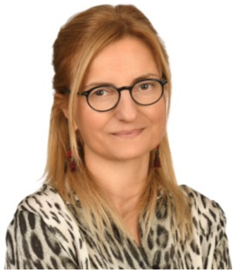

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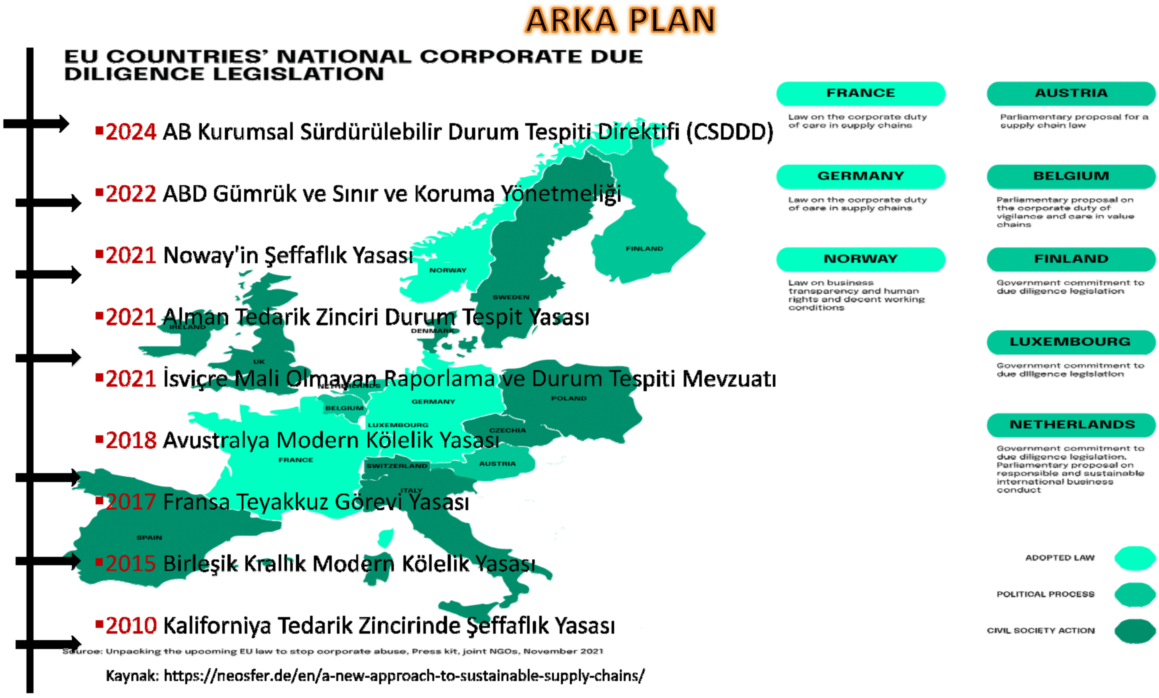
Corporate Sustainability Due Diligence Directive: Council and Parliament Signed a Provisional Agreement

European Parliament and Council Took a Significant Step in the Corporate Sustainability Due Diligence Directive

On 13 December 2023, the European Parliament and the Council reached consensus on contentious issues concerning the Corporate Sustainability Due Diligence Directive (CSDDD), signing a provisional agreement. This development is considered a critical step towards the implementation of the directive. Adopted by the European Commission on 23 February 2022, the CSDDD aims to address adverse impacts arising from corporate value chains and to integrate human rights and environmental risks and impacts more effectively into corporate strategies. We are updating the CS3D Directive, which we previously detailed in the January 2023 issue of our journal, within the framework of this provisional agreement.

The directive is a significant step toward ensuring that companies adopt sustainability principles and are held accountable for their value chains. Companies within the scope of the agreement are required to conduct due diligence regarding environmental and human rights issues to prevent and address adverse impacts from their value chains. With this new agreement, a period is signaled where greater transparency and accountability from businesses concerning environmental and human rights matters will be expected.



Kaynak: https://neosfer.de/en/a-new-approach-to-sustainable-supply-chains/

Background and Interaction with Other EU Legislation

The EU, aligning with the Paris Agreement, has rapidly implemented harmonized legislation to guide economies toward sustainable development. Increased transparency demands from investors, consumers, and other stakeholders, along with insufficient voluntary compliance with international standards and slow integration of sustainability efforts into corporate governance, especially concerning human rights and environmental due diligence, have significantly contributed to the legislative process.

The Council and Parliament, respectively in 2020 and 2021, called upon the European Commission to propose legislation mandating value chain due diligence. The CSDDD, adopted on 23 February 2022, is projected by some sources to come into effect in 2027. