

## Corporate Sustainability Due Diligence Directive

Corporate sustainability themes remain firmly in the spotlight with the recent announcement of far-reaching EU proposals aimed at certain prescribed large companies and their directors. The EU's policy focus to date has been on sustainability reporting for corporates. The latest set of reforms, however, would see a substantive duty on large companies to identify, prevent, and account for harm resulting from their impact on human rights and the environment.

With an understanding of the potential changes coming down the tracks, and some early planning, in-scope companies can ensure a smoother transition to the new regime.



### Background

On 23 February 2022, the European Commission (**Commission**) adopted a proposal for a **Corporate Sustainability Due Diligence Directive (CSDDD)**. This follows on from the April 2021 proposal for a Corporate Sustainability Reporting Directive (**upon which we previously reported**). The two initiatives are closely interrelated and stem from the ambitious legislative targets set by the Commission to underpin the **European Green Deal**. In recent years, measures such as the Sustainable Finance Disclosure Regulation and the EU Taxonomy Regulation were introduced with the aim of reorienting capital flows in the financial services sector towards more sustainable investments and projects and a sustainable economy. The CSDDD represents a significant step on the path towards realising the Commission's ESG goals.



## Companies in scope

The CSDDD will apply to:

### Group 1 companies

All EU limited liability companies with 500+ employees and €150 million+ in net turnover worldwide in the last financial year

Approximately 9,400 companies

### Group 2 companies

Other EU limited liability companies operating (to the extent of 50% of turnover generated) in defined high impact sectors such as textiles, agriculture and mineral extraction, which do not meet both Group 1 thresholds, but have 250+ employees and a net turnover of €40 million+ worldwide in the last financial year

Approximately 3,400 companies

### Non-EU companies active in the EU

Turnover thresholds generated in the EU aligned with Groups 1 and 2

Approximately 4,000 companies

Other types of legal entity may fall within the scope of the CSDDD, depending on their shareholding or ownership structure, or their status as regulated financial undertakings. SMEs will fall outside the scope of the new regime.



## New corporate due diligence duties

The proposal applies to the company's own operations, and those of its subsidiaries and value chains (direct and indirect established business relationships). The CSDDD will not require companies to guarantee, in all circumstances, that adverse impacts will never occur or that they will be stopped. Instead, companies must take appropriate measures (referred to as an 'obligation of means'), in light of the severity and likelihood of different impacts, the measures available to the company in the specific circumstances, and the need to set priorities.

Companies falling within the scope of the new regime must:

- integrate due diligence into all company policies;
- have in place a due diligence policy (updated annually) that: describes the company's approach, including in the long term, to due diligence; contains a code of conduct for company employees and subsidiaries; describes the processes put in place to implement due diligence (including the measures taken to verify compliance with the code of conduct and to extend its application to established business relationships);
- take appropriate measures to identify actual or potential adverse human rights and environmental impacts in the company's operations, and those of their subsidiaries, and in their established direct or indirect business relationships in their value chain;
- take appropriate measures to prevent potential impacts or to mitigate impacts where prevention is not possible or requires gradual implementation. Interestingly, the CSDDD refers to the creation of contractual termination rights and third party contractual assurances in furtherance of these objectives;
- take appropriate measures to bring to an end or minimise actual impacts;
- establish and maintain a complaints procedure for legitimate concerns about potential or actual adverse impacts;
- monitor the effectiveness of the due diligence policy and measures regularly; and
- make public disclosures on due diligence matters.

The human rights issues and environmental impacts encompassed by the due diligence duty are contained in an [annex](#) to the CSDDD and relate broadly to measures under international human rights and environmental conventions.



## Combatting climate change

Group 1 companies (and equivalent non-EU companies) must adopt a plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5°C, in line with the Paris Climate Agreement.

This plan must identify, on the basis of information reasonably available to the company, the extent to which climate change is a risk for, or an impact of, the company's operations. Member States must ensure that, where climate change is or should have been identified as a principal risk for, or a principal impact of, the company's operations, the company includes emission reduction objectives in its plan.

In a move that will impact some company directors, Member States must ensure that companies take into account the fulfilment of these climate change obligations when setting variable remuneration, if variable remuneration is linked to the contribution of a director to the company's business strategy and long-term interests and sustainability.



## Creation of new directors' duties

The CSDDD will also mandate changes to directors' duties at national level, currently codified in the Companies Act 2014 (as amended). Under the new regime, directors will take on a range of further duties and must:

- put in place and oversee the necessary due diligence frameworks and integrate due diligence into corporate management systems;
- adapt the corporate strategy to actual and potential impacts identified and any due diligence measures taken; and
- in fulfilling their duty to act in the best interest of the company, take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term.



## Enforcement

Member States will designate a national authority to supervise and impose effective, proportionate and dissuasive sanctions, including fines and compliance orders. To ensure a coordinated EU approach, the Commission will establish a European Network of Supervisory Authorities that will bring together representatives of national bodies.

A civil liability redress mechanism must be established at national level to ensure that victims can be compensated for failure by a company to comply with its obligations under the CSDDD.



## Timelines

The proposal is at the early stages of the EU legislative process and will be presented to the European Parliament and the European Council for approval. Once adopted, Member States will have two years to transpose the CSDDD into national law. Group 2 companies and their non-EU equivalents, however, will have a further two years before being brought within the new regime.



## Next steps

Sustainability should feature high on the board agenda for large / in-scope companies. The task involved for companies to deliver on this obligation should not be underestimated and warrants early and careful attention accordingly.



## How Matheson can help

ESG is a fast-evolving area and Matheson continues to monitor developments closely. If you would like more information on this or other ESG matters, please get in touch with the partners below, the [ESG Advisory Group](#) or with your usual Matheson contact.

## Key Contacts

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