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Newsletter:
New directive for large companies

Dear reader,

The environment and human rights are more than ever at the heart of concerns. This is confirmed by the European Union by placing (very) large companies at the centre of the sustainability battle waged by EU bodies for several years now.

Indeed, as of 25 July 2024, the so-called *"Corporate Sustainability Due Diligence Directive"* or "*CSDDD"* or "*CS3D"* has come into effect.

In this newsletter, we briefly review the content of this directive, while highlighting some points of attention for companies and their HR departments, who will soon be affected by the legislative changes aimed at transposing these new guidelines.

Enjoy the read!

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1 The new “CS3D" directive has come into force

The new “CS3D” directive must be transposed into national law by 26 July 2026.

Directive 2024/1760 EU of the European Parliament and of the Council of 13 June 2024 “on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859” entered into force on 25 July 2024.

This directive intends to impose certain obligations on companies in order to reduce the potential negative impacts of their business activities on the *environment* as well as on *human rights*.

In this sense, the directive covers a narrower field than the CSRD directive on sustainability *reporting* duties, which covers the three ESG pillars (Environment, Social, Governance) in a broad sense, which in social and human resources practice in particular is much broader than impacts on human rights. Due diligence exercises will therefore not automatically focus on all the social areas covered by the CSRD (to find out more, see our *newsletter* of 16 January 2023), but on a hard core of potential human rights violations. On the other hand, the human rights covered are defined in the annex to the directive in a broad sense, and include, for example, the right to strike, freedom of association, the prohibition of discrimination, and the right to equal remuneration for equal work.

Member States now have two years to adopt the laws, regulations and administrative provisions needed to comply with the European directive. Companies will then have a phased-in period, extending to 2030, to comply.

2 Scope of application

The directive is primarily aimed at (very) large companies.

The directive applies only to the following European companies:

- EU member companies with more than 1,000 employees and worldwide net worldwide turnover exceeding EUR 450 million;
- EU parent companies of a group with more than 1,000 employees and net worldwide turnover exceeding EUR 450 million;
- Franchises in the European Union with net worldwide turnover exceeding EUR 80 million, if at least EUR 22.5 million were generated by royalties;

Secondly, it also applies to non-European companies that meet the above net turnover criteria within the European Union.

In addition, if a parent company's main activity is holding shares in operating subsidiaries and does not take part in management, operational or financial decisions affecting the group or one or more of its subsidiaries, i.e., a pure holding company, it may apply to the competent supervisory authority for exemption from the obligations laid down in the new directive, provided certain conditions are met.

According to informal estimates, this would involve some 5,000 European companies, including 200 in Belgium.

3 A due diligence process

The “CS3D” directive establishes a *due diligence process for large companies*, covering the six measures defined by the *OECD Guide* to Responsible Business Conduct, providing certain tools for companies to identify and remedy negative impacts on the environment and human rights:

- Integrating the principles of responsible business conduct into corporate policies and management systems;
- Identifying and assessing actual and potential negative impacts associated with the company's activities, products and services;
- Ceasing, preventing and mitigating negative impacts;
- Monitoring the implementation of the due diligence and its results;
- Communicating how the company deals with its negative impacts;
- Repairing the company's negative impacts, by its own means or in cooperation with other players.

The directive translates these various measures into a concrete due diligence process that the companies concerned will now have to comply with.

Companies will be required to keep all documentation relating to the measures implemented to meet their due diligence obligations for a minimum of five years, with this period extended until the end of any legal or administrative proceedings that may have arisen during the initial period and not been closed.

3.1 Integrating due diligence into company policies and risk management systems

The due diligence process established by the directive requires companies to integrate the duty of care into all relevant risk management policies and systems.

So if you are concerned, consider *integrating sustainability due diligence into existing risk management policies and systems.*

In this context, companies also need to put in place a due diligence policy that ensures that due diligence is risk-based.

