

# The Voice of RSM Special Edition

## CSDDD: From Obligation to Opportunity?

Through the Green Deal, the European Union (EU) set out a firm ambition to become the first climate-neutral, circular and inclusive economy, focusing on areas such as green energy, sustainable industry, sustainable financing, and safeguarding human rights. To achieve its objectives, the EU has introduced a storm of ESG-related directives and regulations. After implementation of the Corporate Sustainability Reporting Directive (CSRD), the Corporate Sustainability Due Diligence Directive (CSDDD) can be seen as the next key pillar in the EU regulatory framework which aims to stimulate responsible business conduct.

This article is written by Hendrik Bastiaans ([hbastiaans@rsmnl.nl](mailto:hbastiaans@rsmnl.nl)), Gidion Lont ([glont@rsmnl.nl](mailto:glont@rsmnl.nl)) and Annabelle van der Maarel ([avandermaarel@rsmnl.nl](mailto:avandermaarel@rsmnl.nl)). Hendrik, Gidion and Annabelle are part of RSM Netherlands Business Consulting Services with a specific focus on Sustainability and Supply Chain Management.

The CSDDD is expected to play an important role in addressing environmental issues and human rights in operations and supply chains of European companies. It introduces action-driven requirements which build on the reporting requirements of the CSRD. It will impose obligations for companies to act on actual and potential adverse impacts on human rights and the environment, concerning their operations, those of their subsidiaries, and those carried out by their business partners.

Since companies are currently focusing on preparing for the CSRD, which is already a challenging exercise, the CSDDD seems to be under the radar for many large EU companies. However, it is vital to be aware of the CSDDD and its requirements early on, as it builds on the foundations built by CSRD activities. By incorporating CSDDD requirements in CSRD reporting activities, companies can more effectively ensure future compliance and a sustainable strategy.

### NEW OBLIGATIONS UNDER THE CSDDD

The CSDDD extends the previously required scope of accountability, demanding companies to address both actual and potential adverse impacts on human rights and the environment in the operations and across the entire business chain regarding their services and products, those of their subsidiaries, and those of their business partners. This includes the upstream and downstream operations of the company, the company's subsidiaries, and the company's business partners. Therefore not only their own upstream and downstream operations need to be analyzed but also the ones for the ones of the subsidiaries and their business partners. The CSDDD includes a risk-based approach, requiring in-depth assessment and action of the sectors and areas where adverse impacts are most likely to occur or can have the most severe consequences.

Furthermore, the company will need to deliver a plan, including implementing actions and related financial and investment plans, to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy, the limitation of global warming to 1.5 °C in line with the Paris Agreement and achieving climate neutrality by 2050. If climate change is identified as a material risk for a company it is also required to have a Greenhouse gas emission reduction action plan.

To facilitate and ensure enforcement, the CSDDD additionally introduces several obligations for Member States. This includes tasking them to ensure that companies create complaints procedures for specific persons and organizations to file complaints regarding actual or potential adverse impacts that may arise from the company's operations, the activities of their subsidiaries, or their business partners within their activity chains.



The CSDDD also emphasizes civil liability. It obliges the Member States to establish new legal procedures specifically tailored for civil liability, focusing on companies that breach their due diligence obligations. The CSDDD requires member states to implement safeguards that protect the right to request compensation payments.

One such example of safeguards is that the limitation period for bringing actions for damages under this Directive shall be at least 5 years and, in any case, not lower than the limitation period laid down under general civil liability national regimes. This aspect of the framework is particularly noteworthy as it grants affected parties, including individuals and their representatives, which may encompass trade unions and civil society organizations an entrance to claim damages.

National supervisory authorities in the member states will be empowered by the EU Directive to perform inspections and initiate investigations. Companies that fail to comply and depending on the nature, gravity, duration of the infringements can expect to receive sanctions. Among these sanctions are public disclosure measures, commonly referred to as "naming and shaming," and the imposition of minimal financial penalties, which will be linked to the company's worldwide net turnover (5% of the net worldwide turnover in the last financial year preceding the final decision).

