mechanisms for individuals and organisations to report legitimate concerns about actual or potential adverse impacts related to the company's operations or those of their subsidiaries and business partners. Companies should implement provisions to protect the confidentiality of complainants and to prevent retaliation.</p>
<b>Article 10</b>	<b>Monitor the effectiveness of their due diligence policy and measures</b>	<p>Companies will be required to carry out periodic assessments to review implementation and monitor the adequacy and effectiveness of the processes to identify, prevent, mitigate or bring to an end, and minimise the extent of adverse impacts.</p> <p>These assessments should be carried out at least annually. When appropriate, due diligence policies should be updated in accordance with the outcome of the assessments.</p>
<b>Article 11</b>	<b>Publicly communicate on due diligence</b>	<p>Companies should report on due diligence either through a CSRD report (if required to comply), or through an annual statement that can be published to company websites, covering due diligence, potential and adverse impacts, and actions taken.</p>

## Chain of Activities — General

All EU and non-EU companies that fall within scope of the CSDDD are required to conduct due diligence within their “chain of activities”. This definition focuses on a company’s operations and upstream activities related to the production of goods or provision of services for a company, with a limited set of downstream activities in scope. The in-scope downstream activities include those relating to the distribution, transport, and storage of the company’s product.

The definition of the “chain of activities” does not include the activities of a company’s downstream business partners related to the services of the company. The disposal and use of the product is also excluded from the definition.

Companies are only required to conduct due diligence on downstream activities with direct business relations. This definition has a more limited scope than consideration of the entire “value chain”, which generally includes the full range of activities, resources, and relationships related to the undertaking’s business model and the external environment in which it operates.

## Chain of Activities for Financial Institutions and Service Providers

The CSDDD defines the chain of activities differently for financial institutions and service providers than it does for other sectors. The chain of activities under the CSDDD encompasses both upstream and certain downstream dimensions of the product life cycle, from sourcing to distribution. However, for services, and notably for regulated financial undertakings, the definition of downstream activities in the CSDDD (which focuses on activities related to the distribution, transport and storage of products – i.e., areas that are not applicable for financial products or services) means that for these entities, the chain of activities exclusively consists of the upstream activities. This definition reflects the unique position of financial institutions and services providers within the market and acknowledges the challenges inherent in monitoring and managing the downstream use of financial products and services. Throughout the lengthy negotiation process leading up to the adoption of the CSDDD, Member States debated and grappled with the complexities of imposing due diligence obligations on the downstream activities of financial institutions. The resulting provisions reflect a compromise aimed at ensuring financial institutions engage in meaningful due diligence within their spheres of influence, while recognising the practical limitations of extending this responsibility to the downstream recipients of their products and services.

While regulated financial undertakings are only subject to CSDDD obligations for the upstream components of their chains of activities, the CSDDD explicitly points financial institutions towards the OECD Guidelines for Multinational Enterprises as an indication of appropriate due diligence practices. The directive further notes that regulated financial undertakings are “expected” to consider adverse impacts and use their leverage to influence companies, including by exercising shareholder rights to advocate for sustainable practices.

The CSDDD also anticipates the potential for further developments in this area and explicitly tasks the European Commission with evaluating the need for additional sustainability due diligence requirements specifically designed for regulated financial undertakings. The Commission’s report, due no later than two years after the directive enters into force (i.e., July 2026), may lead to a legislative proposal that further refines the CSDDD due diligence framework for the financial sector.

## Parent Company Support

In a significant development for corporate governance, the CSDDD introduces provisions that allow parent companies to support their subsidiaries in fulfilling due diligence obligations. Under Article 4a of the CSDDD, parent companies that fall within the directive's scope can undertake due diligence responsibilities on behalf of their subsidiaries, if doing so ensures effective compliance. This collaborative approach is designed to streamline due diligence efforts across corporate groups, while maintaining accountability for subsidiaries under supervisory authority oversight and civil liability provisions. To qualify for this group-level support, subsidiaries must (1) exchange necessary information with the parent company, (2) abide by the parent company's due diligence policies, and (3) integrate due diligence into their own policies and risk management systems, among other requirements. Additionally, subsidiaries are required to comply with parent company transition plans for climate change mitigation, as tailored to their specific business models and strategies.