In order *to draw up this policy*, it is necessary to organise a *consultation between the company and its employees, as well as their representatives*. At this stage, we do not know how the directive will be transposed in Belgium, but it is likely that this will be a new competence of the works council. In addition, the policy contains several elements defined by the directive, and must be reviewed and updated regularly, or at least every two years.

3.2 Identifying, assessing and prioritizing actual or potential adverse impacts

Companies must take appropriate measures to *identify and assess* the actual and potential impacts (again, on the environment and human rights) arising from their own activities, those of their subsidiaries, or those of their business partners when linked to their chains of activity.

To this end, companies take appropriate measures such as:

- Mapping their own activities, those of their subsidiaries and those of their business partners, in order to identify the general areas in which negative impacts are most likely to occur and to be most severe;
- Then carry out an in-depth assessment of these activities in the areas identified.

Companies prioritise these negative impacts according to their means and possibilities for mitigating, eliminating or *reducing them*, but also according to their degree of severity and probability.

3.3 Preventing and mitigating potential adverse impacts

Companies must prevent or adequately mitigate *potential adverse impacts* that have been or should have been identified as described above.

To this end, companies should take appropriate measures, which are determined on the basis of a number of factors, influenced in particular by:

- the origin of the adverse impact, which may have been caused by the company itself, one of its subsidiaries or a business partner;
- the company's ability to influence such a trading partner.

The directive therefore provides for a series of appropriate measures to be taken by the company, according to its needs. These measures may also be accompanied by any other appropriate measures, such as dialogue with the business partners concerned, or the possibility of reinforcing the latter's capacities in terms of guidance, administrative and financial support, etc.

Where it has not been possible to prevent or mitigate certain potential adverse impacts through the above-mentioned measures, companies may seek to obtain contractual assurances from an indirect business partner, backed up by appropriate verification measures.

Finally, for potential adverse impacts that could not be prevented or could not be adequately mitigated, the company must suspend or terminate the business relationships that are problematic in terms of compliance with the due diligence and sustainability objectives advocated by the new directive - unless it can justify to the supervisory authority why such action would lead to more serious consequences than those that could not be put an end to.

3.4 Eliminating and mitigating actual adverse impacts

The companies concerned must put an end to the *actual adverse impacts* identified in accordance with the due diligence procedure.

Once again, companies must take appropriate measures, which are determined on the basis of a number of factors, including whether the adverse impact originated with the company itself, one of its subsidiaries or a business partner, and the company's ability to influence such a business partner.

If it is not possible to put an end to it, companies must try to minimise the extent of this adverse impact using the procedures developed by the directive. The latter seems to broadly incorporate any

appropriate means of reducing such impact, and in particular encourages dialogue between the various players.

When none of the first two means of eliminating adverse impact has been successful, companies can seek contractual assurances from an indirect trading partner, backed up by appropriate verification measures.

Finally, if no solution is feasible, and no measures can reasonably be taken to put an end to or minimise the adverse impact, the company must suspend or terminate the business relationship which is problematic in terms of compliance with the due diligence and sustainability objectives of the new directive - unless it can justify to the supervisory authority why such action would lead to more severe consequences than those which could not be put an end to.

3.5 Remediation of actual adverse impacts

Where an adverse impact has actually been caused by a company, it is clearly the company's responsibility to provide remediation.

In this respect, *"remediation"* means restoring the affected person or persons, communities or environment to a situation equivalent or as close as possible to the situation they would have been in had the actual adverse impact not occurred, proportionate to the company's implication in the adverse impact, including through financial or non-financial compensation provided by the company to a person or persons affected by the actual adverse impact and, where applicable, reimbursement of the costs incurred by public authorities for any necessary remedial measures.

If the impact in question is caused by the company's business partner, the company may also provide voluntary remediation.

3.6 Meaningful engagement with stakeholders

In order to conduct meaningful human rights and environmental due diligence, the directive requires companies to ensure *effective engagement with stakeholders* for the process of carrying out the due diligence actions.

The stakeholders mainly means: "*the company's employees, the employees of its subsidiaries, trade unions and workers' representatives, consumers and other individuals, groupings, communities or entities whose rights or interests are or could be affected by the products, services and operations of the company, its subsidiaries and its business partners, including the employees of the company's business partners and their trade unions and workers' representatives, national human rights and environmental institutions, civil society organisations whose purposes include the protection of the environment, and the legitimate representatives of those individuals, groupings, communities or entities*."

According to Recital 65, the directive states that when carrying out consultations, it should be possible for companies to rely on industry initiatives to the extent that they are appropriate to support effective engagement. However, the use of industry or multi-stakeholder initiatives is not in itself sufficient to fulfil the obligation to consult workers and their representatives.

It remains to be seen how this consultation or engagement mechanism, at first sight highly complex and for which there is no real precedent, will be structured in practice.

3.7 Notification mechanism and complaints procedure

Companies must also establish and maintain a notification mechanism and complaints procedure under which companies should provide the possibility for persons and organisations to *submit complaints directly* to them in case of *legitimate concerns regarding actual or potential* human rights and environmental *adverse impacts*.

This is a fair, predictable and transparent procedure, accessible for the submission of notifications by persons and organisations where they have legitimate concerns regarding adverse impacts of a company's failure to comply with its due diligence obligations.

According to national law, the complaint or notification can be made either anonymously or confidentially, in order to remove the possibility of retaliation.

In this respect, it is specified that such a *complaints mechanism* may be combined with the *internal reporting procedure* set out in accordance with the Whistleblowers Act transposing Directive (EU) 2019/1937, subject to two cumulative conditions:

- if the breach of Union or national law included in the material scope of that directive can be considered to be an adverse impact as referred to in directive CS3D;
- if the reporting person is a company employee that is directly affected by the adverse impact.

It is therefore interesting to point out that this person could use both procedures.

3.8 Monitoring the effectiveness of the due diligence policy and measures

The directive also provides for assessment of the *implementation* and monitoring of the *adequacy* and *effectiveness* of the identification, prevention, minimisation, bringing to an end and mitigation of the above-mentioned adverse impacts.

In this context, the Member States have to ensure that companies carry out *periodic assessments of their own operations and the measures* they have taken. These assessments must be carried out both for the company itself and for its subsidiaries and its business partners (where related to the chain of activities of the company).

Where appropriate, the due diligence policy and the measures derived from any adverse impacts identified shall be updated in accordance with the *outcome* of such *assessments* and with due consideration of relevant information from *stakeholders*.

3.9 Public communication on the due diligence requirement

The focus is once again on transparency, with this new requirement for companies to publish *an annual statement on their website*.

However, the content of this statement is not strictly regulated, as it must provide information on "*the matters covered by this directive".*

If a company is already subject to sustainability reporting requirements in accordance with irective 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, the company is exempt from this disclosure requirement.

4 Due diligence support at a group level

It is important to note that under certain conditions, *a parent company falling under the scope of the directive is allowed to fulfil the obligations relating to the due diligence process on behalf of its own subsidiaries* which also fall under the scope of the directive, if this ensures effective compliance.

The fulfilment of the due diligence obligations by a parent company is subject to certain conditions focusing on communication, cooperation and consistency of relations between the parent company and the subsidiary concerned. In some cases, the subsidiary must continue to take appropriate measures itself as part of the due diligence process.

5 What are the consequences for the business partners of these large companies?

A chain reaction as part of a self-control mechanism.

Even though the new directive only applies to large companies, the European authorities are nevertheless ensuring that future legislation will have an impact on the *business partners of these large companies* (both in the upstream part and the downstream part), who will themselves have to *demonstrate that their business operations do not have adverse impacts on the environment or human rights.*

This is simply the direct consequence of the transparency and information obligations now placed on large companies, which will have to report on the sustainability of their supply chain.

