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EU Reaches Political Agreement on Groundbreaking New Rules for Corporate Sustainability Due Diligence Impacting US Companies

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On 14 December 2023, the European Union (EU) announced that it had reached political agreement on the new Corporate Sustainability Due Diligence Directive (CSDDD or CS3D). Once adopted, the CSDDD will create new and far-reaching mandatory human rights and environmental due diligence obligations for EU and non-EU companies operating in the EU. For the first time, large companies also will be required to adopt and put into effect a plan ensuring that their business model and strategy are compatible with limiting global warming to 1.5 °C. This new legislation represents a significant shift from the voluntary regimes of the Organisation for Economic Co-operation and Development (OECD) and the United Nations Guiding Principles on Business and Human Rights. The CSDDD establishes a civil liability regime for damages and introduces penalties for noncompliance – including fines of up to 5% of a company's global turnover.

While we are waiting for the full text of the provisional agreement to become available, we have listed some key highlights below.

Who does the CSDDD apply to?

The new diligence rules will apply to:

- **EU companies** with more than 500 employees and a net global turnover of more than 150 million euros, or which operate in specific high-impact sectors (e.g. manufacture, food, clothing and textiles) with more than 250 employees and a net global turnover of 40 million euros.
- **Non-EU companies** meeting certain thresholds for turnover generated in the EU. There remains some uncertainty as to exactly what EU presence (if any) is required for non-EU companies to come in scope.

Whether the financial services industry should be included in the scope of the CSDDD was a point of significant tension in the negotiation of the final text. It has been reported that **financial services will be temporarily excluded** from the due diligence obligations in the CSDDD. This is something, however, that European legislators have emphasized will be reviewed at a later date. Notwithstanding, the financial sector will still be required to adopt and put into effect a **climate transition plan** ensuring their business model complies with limiting global warming to 1.5 °C.

We anticipate that the CSDDD also will indirectly impact many companies that are not themselves in scope. If they are upstream or downstream of in-scope companies, they can expect to receive requests for information, contractual assurances and audits to verify compliance.

What are the main features of the CSDDD?

Due diligence obligation

The CSDDD introduces a requirement for in-scope companies to identify and either prevent, mitigate or bring to an end actual or potential adverse human rights and environmental impacts. In practice, this means companies will need to:

- Integrate human rights and environmental due diligence into their policies.
- Identify actual and potential adverse human rights and environmental impacts in their own operations and those of their

subsidiaries and upstream and downstream business partners (e.g., child labour and exploitation of workers, pollution, and biodiversity loss).
- Take appropriate measures to prevent or mitigate potential adverse impacts.
- Bring to an end, minimize and remedy adverse impacts that materialise.
- Establish and maintain a notification mechanism and complaints procedure.
- Monitor the effectiveness of their due diligence policy and measures.
- Publicly communicate due diligence procedures.

Mandatory climate transition plan

The CSDDD requires companies – including those in the financial services industry – to adopt and put into effect a climate transition plan with time-bound targets for climate change mitigation to ensure that their business strategy is compatible with limiting global warming to 1.5 °C. Reportedly, it also will be a requirement for a company's director remuneration to be linked to the implementation of the climate transition plan. The law is likely to require companies to revisit their current climate targets and associated disclosure practices. Whether this obligation extends to non-EU companies operating in the EU is unclear, but clarity is expected on publication of the agreed text.

Value chain considerations

The CSDDD will apply to the company's own operations, its subsidiaries, and their upstream and downstream business partners. The exact definition of 'business partners' is not yet known but will be clarified on publication of the agreed text. Companies will be expected to use their leverage to engage and effect change throughout their value chains. In extremis, companies will be required to disengage if the adverse impacts cannot be prevented.

Enforcement

Fines

Companies that do not comply with these rules may face sanctions from national administrative authorities – including fines of up to 5% of their global turnover if they fail to comply.

New civil liability regime

The CSDDD introduces a civil liability regime whereby companies could be liable for damages if their failure to comply results in harm. Concerned parties – including trade unions and civil society organizations – will have a five-year period to bring claims against a company, and claimants will reportedly benefit from reduced disclosure and procedural cost requirements.

Exclusion from public tenders

Compliance with the CSDDD also could be qualified as a criterion for the award of public contracts and concessions.

Next steps?

The provisional agreement still needs to be formally approved by the European Parliament and European Council, and it's possible there could be changes along the way (usually legal linguistic amendments, but theoretically other changes also could pass). The text of the legislation will then be signed and published in the Official Journal of the European Union and will enter into force 20 days later to complete the lawmaking process.

In terms of timing, we'd expect this lawmaking process to be completed between the first and second quarters of 2024, with the new requirements starting to apply beginning in Q1 or Q2 2026. It is possible that a longer lead time will apply for non-EU companies.

These rules are part of the EU's broader push to promote a shift to sustainable international business. For other

recent sustainability developments impacting international clients, see our publications on the Corporate Sustainability Reporting Directive, the new Deforestation Regulation and the EU's proposal to ban products made with forced labour.

If you have any questions or would like support understanding the implications of this new regime, please contact a member of Cooley's international ESG & sustainability advisory team.

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