



YOUR GUIDE TO UNDERSTANDING

The EU Corporate Sustainability Due Diligence Directive (CSDDD)

BRIEF INTRODUCTION TO THE CSDDD

The European Union (EU) Corporate Sustainability Due Diligence Directive (CSDDD) was approved by the EU on June 13, 2024, and officially entered into force on July 25, 2024.

This approval comes after a number of revisions to the CSDDD (also referred to as the CS3D) made by various EU entities during the negotiation process and a contentious period of adoption that saw several changes to the scope of the CSDDD prior to adoption.

As companies look forward to implementation of the CSDDD, preparations will need to include evaluation from a legal perspective of what obligations apply and to which entities within the corporate group. At the same time, supply chain mapping and data collection tools will be essential to compliance efforts, as will analysis of potential disclosure obligations as companies also implement the EU Corporate Sustainability Reporting Directive (CSRD). As companies are already dealing with a number of other environmental, social and governance (ESG) regulations across jurisdictions, the advice of trusted advisors and guidance for implementing key tools and their interaction with existing processes will grow in importance.

New prescriptive governance requirements

Generally speaking, the CSDDD contains a number of prescriptive governance requirements with the overarching aim of having in-scope companies integrate

“sustainability due diligence” throughout their business model. This means that in-scope companies – including both EU and non-EU companies doing significant business in the EU¹ – need to identify, address, and monitor the impact of their activities on environmental and human rights matters, including by their subsidiaries and supply chain. Additionally, the CSDDD will require companies to adopt and implement transition plans that intend to mitigate climate change.

Harmonize supply chain obligations across the EU

The CSDDD was developed as part of the European Green Deal aiming to promote the integration of sustainable processes into the day-to-day operations of companies doing significant business in the EU. The CSDDD also is intended to harmonize the supply chain rules already in place in some EU countries, such as France, Germany and the Netherlands, to create a level playing field for companies operating within the EU. The EU has stated that it seeks to avoid fragmentation of due diligence requirements in the EU market and is seeking to create legal certainty for companies and stakeholders of expected governance requirements and potential accountability for violations — although the actual effect of the CSDDD’s implementation remains to be seen.

The CSDDD will create significant penalties for non-compliance

To date, companies have generally applied sustainability due diligence on a voluntary basis. The CSDDD will require companies to implement an extensive due diligence process covering a number of specified “adverse impacts” throughout their upstream and downstream supply chain, allowing EU countries to impose significant potential liabilities for violations of these obligations².

One of the CSDDD’s driving forces is to hold companies accountable for the quality and reliability of their due diligence processes while improving access to remedies for those affected by the alleged adverse impacts caused by a company or its supply chain.

Going forward, given that the CSDDD is a directive, the CSDDD will be implemented into the national laws of 27 EU member states (which has proven a slow process in light of the delayed CSRD implementation). National legislation may be more stringent than the CSDDD in certain aspects of the rules, although they cannot make more stringent certain CSDDD requirements, including the obligations to identify, prevent, mitigate and terminate “adverse effects” as described below.

¹ References to “companies” in this document means such companies that are in scope of the CSDDD, unless context otherwise requires.

² The Annex to the CSDDD lists a number of provisions from international human rights and environmental law treaties that must be considered when determining whether an “adverse impact” exists.



BACKGROUND

The European Commission adopted a package of proposals focused on reducing net greenhouse gas emissions by at least 55% by 2030, with the ultimate goal of achieving climate neutrality by 2050.

To date, certain key regulations included in the Green Deal are:

- The Sustainable Finance Disclosure Regulation, or SFDR (Regulation (EU) 2019/2088 of the European Parliament and of the Council of November 27, 2019, on sustainability-related disclosures in the financial services sector)
- The Taxonomy Regulation (Regulation (EU) 2020/852 of the European Parliament and of the Council of June 18, 2020, on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088)
- The Corporate Sustainability Reporting Directive, or CSRD (Directive (EU) 2022/2464 of the European Parliament and of the Council of December 14, 2022, as regards corporate sustainability reporting)
- The Carbon Border Adjustment Mechanism, or CBAM (Regulation (EU) 2023/956 of the European Parliament and of the Council of May 10, 2023)
- The EU Deforestation Regulation, or EUDR (Regulation (EU) 2023/1115 of the European Parliament and of the Council of May 31, 2023, on the making available of deforestation-free products)
- The CSDDD

While the Green Deal rollout is expected to slow, in particular given the new composition of the European Commission, the existing rules on the books are already significant and will continue to phase in through 2030.

The role of the CSDDD within the European Green Deal

The SFDR, Taxonomy Regulation and CSRD seek to protect investors and provide the market with sufficient sustainability disclosure, while the Deforestation Regulation and CBAM will impose new reporting and other requirements. The CSDDD's adoption marks a significant turning point in the EU's Green Deal because the rules will impose prescriptive obligations to act and take on liability with respect to human rights and environmental issues.

How are the CSRD and CSDDD related?

The CSRD expanded on existing requirements for large companies operating in the EU to provide information on environmental, social and governance impacts of a company's activities and the impacts of sustainability risks on the company's operations, as well disclosure around the procedures implemented, assessed and managed.