## **IMPACT ON BUSINESS**

The existing requirements of the CSRD only address required ESG reporting. The EU-sustainability standards currently require that there is due diligence on the supply chain to check for human rights and sustainability risks, using the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights as a process. The standards require that a company reports on the identified risks, and when available, on the specific actions to remove, mitigate, and remedy the identified risk in the supply chain. It does not impose requirements regarding a minimum level of ESG performance, established action policies or year-on-year progress. The CSDDD will complement the CSRD reporting requirement by adding action-driven obligations. Companies are expected to take measures to prevent, cease, and remedy adverse impacts on human rights and the environment. In a later paragraph, more will be explained about the steps to be taken by companies.

Companies covered by the CSDDD themselves are large multinational enterprises with operations in the EU. However, small and medium-sized enterprises (SMEs) will also be affected when they have an established business relationship with a company subject to the directive, for example, as a supplier, subcontractor or reseller in the value chain. These smaller companies need to provide information and meet certain standards to enable their business partners to fulfill their up- or downstream due diligence obligations.

## **IMPACT-DRIVEN RISK ASSESSMENT AND ACTION-DRIVEN OBLIGATIONS**

Companies that fall within the scope of the CSDDD are obliged to take steps to diligently monitor and mitigate the potential and actual adverse impacts of their operations on the specified ESG factors outlined in the CSDDD Annex. These factors encompass environmental considerations such as proper waste handling, the prohibition of certain pollutants, chemicals, and pesticides, as well as human rights aspects including the prevention of torture, promotion of freedom of religion, provision of safe working conditions, and the prohibition of forced and child labor.

As a first step, companies need to understand their supply chain. The CSDDD extends ESG due diligence obligations throughout a company's entire value chain, covering all upstream and downstream activities associated with the production of goods or services offered in the European market. This encompasses the entire life cycle of a product, from development to disposal. Upstream relationships include entities involved in the design, extraction, manufacturing, transportation, storage, and supply of raw materials and components. Downstream relationships include entities using or receiving products, and product distribution, transport, storage, dismantling, recycling, composting, or landfilling. Established business relationships within this value chain encompass both direct and indirect contractors, subcontractors, and other entities with a commercial relationship.

For regulated financial undertakings, the definition of the term 'chain of activities' should not include downstream business partners that are receiving their services and products. Therefore, as regards regulated financial undertakings, only the upstream but not the downstream part of their chain of activities is covered.



## BUSINESS ASPECTS OF THE CSDDD

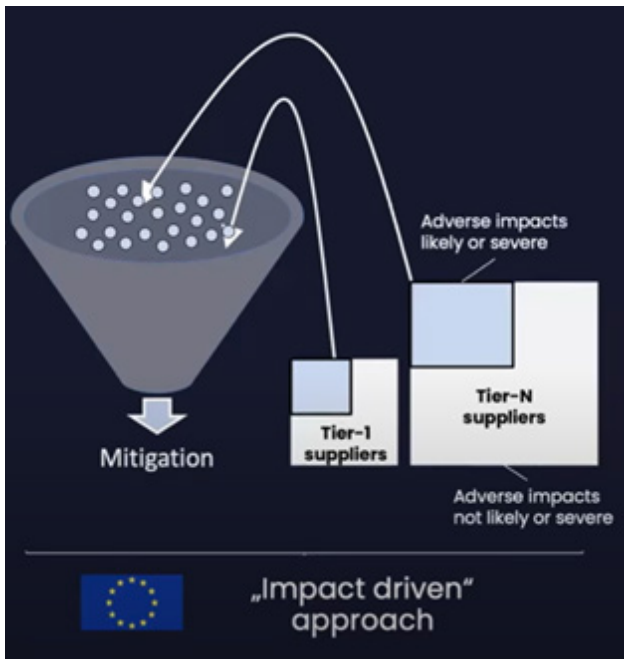
Essentially, the CSDDD requires companies to take action based on the transparency regarding their impact, which they have provided in the CSRD process. It reflects the demands of today's society and pushes companies to meet those demands. Investors are increasingly reluctant to invest in companies that are not ESG considerate, companies must build resilience through ESG considerations to deal with geopolitical tensions, supply chains are becoming more complex, attraction and retention of talent is a major challenge, and companies are facing more and more risks related to climate change. These developments demonstrate the need for companies to deal with ESG, as well as the need for a regulatory instrument to pressure companies into behaving sustainably.

