Legal Flash

July 2024

In brief

EU adopts Corporate Sustainability Due Diligence Directive (CSDDD or CS3D)

The CSDDD (“Directive (EU) 2024/1760 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859”) which was formally published in the Official Journal of the European Union on July 5th, 2024, and entered into force on July 25th, 2024, will mandate companies to identify, mitigate, and report on the impact of their operations and supply chains on human rights and the environment. This Directive, applies to both EU and non-EU companies operating in the EU; ensuring that companies active in the internal market contribute to sustainable development and the sustainability transition of economies and societies

Which companies are within scope?

The CSDDD is set to be applicable to the following entities:

A. EU-Based Companies

Companies that are formed in accordance with the legislation of an EU Member State (referred to as EU companies) will be subject to the Directive if they meet one of the following conditions:

1. **Employee and Worldwide Turnover Criteria**

- The company has an average employee count exceeding 1,000 (employee threshold).
- The company has achieved a net worldwide turnover exceeding €450 million in the last financial year for which annual financial statements have been or should have been adopted (worldwide turnover threshold).

2. **Royalties and Turnover Criteria**

- The company entered into or is the ultimate parent company of a group that entered into franchising or licensing agreements in the EU in return for royalties with independent third-party companies, where those royalties amounted to more than €22.5 million in the last financial year for which annual financial statements have been or should have been adopted.

- And provided that the company had or is the ultimate parent company of a group that had a net worldwide turnover of more than €80 million in the last financial year for which annual financial statements have been or should have been adopted.

B. Non-EU-Based Companies

Companies that are formed in accordance with the legislation of a third country (referred to as non-EU companies) will fall under the purview of the Directive if they meet any of the following thresholds:

1. **EU Turnover Threshold**

- The company has a net turnover exceeding €450 million within the EU, based on the financial year preceding the last financial year.

2. **Royalties and EU Turnover Criteria**

- The company entered into or is the ultimate parent company of a group that entered into franchising or licensing agreements in the EU in return for royalties with independent third-party companies, where those royalties amounted to more than €22.5 million in the EU in the financial year preceding the last financial year.
- And provided that the company generated or it is the ultimate parent company of a group that generated a net turnover exceeding €80 million within the EU, based on the financial year preceding the last financial year.

If a company does not meet the respective EU or non-EU thresholds on a standalone basis, but the relevant thresholds are met at a group level and the group produces consolidated annual reports based on the aforementioned Turnover Criteria as enshrined in the Directive, CSDDD applies to the ultimate parent company of that group (whether EU or non-EU).

These requirements must be fulfilled in **two consecutive financial years.**

Specific obligations of the companies

Obligations for Eligible Entities

Eligible entities are required: to (1) conduct thorough due diligence and (2) formulate and execute a climate transition strategy.

1. Due Diligence (DD):

Eligible entities are mandated to identify, assess, prevent, and mitigate any actual or potential adverse impacts on individuals and the environment. These impacts may stem from the entity's own operations, including those of its subsidiaries, or from the operations of certain upstream and downstream business associates.

- **Nature of Negative Impacts:**

- Environmental impacts: These are the adverse effects that arise from not adhering to the environmental obligations outlined in Annex Part II of the Directive.
- Human rights impacts: These refer to the violation of human rights and fundamental freedoms as specified in Annex Part I of the Directive.

- **Due Diligence Requirements:**

Eligible companies shall conduct **risk-based human rights and environmental** due diligence by carrying out the following activities:

- Integrate due diligence into corporate policies and maintain due diligence processes that are based on risk assessment.
- Identify and evaluate actual and potential adverse impacts, based on quantitative and qualitative information including the relevant disaggregated data that can be reasonably obtained by the company.
- Prevent and mitigate potential adverse impacts, cease actual adverse impacts and minimize their extent (prioritization based on the severity and likelihood of impacts is permissible), and provide remedies for actual negative impacts.
- Engage stakeholders in a meaningful way.
- Implement a system for reporting and handling complaints.
- Periodically monitor the effectiveness of the due diligence policy (*i.e.*, such assessments shall be carried out without undue delay after a significant change occurs, but at least every 12 months).
- Disclose information on corporate sustainability due diligence (CSDDD) matters by publishing an annual statement; this is also relevant to the compliance timeline schedule mentioned below.

- **Extent of Due Diligence Responsibilities:**

Entities must apply due diligence to their own operations, those of their subsidiaries, and the operations of both direct and indirect business partners within their "chain of activities." This chain is more limited than the entire value chain and includes:

- **Upstream activities** related to the production of goods or services, including design, extraction, sourcing, manufacturing, transportation, storage, and supply of raw materials, products, or components, and product or service development.
- **Downstream activities** related to the distribution, transportation, and storage of products (excluding disposal of products and the services), where the business partners carry out those activities for the company or on behalf of the company.

- **Character of Due Diligence Obligations:**

The Directive does not expect companies to ensure the complete absence of adverse human rights and environmental impacts, acknowledging the impracticality of such a guarantee. Instead, it sets forth "obligations of means," requiring companies to take effective measures to implement suitable due diligence policies and procedures, considering the nature and extent of the adverse impact and relevant risk factors.

- **Compliance within Corporate Groups:**

At the group level, a parent company is allowed to satisfy due diligence obligations for its eligible subsidiaries, provided it ensures effective compliance and meets certain criteria. Nevertheless, subsidiaries remain accountable to the supervisory authority of the relevant EU Member-State and are subject to civil liability.

2. Climate Transition Plan (CTP):

Companies are obligated to develop and implement a climate transition plan aimed at mitigating climate change. This plan should align the company's business model and strategy with the shift towards a sustainable economy and the goal of limiting global warming to 1.5°C, consistent with the Paris Agreement and the EU's objective for climate neutrality by 2050, including its intermediate and long-term targets. The plan should also consider the company's exposure in coal, oil, and gas activities.

At the group level, parent companies are permitted to meet the CTP requirements on behalf of their eligible subsidiaries, subject to the conditions outlined in the due diligence compliance section.

Entities that have already reported a CTP in line with their obligations under the respective Articles of the Corporate Sustainability Reporting Directive (CSRD) are considered to have met the requirement to adopt a CTP under CSDDD. However, to fulfill their CSDDD responsibilities, all companies must still effectively implement the CTP and update it annually to evaluate progress towards achieving its goals.

Non-compliance consequences

Member states are tasked with the establishment of a comprehensive sanctioning framework as they transpose the Corporate Sustainability Due Diligence Directive (CSDDD). This framework is to be inclusive of, but not limited to, the following punitive and corrective measures:

- **Imposition of Financial Penalties**: Entities found in breach of compliance may be subjected to monetary fines. These fines can amount to as much as 5% of the entity's global net turnover, as recorded in the financial year preceding that of the decision to impose the fine.

- **Public Disclosure of Non-Compliance:** There is a mandate for the public declaration of instances of non-compliance. Such disclosures will detail the company in question, outline the specific responsibilities neglected, and describe the nature of the infringement.

- **Civil Liability:** Companies that fail to adhere to the Directive may face civil liability. This provision ensures that legal or natural persons who have suffered harm due to the violations have the right to seek redress (*i.e.*, full compensation for the damage caused).

In addition to these measures, the Directive calls for robust administrative oversight. This will be executed by national supervisory authorities, which will operate in a coordinated manner across the European landscape to ensure uniform application and enforcement of the Directive's provisions.

Compliance Timeline

Entry into force: The CSDDD entered into force on July 25th, 2024.

Transposition into National Law: Member States shall transpose the CSDDD by 26 July 2026.

Staggered Application Dates: The Directive will apply to companies on a staggered timeline based on net turnover thresholds and employee numbers, with full effect by 26 July **2029.**

In particular:

- **From July 26, 2027:** EU companies with over 5,000 employees and a global net turnover exceeding €1,500 million; non-EU companies that have generated a net turnover in the EU exceeding €1,500 million;

- **From July 26, 2028:** EU companies with over 3,000 employees and a global net turnover exceeding €900 million; non-EU companies that have generated a net turnover in the EU exceeding €900 million;

- **From July 26, 2029:** all other obligated companies.

Interrelations with other ESG requirements and guidelines

The Corporate Sustainability Due Diligence Directive (CSDDD) is part of the European Union's broader agenda to promote sustainable and responsible business practices. It aims to ensure that companies operating within the EU take accountability for their impacts on human rights and the environment throughout their entire supply chains. Understanding its interrelations with other ESG (Environmental, Social, and Governance) regulations and directives is essential for comprehensive compliance and strategic planning. Here are some key interrelations:

- **Corporate Sustainability Reporting Directive (CSRD):**

Interrelation: The CSRD mandates companies to disclose detailed information on sustainability risks and impacts, enhancing transparency and accountability. The CSDDD complements this by requiring companies to actively manage and mitigate those risks.

Synergy: Together, they create a feedback loop where due diligence measures (CSDDD) inform sustainability reporting (CSRD), and the reporting outcomes can highlight areas needing more robust due diligence.

- **EU Taxonomy Regulation:**

Interrelation: This regulation provides a classification system for environmentally sustainable economic activities. The CSDDD aligns with this by pushing companies to identify and mitigate negative environmental impacts.

Synergy: Companies using the EU Taxonomy to classify their activities can better understand the environmental risks and opportunities, aiding in more effective due diligence per the CSDDD.

- **Sustainable Finance Disclosure Regulation (SFDR):**

Interrelation: SFDR imposes transparency obligations on financial market participants, requiring them to disclose how they integrate ESG factors into their investment decisions. The CSDDD's due diligence requirements help companies align their operations with investors' expectations under SFDR.
Synergy: Both regulations promote greater transparency and accountability, making it easier for investors to assess the sustainability of their investments.

- **EU Green Deal:**

Interrelation: The EU Green Deal is a comprehensive strategy aiming for climate neutrality by 2050. The CSDDD supports this by obliging companies to address environmental impacts and integrate sustainability into their business models.

Synergy: The directive helps operationalize the Green Deal's goals at the corporate level, ensuring that businesses contribute to the broader climate and environmental objectives.

- **United Nations Guiding Principles on Business and Human Rights (UNGPs):**

Interrelation: The CSDDD is closely aligned with the UNGPs, which set out the responsibility of businesses to respect human rights. The directive formalizes these principles into EU law, requiring companies to perform human rights due diligence.

Synergy: Companies compliant with the UNGPs will find it easier to meet CSDDD requirements, as both frameworks emphasize proactive risk management and mitigation.

- **OECD Guidelines for Multinational Enterprises:**

Interrelation: These guidelines provide recommendations for responsible business conduct, including due diligence for human rights and environmental impacts. The CSDDD enforces similar expectations within the EU.

Synergy: Adherence to OECD guidelines can facilitate compliance with the CSDDD, as both stress the importance of due diligence in managing corporate impacts.

By understanding these interrelations, companies can develop integrated strategies that ensure compliance with the CSDDD while also meeting other relevant ESG regulations and directives, thereby enhancing overall sustainability performance.

Let’s talk!

Vassilios Vizas

Partner, Leader of Tax & Legal Services, PwC Greece

Tel: +30 697 818 0026
E: vassilios.vizas@pwc.com

Dimitris Tzavaras

Director, Tax, Sustainability, Energy, Transfer Pricing
PwC Greece

Tel: +30 6940 460516
E: dimitrios.tzavaras@pwc.com