CS3D

EU's Corporate Sustainability Due Diligence Directive

In a historic move, the European Union has reached a provisional agreement on a new Directive to ensure corporate sustainability and accountability across global value chains. The legislation, set to transform companies' operations, will enforce strict due diligence requirements to safeguard human rights and the environment.

After intense inter-institutional negotiations, the European Parliament and Council announced on 14 December 2023 that they had agreed on a legislative text that compels companies to actively mitigate their negative impacts on child labour, slavery, labour exploitation, pollution, deforestation, and excessive water consumption.

Under the new Directive, companies must integrate due diligence into their policies and risk management systems. This includes adopting a plan to align their business models to limit global warming to 1.5°C. Companies with over 1000 employees will receive financial incentives to implement these plans.

The legislation will apply to EU companies and parent companies with more than 500 employees and a worldwide turnover exceeding 150 million euros. It will also affect companies with over 250 employees and a turnover of more than 40 million euros, mainly if they operate in high-impact sectors such as textiles, agriculture, mineral resource extraction, and construction. Non-EU companies with significant turnover in the EU will also be subject to these obligations.

Companies will be expected to address the negative impacts of their actions and those of their partners throughout the entire value chain. This includes making investments, seeking contractual assurances, improving business plans, or supporting small and medium-sized enterprise partners.

The Directive also mandates meaningful engagement with affected parties, introducing a complaints mechanism, public communication on due diligence policies, and regular monitoring of their effectiveness. EU governments will support companies by creating practical portals to guide them in their due diligence obligations.

A supervisory authority will oversee compliance, sharing best practices within the European Network of Supervisory Authorities. Non-compliant companies may face penalties, including public exposure and fines of up to 5% of their worldwide turnover.

The agreed draft law now awaits formal approval by the JURI Committee, the European Parliament, and the Council EU Ambassadors before it can be enacted.

This legislative milestone underscores the EU's commitment to an economy that works for people and the planet, setting a global benchmark for sustainable corporate governance.

BUSINESS - GOING BEYOND

The impact on businesses under the new EU Directive on corporate sustainability due diligence revolves around the potential for increased operational costs and the need for significant changes to existing business practices. Companies must integrate comprehensive due diligence processes into their policies and risk management systems, which may necessitate substantial investment in new procedures, training, and staffing.

Businesses must identify, assess, prevent, mitigate, end, and remedy negative impacts on human rights and the environment throughout their entire value chain. This could mean altering supply chains, seeking contractual assurances from partners, and investing in improvements to ensure compliance with the Directive's requirements. Companies with over 1,000 employees are also required to adopt a plan that aligns their business model with the goal of limiting global warming to 1.5°C.

The legislation applies to a broad range of companies, including those with over 500 employees and a worldwide turnover higher than 150 million euros, as well as companies with more than 250 workers and a turnover of more than 40 million euros if they operate in specific sectors. Non-EU companies with equivalent turnover in the EU are also subject to these obligations.

Firms must engage meaningfully with affected parties, introduce a complaints mechanism, communicate their due diligence policies, and regularly monitor their effectiveness. This level of engagement and transparency requires resources and may expose companies to reputational risks if they fail to meet the standards.

EU will support companies by creating practical portals dedicated to due diligence obligations, but companies will still be responsible for compliance. A supervisory authority will monitor adherence to the Directive, and non-compliant companies could face penalties, including public exposure ("naming and shaming") and fines of up to 5% of their net worldwide turnover.

In summary, while the Directive aims to foster sustainable and responsible corporate behaviour, it introduces new challenges for businesses, including increased compliance costs, potential supply chain restructuring, and the risk of significant penalties for non-compliance.