This means that smaller companies will be indirectly affected by the directive and may be forced to adapt their activities to reduce their adverse impacts on the environment and human rights, in order to retain their customers.

Therefore, by raising the expectations of large companies in relation to sustainability, the directive places them on the shoulders of a large number of smaller companies which, in order to stay up to date, will be obliged to comply with the new targets set.

Is my company a business partner within the meaning of the directive?

In order for the *due diligence to have a meaningful impact*, it should cover human rights and environmental adverse impacts generated *throughout the chains of activities of the companies* and thus of their subsidiaries and of their business partners, especially in terms of:

- design;
- extraction;
- sourcing and supply of raw materials;
- manufacture and production;
- distribution;
- transport;

- storage and disposal;
- provision of services, etc.

The concept of "*chain of activities"* should cover activities of a company's *upstream* business partners and activities of a company's *downstream* business partners. If you work directly for a large company, as defined in the Directive, in one of the areas listed above, there is a high probability that these activities will be included in the scope of that company's due diligence requirements.

In addition, the Directive provides that the European Commission should provide guidance on model contractual clauses that can be used voluntarily by companies as a tool to help fulfill their due diligence obligations and that will probably define the terms and conditions.

Business partners' trade secrets are spared.

According to the Directive, business partners of targeted companies should not be obliged to disclose to these companies information that is a trade secret (as defined in Directive (EU) 2016/943 of the European Parliament and of the Council).

As a reminder, a trade secret means information which meets all of the following requirements:

- it is secret in the sense that it is not, as a body or in the precise configuration and assembly of its components, generally known among or readily accessible to persons within the circles that normally deal with the kind of information in question;
- it has commercial value because it is secret;
- it has been subject to reasonable steps under the circumstances, by the person lawfully in control of the information, to keep it secret.

However, this information may have to be disclosed as part of the company's compliance with its due diligence requirements: the identity of direct and indirect business partners, or essential information needed to identify actual or potential adverse impacts, where necessary and duly justified for the company's compliance with due diligence obligations.

This should be without prejudice to the possibility for the business partners to protect their trade secrets through the mechanisms established in Directive (EU) 2016/943.

6 Civil liability of companies

If a company fails to comply with its due diligence requirements, it may be held liable by a third party who has suffered damage. A company can therefore be held liable for damage caused to a third party provided that the company intentionally or negligently failed to comply with its due diligence obligations.

In this respect, a natural or legal person shall have the right to full compensation for the damage caused.

A company cannot be held liable if the damage was caused only by its business partners. In this context, the latter remain liable under the directly applicable national law.

Furthermore, where a parent company fulfils the obligations relating to due diligence requirement on behalf of its subsidiaries, these subsidiaries nevertheless remain civilly liable under the new Directive CS3D.

7 Penalties incurred

Besides the possible claims for damages resulting from the company's civil liability, the company may also be subject to sanctions, including financial penalties, if it fails to fulfil its due diligence obligations with regard to sustainability.

Directive CS3D allows the Member States to lay down the rules on penalties applicable to infringements of the provisions of national law adopted pursuant to this Directive. The Member States are instructed to implement proportionate, dissuasive and effective penalties.

When pecuniary penalties are imposed, they shall be based on the company’s net worldwide turnover (consolidated), with a cap of at least 5% of the turnover.

8 Conclusion

If you collaborate in any way with a large company subject to the new Directive CS3D, it is likely that you will soon be required to report to certain co-contractors with regard to sustainability.

Respect for human rights and the environment by large companies will shortly be governed by clear and binding legislation. In this respect, Directive CS3D breaks new ground by introducing a proactive monitoring system for the environmental and human aspects of a company's value chain, and requires the company to demonstrate due diligence in assessing any adverse impacts on these aspects.

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