<u>Checklist: 6 Things You Need to Know About the EU CSDD</u>

By PracticalESG.com

The EU's Green Deal is coming with many new laws as Europe seeks to become the first carbon-neutral continent. One of these new laws is the Corporate Sustainability Due Diligence Directive (CSDD). The CSDD has not yet been passed and passage is unlikely before the end of 2023. It is unlikely that the CSDD will be adopted before the end of 2023, so the very earliest companies would have to comply would be 2025.

Any final version adopted may vary in significant ways from the proposed directive, so you'll want to watch this closely as it develops on its way to adoption. Although the anticipated compliance dates may seem far off, given the scale of the CSDD and the structural governance changes that will be required for compliance, in-scope companies should be planning now to stay ahead of this rule.

This checklist walks through some of the requirements of the draft CSDD and break down what companies will be required to comply with the new law if it passes as currently proposed.

1. **Background on the CSDD.** The EU is attempting to address human rights and environmental impacts companies make through their operations. However, these issues often lie in supply chains up and downstream, in places that EU enforcement cannot reach. Therefore, to mitigate these problems, the EU is introducing due diligence requirements to integrate sustainability into corporate governance and management systems, as well as help frame business decisions in terms of human rights, climate and environmental impact.

   In the current legal landscape across the EU, member states are introducing due diligence requirements. These requirements are not uniform, which creates confusion and unfair competition for companies. The CSDD seeks to provide a standard framework for all member states so that member state countries will have a uniform foundation for implementing due diligence standards.

   Additionally, many of the problems the CSDD seeks to address are transboundary in nature, such as pollution, climate change and biodiversity. Having an EU level framework allows for more even enforcement and mitigation of these issues.

2. **CSDD applies to non-EU companies.** The CSDD splits in-scope companies into two categories: Group 1 and Group 2. EU companies fall into Group 1 if they generate a net turnover of €150 million worldwide and have over 500 employees. EU companies are in Group 2 if they generate over €40 million worldwide, have over 250 employees and generate at least 50% of their net turnover through a "high impact sector." A list of industries considered to be "high impact" is contained in Article 2(1)(b)(i-iii) of the proposal on pages 46 and 47. It states as follows:

   (i) The manufacture of textiles, leather and related products (including footwear), and the wholesale trade of textiles, clothing and footwear;

   (ii) Agriculture, forestry, fisheries (including aquaculture), the manufacture of food products, and the wholesale trade of agricultural raw materials, live animals, wood, food, and beverages;

   (iii) The extraction of mineral resources regardless from where they are extracted (including crude petroleum, natural gas, coal, lignite, metals and metal ores, as well as all other, non-metallic minerals and quarry products), the manufacture of basic metal products, other non-metallic mineral products and fabricated metal products (except machinery and equipment), and the wholesale trade of mineral resources, basic and intermediate mineral products (including metals and metal ores, construction materials, fuels, chemicals and other intermediate products).

   Rules for non-EU companies, referred to as "third countries," are slightly different. Non-EU companies that fall into Group 1 are those that generate a net turnover of more than €150 million in the EU. Non-EU Group 2 companies are those with a net turnover of over €40 million in the EU and who generate more than 50% of their worldwide turnover from a "high impact" sector.

   It is important to point out that EU companies are grouped based on their **worldwide net turnover**, whereas non-EU companies are brought into scope based only on **turnover generated within the EU**. Additionally, non-EU companies have no minimum employee requirements. This is because the European Commission felt that it would be too difficult to accurately ascertain the number of employees working for large multinationals that are not established in the EU.

The European Commission estimates that 9,400 EU companies will fall into Group 1 and 3,400 EU companies into Group 2. The Commission also expects 2,600 non-EU companies to fall into Group 1 and 1,400 non-EU companies to fall into Group 2.

3. **The CSDD may require new governance mechanisms.** The goals of the CSDD are to improve governance practices to better integrate management processes for social and environmental (E&S) risks and impacts, including those that arise from a company's supply chain. The CSDD seeks to accomplish this by requiring companies to integrate due diligence into corporate policies and have a due diligence policy in place that is updated annually.

   A large portion of the CSDD is dedicated to mandating that companies identify human rights and environmental risks and impacts, as well as ensuring that companies are actively taking steps to mitigate the risks. The CSDD requires companies to make plans, policies and enact procedures to further these goals. For EU companies, directors must set up and oversee the implementation of due diligence procedures. That requirement is waived for non-EU companies, but robust E&S governance practices will be vital to compliance, so even non-EU companies should give serious consideration to implementing governance structures similar to those required for EU companies.

4. **The CSDD will have impacts up and downstream in supply chains.** The CSDD requires companies to look through their supply chains to identify and mitigate E&S risks. In-scope companies may need to re-evaluate business relationships and prioritize business partners that are managing E&S risks successfully. By influencing what firms in-scope companies work with, the CSDD will impact non-EU, out-of-scope companies.

   If you do business with an in-scope EU company, expect your role in the supply chain to be scrutinized by your EU partner companies. Mitigating E&S risks in your supply chain will make you a more attractive business partner to companies subject to the CSDD. Even if you aren't directly affected by the directive, you should anticipate that the CSDD will affect your business relationships and what practices you may need to change to maintain those partners.

5. **Compliance will be expensive.** The European Commission provided no estimated cost for compliance with the CSDD. Costs will vary largely

depending on the individual company's complexity and E&S risk level. The CSDD comes with financial penalties for companies that fail to comply after being given a warning, so it's likely worth spending the money on compliance to avoid legal action. Some large multinational companies are setting aside as much as €20 million to bring themselves into compliance with the new Green Deal laws in the EU, so it's important to watch these rules develop and plan to budget for compliance. The sooner companies assess their needs and implement data collection tools and management programs, the less expensive compliance is likely to be.

6. **Companies could have to comply as soon as 2025.** Member states will have two years from the date of passage to implement standards for Group 1 EU companies. Member states will have four years from the date of passage to implement standards for Group 2 EU companies and all non-EU companies. It is unlikely that the CSDD will be adopted before the end of 2023, so the very earliest companies would have to comply would be 2025. It is more likely that the window for compliance will be somewhere between 2026-2027 for large EU companies and 2028-2030 for all other in-scope companies.