It is important to note the potential risks associated with this approach, as parent companies must carefully consider the liability implications of assuming due diligence responsibilities on behalf of their subsidiaries.

## Transition Plan Requirements

To further align corporate activities with the EU's global climate goals, Article 15 of the CSDDD requires in-scope companies to develop and execute transition plans for climate change mitigation. These transition plans must aim to ensure, through best efforts, that a company's business model and strategy are in line with efforts to limit global warming to 1.5°C, as stipulated by the Paris Agreement and the EU's intermediate and 2050 climate neutrality objectives. Under the CSDDD, transition plans must include time-bound climate targets for 2030 and onwards in five-year increments up to 2050. Transition plans must be grounded in conclusive scientific evidence, and they must include, when appropriate, absolute greenhouse gas emission reduction targets across scopes 1, 2, and 3. Finally, transition plans must describe a company's decarbonisation strategies, investment plans, and governance related to the plan's implementation. Notably, companies that have already reported a climate transition plan under the CSRD will be considered compliant with CSDDD's transition plan requirements. Companies must update their transition plans annually, ensuring continuous progress towards their climate objectives.

In-scope companies may consider proactively considering the materials from the UK Transition Plan Taskforce Disclosure Framework (now under the responsibility of the IFRS Foundation) as guidance for developing or improving existing transition plans.

## Enforcement and Penalties

The CSDDD requires Member States to establish "effective, proportionate, and dissuasive" penalties — including pecuniary fines — for violations of the relevant provisions. In determining the nature and severity of penalties, Member States must consider a range of aggravating and mitigating factors, including (1) the nature, gravity, and duration of the infringement; (2) any previous infringements by the company; and (3) any remedial actions taken by the company; among other factors. Notably, while Member States have some discretion to set maximum penalties, they may not set those maximum penalties below 5% of a company's net worldwide turnover from the preceding financial year — underscoring the significant financial implications for



non-compliance. Furthermore, supervisory authorities must ensure that all decisions concerning CSDDD penalties are publicly available for a minimum of five years. In sum, the approach under CSDDD with respect to penalties sends a clear signal that the EU is seeking for regulatory authorities to rigorously enforce EU standards for corporate sustainability.

The CSDDD also introduces a civil liability scheme in relation to failure to adhere to due diligence obligations. Under Article 22, companies may be liable for intentionally or negligently inflicting certain adverse impacts upon individuals or other legal persons. Annex I of the CSDDD lists the specific rights, prohibitions, and obligations whose violation can give rise to liability under CSDDD. The CSDDD also ensures that limitation periods for claims are not unduly restrictive, setting a minimum limitation period of five years. Additionally, claimants may seek injunctive relief and may authorise certain representative organisations, such as trade unions and non-governmental organisations (NGOs), to enforce their rights under CSDDD. While liability under the CSDDD does not extend to damages *solely* caused by business partners within a company's chain of activities, damage caused *jointly* by business partners will be subject to joint and several liability. The civil liability provisions of the CSDDD are designed to complement (rather than replace) companies' liability under existing national legal systems, ensuring that victims can effectively seek redress for damages related to human rights and environmental impacts.

The CSDDD also integrates sustainability into the EU public procurement process. Under Article 24, public sector contracting authorities are required to recognise compliance with the CSDDD — or voluntary adoption of CSDDD standards — as a qualifying environmental or social factor in public procurement processes.

## Next Steps

As the CSDDD is a directive, it must be transposed into national legislation by the individual EU Member States. During this process, Member States may take inconsistent approaches to application, including “gold-plating” (which occurs if a Member State introduces even more rigorous obligations than the CSDDD itself requires).

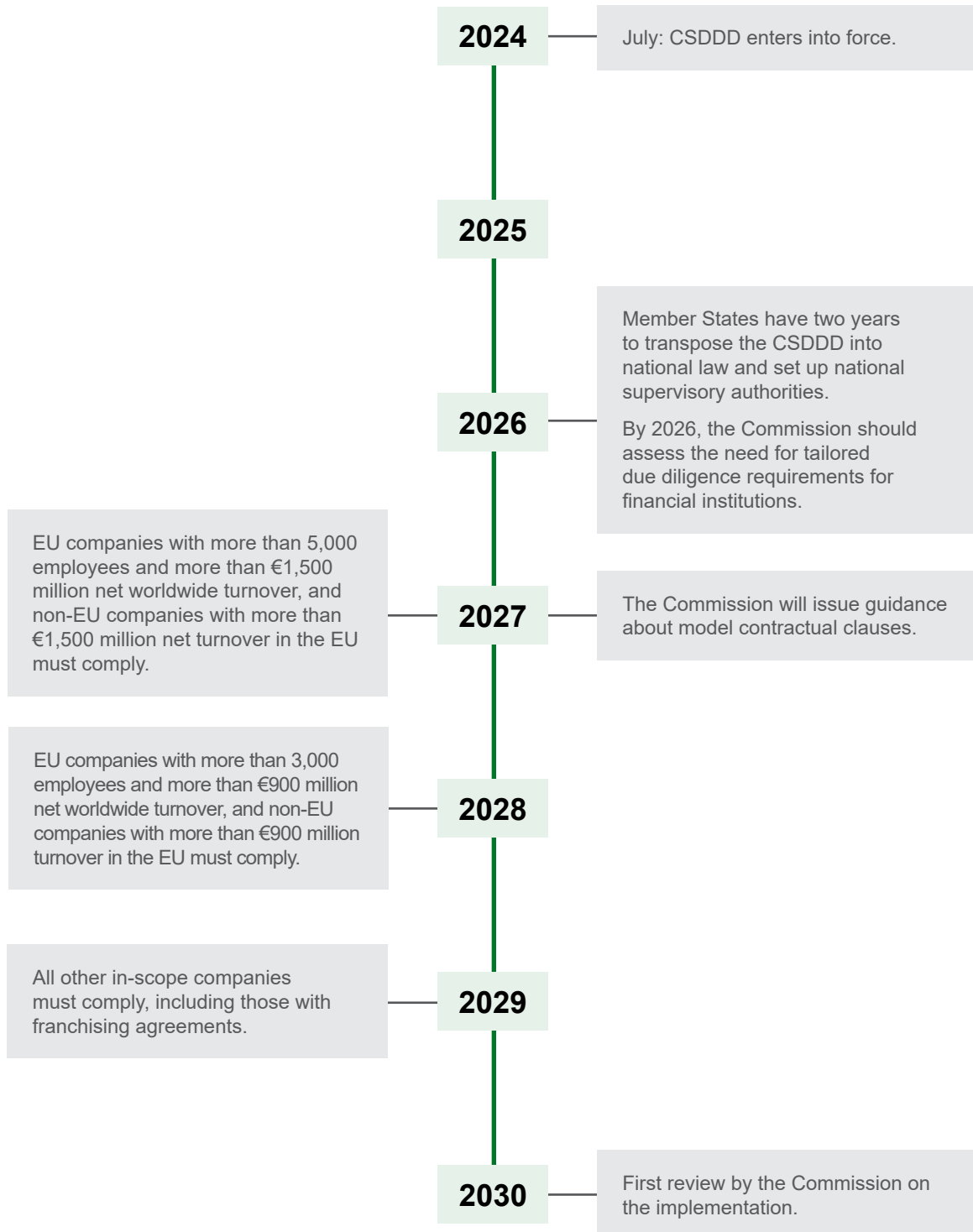
## Model Clauses and Guidelines

Within 30 months of the date on which the CSDDD enters into force, the European Commission will issue guidance about model contractual clauses, which the Commission will develop in consultation with Member States and other stakeholders in order to assist companies with CSDDD compliance. The Commission will also issue a wider set of guidelines to provide practical support on the implementation of due diligence processes, based on consultations with Member States, EU agencies, and due diligence experts. These guidelines will cover a broad range of topics, from due diligence best practices to sector-specific guidance and practical advice about drafting transition plans. The guidelines will also offer insights into the use of digital tools to facilitate compliance, as well as methods for sharing information within corporate groups while safeguarding trade secrets and preventing retaliation. These resources will be accessible in all official languages of the EU and will be periodically updated to reflect evolving best practices.



## Implementation Timeline

The CSDDD will be implemented via a phased-in approach based on company size and turnover. The first companies will need to report three years after the CSDDD enters into force.



## The Indirect Impact of the CSDDD

The CSDDD will have significant impact to both companies directly in scope, but also a large number of EU and non-EU companies that will be indirectly affected by the obligations under the directive. With in-scope companies obligated to take a degree of responsibility for the conduct of their supply chain under the CSDDD, there will likely be a ripple effect for companies across the supply chain. With the potential for significant fines for non-compliance, in-scope companies are likely to apply pressure to their suppliers and companies across the supply chain to comply with the requirements of the CSDDD. To remain competitive in the EU and the broader global market, suppliers able to be good business partners to their customers in relation to the obligations under the CSDDD are likely to become increasingly attractive. This means the impact of the CSDDD will be keenly felt worldwide, as entities from outside the EU, and suppliers to those entities, will all be impacted.

Companies are also likely to be subject to data requests from in-scope companies, and implementing robust ESG data collection systems will be an advantage to ease compliance costs and complexities. Further, non-EU companies that have significant business in the EU market can likely expect increased scrutiny from regulators and stakeholders with enhanced due diligence requirements in the EU.

## How Can Companies Prepare?

Firstly, companies will need to assess whether they fall in scope of the CSDDD, considering the thresholds and any relevant exemptions or conditions as set out above. For many companies, this assessment will be a relatively simple analysis exercise, although there are nuances, particularly for non-EU companies that need to consider their EU turnover. In those instances, the method for calculating net turnover for third-country companies per the Accounting Directive should be used.

Once companies have determined whether they are in scope of the CSDDD, they should also take into account the relevant timeline for application.

Since the obligations under the CSDDD are complex, companies should begin to take preparative steps to reflect this. Practical actions for in-scope companies may include:

### 1. Supply chain assessment

Companies should consider a thorough review of existing supply chain arrangements and disclosures as a baseline assessment process.

Companies may also consider a benchmarking exercise, comparing existing practices and disclosures against industry standards and best practices.

### 2. Gap analysis

A detailed gap analysis can be performed to identify discrepancies between current practices and the requirements of the CSDDD. Once gaps are identified, a roadmap for improvement can be developed.

### 3. Building out CSDDD requirements

In some cases, companies may already be subject to supply chain-related requirements such as the EU Deforestation Regulation, Germany Supply Chain Act, the Batteries Regulation, or other requirements. These obligations can be used as frameworks to build out CSDDD requirements,



for example by integration of CSDDD requirements into existing compliance programmes.

Companies can also provide training to relevant teams on how CSDDD requirements align with existing obligations.

#### **4. Establishing grievance mechanisms**

Companies should work to establish or enhance grievance mechanisms to allow stakeholders such as employees, suppliers, and communities to report concerns in relation to CSDDD compliance. These mechanisms should be accessible, transparent, and effective.

Dedicated teams should be developed to respond to CSDDD-related issues, including members from compliance legal, procurement, and other relevant departments. For this process, existing compliance arrangements can be leveraged to build robust mechanism. For example, companies may build on using existing reporting channels, investigation procedures, and remediation processes.

#### **5. Consideration of commercial contracts**

Companies should review existing commercial contracts to identify where CSDDD provisions should be incorporated. This includes the need to distinguish between long-term contracts, short-term contracts, as well as standard form and bespoke contracts.

While model clauses are expected in the future, companies can start by developing their own clauses to address CSDDD requirements. These should be flexible enough to be adapted to the extent that official model clauses become available.

Companies should communicate with suppliers in regards to the new contract provisions and the importance of compliance. Support and resources should be provided to help suppliers understand and meet these requirements.

## **Practical Steps for Companies Outside the Scope of CSDDD**

For companies that do not fall in scope of the CSDDD, there is still the indirect impact associated with the directive to be considered, as discussed above. In order to best prepare, next steps may include a strategic review of value chains to understand the extent to which their business partners will be caught by the CSDDD. By anticipating potential requirements, these companies can position themselves as proactive and responsible business partners, thereby enhancing their reputation and relationships within the supply chain. Significantly, many entities directly affected by the CSDDD will also have their own value chain partners subject to the directive, creating a ripple effect that underscores the importance of compliance and collaboration across the entire supply chain.

By taking these steps, companies can proactively prepare for the CSDDD and ensure they are well-positioned to meet the directive's requirements.

*Navigating the CSDDD obligations will require extensive experience and in-depth advice. For more information on how Latham & Watkins can support you, please contact any of the authors of this article or your usual Latham & Watkins contact.*



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