The CSDDD also requires in-scope companies to provide an "annual statement" on their due diligence processes. The contents and requirements of this statement are expected to be clarified in future EU guidance. However, companies will be exempted from this requirement if they are already reporting under the CSRD.

CSRD disclosure is expected to combine with CSDDD obligations in such a way as to create significant new liability for companies operating in the EU. As the CSDDD will require companies to uncover potential or actual adverse impacts on a long list of human rights and environmental matters, the CSRD will require disclosure of these impacts when they are "material" (from the CSRD's "double materiality" perspective) — and third parties may seek to take companies to court for these reported violations.

CSDDD SCOPE AND TIMELINE

The CSDDD applies to large EU and non-EU companies and groups that exceed specified thresholds discussed below, as well as companies with certain franchising or licensing agreements in the EU.

Both EU and non-EU companies must apply the same revenue threshold to determine whether they fall within the scope of the CSDDD, but EU companies must also meet an additional “employee” threshold (effectively making it “easier” for a non-EU company to be in scope of the CSDDD than an EU company). The CSDDD will phase in through 2029, impacting the largest companies first.

Which EU companies need to comply with the CSDDD?

CSDDD obligations will be phased in for EU companies as follows:

Covered companies:	CSDDD will apply in:	Application period:
EU companies with more than 5,000 employees and a worldwide net turnover of more than €1.5 billion in the last financial year preceding July 26, 2027, for which annual financial statements have been or should have been adopted	July 26, 2027	Financial years starting on or after January 1, 2028
EU companies with more than 3,000 employees and a worldwide net turnover of more than €900 million in the last financial year for which annual financial statements have been or should have been adopted	July 26, 2028	Financial years starting on or after January 1, 2029
EU companies with more than 1,000 employees and a worldwide net turnover higher than €450 million in the last financial year	July 26, 2029	Financial years starting on or after January 1, 2029
EU companies with worldwide net turnover generated in the EU of more than €80 million, provided that at least €22.5 million were generated by royalties from certain franchising or licensing agreements		

Note that even if an individual company does not meet the thresholds set out above, an EU company that is the “ultimate parent company” of a group of controlled subsidiaries will be required to comply with the CSDDD if the group on a consolidated basis exceeds the above thresholds (with certain exceptions, such as holding companies in certain circumstances).

How does the CSDDD impact non-EU companies?

CSDDD obligations will be phased in for non-EU companies as follows:

Covered companies:	CSDDD will apply in:	Application period:
Non-EU companies generating net turnover in the EU of more than €1.5 billion in the financial year preceding the last financial year	July 26, 2027	Financial years starting on or after January 1, 2028
Non-EU companies generating net turnover in the EU of more than €900 million in the financial year preceding the last financial year	July 26, 2028	Financial years starting on or after January 1, 2029
Non-EU companies generating net turnover in the EU of more than €450 million in the financial year preceding the last financial year	July 26, 2029	Financial years starting on or after January 1, 2029
Non-EU companies with net turnover generated in the EU of more than €80 million, provided that at least €22.5 million were generated by royalties from certain franchising or licensing agreements in the EU		

As with EU companies, even if an individual non-EU company does not meet the thresholds set out above, a company that is the “ultimate parent company” of a group of controlled subsidiaries may also be in-scope.

As with other aspects of the CSDDD, further guidance is expected with respect to non-EU company compliance with CSDDD. For example, it is expected that the European Network of Supervisory Authorities will publish a regularly-updated indicative list of third-country companies that it deems to be in-scope of the CSDDD.

WHAT ARE IN-SCOPE COMPANIES' CORE OBLIGATIONS UNDER THE CSDDD?

The CSDDD requires in-scope companies to adopt a sustainability due diligence policy, actively manage and mitigate adverse environmental and human rights impacts, and implement specific actions such as adopting and making best efforts to effect a transition plan with time-bound targets for 2030 and 2050.

Due diligence policy

Under the CSDDD, companies will be required to adopt a “risk-based” due diligence policy, assessing the severity and likelihood of adverse impacts of a list of human rights and environmental matters set out in an annex to the CSDDD. The policy must be designed to identify, mitigate and ultimately prevent potential and actual adverse impacts on human rights and the environment, to be integrated across operations and the value chain in “all...relevant policies and risk management systems.” Thereafter, companies must monitor the effectiveness of the policy and measures taken in response to identified adverse impacts and publicly communicate around the same.

Due diligence applies to the entire “chain of activities,” which includes:

- The company’s own business activities.
- The company’s subsidiaries.
- Direct business partners that are either upstream of the company, such as suppliers, or downstream, for example, customers, distributors, transporters or storage.
- Indirect business partners of the company — in other words, any entity that is not party to a commercial agreement with the in-scope company but performs business operations related to the company’s operations, products or services.