Companies need to fully integrate the CSDDD into their strategy and in all their business relations. It cannot be dealt with in an isolated manner, all departments must become aware of it. When companies have established an effective and efficient due diligence system for this, this can form the basis for all kinds of compliancy requirements, including other EU directives and regulations. Moreover, the information that is required under the CSDDD about the supply chain will also be required by other regulatory frameworks. For example, much of the due diligence required under the CSDDD will also be of great importance for compliance with the Deforestation Regulation, the proposed Forced Labor Regulation, and many other instruments. Hence, it is worthwhile for companies to invest in the CSDDD.

The CSDDD will likely have a significant impact on supply chains. As a result of the spill-over effect, not only organizations that fall within the official scope of the Directive are affected, but also those in their supply chains that do not officially fall within the scope. This is the case as organizations that are subject to compliance are required to provide insight into their entire supply chain, meaning their suppliers must also provide information regarding their practices. Therefore, the CSDDD stretches much further than its official scope, and entire supply chains must adapt. Consequently, qualitative and transparent due diligence could also bring companies a competitive advantage. Companies that provide full transparency regarding the sustainability of their business conduct will become more favorable and attractive, as they facilitate other companies' compliance with the CSDDD and other legislation.

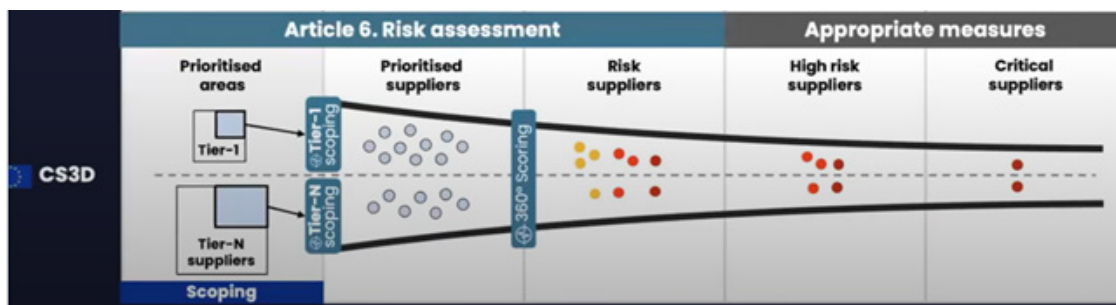






After the supply chain has been mapped out, the risk assessment needs to be performed. The risk assessment follows an impact-driven approach in which suppliers are scrutinized based on their likelihood of causing an adverse impact and the severity of such an impact. Suppliers which are unlikely to cause impacts and do not have the potential to cause severe impacts at all, do not have to be investigated. The order in which impacts are assessed should be based on the same criteria. Severity refers to an impact's intensity, the number of individuals affected, the extent of the environmental impact, and the difficulty of restoring the situation to its state before the occurrence of the adverse impact.

When an actual or potential adverse impact has been identified, the appropriate measures to be taken are determined by the nature of the company's contribution. If the company directly causes or contributes to the impact, proactive steps need to be taken to cease, avoid, or mitigate it. If the company is only linked to the impact through the value chain and does not directly cause or contribute to the adverse impact, the CSDDD states that it is sufficient to simply use or increase its leverage to decrease or stop the impact.



In proactively addressing the adverse ESG impacts of their operations, companies are expected to take a multifaceted approach. This involves developing and implementing comprehensive preventative or corrective action plans, complete with defined timelines and performance indicators. Seeking contractual assurances, whether directly from business partners or cascading to include indirect partners, is crucial to ensuring the compliance of established business relationships with the company's code of conduct and action plans. Active verification of compliance through methods like third-party audits adds a layer of accountability. Temporary suspension and, as a last resort, termination of relationships are considered appropriate actions when severe negative impacts persist without viable solutions.

