

CORPORATE SUSTAINABILITY

After a volatile political journey, the EU is poised to adopt the new Corporate Sustainability Due Diligence Directive ("CS3D") in the coming months, after being approved by the European Parliament in April 2024. Matheson's Garret Farrelly explains.

CS3D will, when adopted, require EU member states to introduce laws requiring in-scope companies to significantly enhance environmental and human rights due diligence in their business conduct.

DUE DILIGENCE REQUIREMENTS

The version of CS3D endorsed by the European Parliament has changed significantly from the version initially proposed by the Commission in February 2022. In particular, aspects of the proposed CS3D were cut back, in light of concerns raised by several EU member states about the possible administrative burden for companies in their jurisdictions. Under the text approved by the European Parliament, in-scope companies would be required to:

- Integrate due diligence into their policies and risk management systems and to have a due diligence policy that ensures risk-based due diligence;
- Identify and assess actual or potential adverse environmental or human rights impacts arising from their own operations or those of their subsidiaries or, where relating to their "chains of activities", those of their business partners;
- Take appropriate measures to prevent (or where not possible, adequately mitigate) potential adverse environmental or human rights impacts;
- Take appropriate measures to bring actual adverse environmental or human rights impacts to an end;
- Remediate actual adverse environmental human rights impacts that the company has caused; and
- Adopt and put into effect a transition plan for climate change mitigation, which aims to ensure, through best efforts, that the business model and strategy of the company are compatible with the transition to a sustainable economy and limiting global warming to 1.5°C in line with the Paris Agreement.

SCOPE OF APPLICATION

The version of CS3D approved by the European Parliament would apply to EU-incorporated companies with more than 1,000 employees and net worldwide turnover of more than €450 million (including when consolidated with any subsidiaries) and non-EU incorporated companies that have generated more than €450 million of net turnover in the EU in two consecutive financial years. The CS3D also includes provisions designed to capture companies that do not meet these thresholds but enter into certain franchising or licencing agreements. The proposed legislation would also include certain carve-outs for the



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financial services sector: alternative investment managers and certain investment funds are entirely out of scope, while CS3D envisages that companies in the financial services sector would only be required to perform due diligence in respect of their 'upstream' chain of activities (ie, excluding their customers).

Companies will likely come into scope for CS3D on a phased basis over three years, starting with the largest companies in 2027. Significantly fewer companies will come into scope for CS3D than under the related Corporate Sustainability Reporting Directive. However, given that businesses all over the world are likely to fall within the supply chains of larger businesses that are directly in-scope, CS3D will likely have far reaching implications for all EU businesses.

ENFORCEMENT, PENALTIES AND NATIONAL TRANSPOSITION

Each EU member state will be required to designate a national supervisory authority, which will have enforcement powers. Member states will be required to introduce penalties for non-compliance; the upper limit for these penalties must be at least 5% of the net world turnover. The CS3D will also introduce a new civil liability regime: those affected by a company's breach of due diligence obligations will be able to seek damages from the company.

For CS3D to be finally enacted, it will need to be formally endorsed by the Council of the European Union and signed and published in the EU Official Journal. Member states will then have two years to transpose the new rules into national law.

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