Identifying, preventing and terminating adverse impacts

CSDDD obligations to monitor potential adverse impacts on an ongoing basis include:

- Identifying and assessing actual and potential negative impacts of the company, its subsidiaries and parent companies, and their business partners’ business activities.
- Taking appropriate measures to prevent potential negative impacts or mitigate identified potential negative impacts.
- Taking appropriate measures to bring actual adverse impacts to an end whether through mitigation measures such as financial assistance, corrective actions or contractual assurances, or as a last resort, terminating or suspending a business relationship.

Adopt and carry out a transition plan for climate change mitigation

Importantly, the CSDDD will require companies to adopt and carry out a climate change mitigation transition plan that “aims to ensure, through best efforts” that the business model and strategy of the company are “compatible” with the following:

- The transition to a sustainable economy
- Limiting global warming to 1.5°C in line with the Paris Agreement
- The objective of achieving climate neutrality

The transition plan must include:

- Temporary targets based on scientific evidence and, where appropriate, the Scope 1 (emissions from sources that an entity owns or directly controls), Scope 2 (emissions that an entity causes indirectly and are caused where the energy is produced) and Scope 3 (emissions that are produced by the chain of activities of an entity), including greenhouse gas emission reduction targets for each significant category.
- Decarbonization levers and key transition actions to be implemented as identified by the company.
- Financing and investment allocated and used for the implementation of the transition plan.
- The role of the supervisory and management bodies of the company. The transition plan must be updated every 12 months considering the companies’ efforts and progress towards such plan.

Establish a whistleblower mechanism

In addition, companies must establish a whistleblower or complaints procedure enabling a number of stakeholders including employees, suppliers, individuals, trade unions, non-governmental organizations (NGOs) and employee representatives to lodge complaints alleging that environmental or human rights have been adversely affected.

The whistleblower mechanism must be “fair, publicly available, accessible, predictable and transparent” while maintaining confidentiality and anti-retaliation policies. Complainants are meant to be able to meet with appropriate company representatives.

KEY LIABILITY RISKS UNDER THE CSDDD

The CSDDD generally seeks to require EU member states to allow certain third-party claims against in-scope companies for failures to prevent, mitigate or end certain human rights and environmental violations, including those committed by business partners in their global supply chain. While some EU member states have already adopted national legislation concerning supply chain sustainability due diligence and governance, national laws and penalties vary widely in scope and are expected to expand to implement CSDDD.

Civil liability (third party litigation)

One of the most salient and controversial aspects of the CSDDD is its expansion of the civil liability regime for companies. Under the CSDDD, EU member states may need to expand potential claims available for civil liability relating to certain alleged violations of the CSDDD. This will be a key legal aspect for in-scope companies to watch going forward.

Enforcement and regulatory penalties

Under the CSDDD, EU member states may impose penalties and sanctions via national regulators. These penalties should be “proportionate and dissuasive” with the maximum amount of monetary fines being no less than 5% of the company’s net worldwide turnover. The details and mechanisms of these enforcement measures are to be defined as EU countries implement the CSDDD into national law.





PREPARING FOR THE CSDDD & HOW JONES DAY CAN HELP

Given the upcoming CSDDD requirements and related disclosure being required under the CSRD, companies doing business in the EU should consider seeking legal advice in order to, among other things:

- **Scoping & timing** – Conduct a corporate scoping exercise to determine whether the CSDDD applies, and if so, to which entities, when compliance is required, and how the CSRD scoping overlays with CSDDD applicability.
- **Due diligence process and documentation** – Update or put in place due diligence processes and procedures to comply with the CSDDD and demonstrate “best efforts” – including building and/or updating supply chain due diligence programs to meet the CSDDD requirements and obtain information about the human rights and environmental matters contained in the CSDDD.
- **Consider how to mitigate potential litigation risk** – Assessing legal liability in connection with the CSRD and other disclosure obligations, determining strategy for mitigating liability related to disclosures in multiple forms and with multiple regulatory authorities; adopting a fully integrated cross-border approach to litigation risk to prepare for the CSDDD’s new third-party litigation mechanism.
- **Specific actions** – Put in plan to comply with substantive requirements, including adopting and carrying out a transition plan, conducting stakeholder engagement and adopting a whistleblower policy as needed.
- **Contractual clauses** – Analyze key contractual knock-on effects and consider contractual clauses to obtain required data and respond to due diligence requests, as well as other potential provisions.

Contact your Jones Day team for more information.



HOW SPHERA CAN HELP

Once you know whether you fall within the scope of the CSDDD and you understand the timeline for implementation, you need to identify the software and data you will need for your compliance effort.

Sphera’s software and data enable you to:

- Establish a foundation of defensible data for reporting and due diligence activities.
- Create due diligence policies and processes.
- Calculate your organization’s carbon footprint and other environmental impacts.
- Conduct supply chain risk assessments from tier 1 to the source level to uncover possible negative environmental or human rights impacts.
- Develop a transition plan for climate change mitigation.
- Design mitigation and prevention strategies with internal stakeholders and supply chain partners and carry out action plans.
- Technical assistance with creating reports for reporting per regulations, voluntary frameworks and to investors and consumers.

Additionally, Sphera’s 200+ sustainability experts can provide industry-specific knowledge and guidance for your compliance effort and your sustainability strategy.

Get in touch for more information on how Sphera can help with CSDDD compliance.



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