The European Commission will provide additional material in due time. This includes Guidance and best practices on how to conduct due diligence, guidance on voluntary model contractual clauses and references to data and information sources, digital tools and technologies that could facilitate and support compliance.

The CSDDD prescribes that there will be an annual reporting requirement to be published on the company- website specifying information on the description of the due diligence process, potential and actual adverse impacts, and actions taken with respect to those impacts.

## PRACTICAL DETAILS AND IMPLEMENTATION DATE

The CSDDD requires large companies inside EU that employ more than 1000 employees and have a global net turnover of more than EUR 450 million, to address both actual and potential adverse impacts on human rights and the environment in their operations and across their entire value chain. In the case of non-EU companies, only a global net turnover of more than 450 million in the Union needs to be met. When the thresholds are not met at the entity level for EU and non-EU companies, the criteria are also reached if the ultimate parent company on a consolidated level of a group has met those thresholds.

Furthermore, the CSDDD in the case of EU companies brings companies in scope that generate business through franchisee royalties with an amount of more than EUR 22.5 million, additionally the companies or the ultimate parent company of the group also needs to have a net worldwide turnover of EUR 80 million. In the case of a non-EU company the franchisee royalties need to be at least EUR 22.5 million in the EU and there needs to be at least a net turnover of EUR 80 million in the EU by the company or the ultimate parent company.

The CSDDD legislative process moved to its final stage. The Council has formally adopted on May 24, 2024 the corporate sustainability due diligence directive. This was the last step in the decision-making procedure. Now the directive has been formally adopted EU Member States will have two years to transpose the CSDDD into domestic law. The implementation timeline will be as follows:

EU based companies	Non-EU based companies
<ul style="list-style-type: none"> <li>3 years from the entry into force of this Directive.</li> <li>5000+ employees</li> <li>net worldwide turnover of over EUR 1500 million in the last preceding year;</li> </ul>	<ul style="list-style-type: none"> <li>3 years from the entry into force of this Directive.</li> <li>net EUR 1500 million annual turnover in the EU in the last preceding year;</li> </ul>
<ul style="list-style-type: none"> <li>4 years from the entry into force of this Directive.</li> <li>3000+ employees</li> <li>net worldwide turnover of over EUR 900 million in the last preceding year;</li> </ul>	<ul style="list-style-type: none"> <li>4 years from the entry into force of this Directive.</li> <li>net EUR 900 million annual turnover in the EU in the last preceding year;</li> </ul>
<ul style="list-style-type: none"> <li>5 years from the entry into force of this Directive.</li> <li>All smaller EU companies that fall under the scope of the CSDDD.</li> <li>EU companies with a franchise with at least EU 22,5 million royalty income and a net worldwide turnover of EU 80 million</li> </ul>	<ul style="list-style-type: none"> <li>5 years from the entry into force of this Directive.</li> <li>All smaller non-EU companies that fall under the scope of the CSDDD.</li> <li>Non-EU companies where there is a franchise with at least EU 22,5 million royalty income and a net turnover of EU 80 million in the EU.</li> </ul>

## OPPORTUNITIES AND RISKS

The European Commission has identified numerous benefits and opportunities associated with the CSDDD, applicable to diverse stakeholders in climate change efforts. For companies, the CSDDD brings a harmonized legal framework, fostering certainty, customer trust, and better risk management. Citizens gain from improved human rights protection and a healthier environment, fostering trust in businesses. Developing countries benefit through enhanced rights protection, increased stakeholder awareness, sustainable investment, and adoption of international standards. However, businesses that are not prioritizing sustainability may face significant financial and non-financial risks.

By identifying and assessing the parts of their operations and supply chains that are most susceptible to human rights infringements and sustainability risks, future activities to reduce adverse impacts can be planned. Starting discussions about (reducing) these adverse impacts with the relevant operational business units and suppliers may be an appropriate first step in preparing for the CSDDD.

RSM is a thought leader in the field of Sustainability and Strategy Consulting. We offer frequent insights through training and sharing of thought leadership that is based on a detailed knowledge of regulatory obligations and practical applications in working with our customers. If you want to know more, please reach out to one of our consultants.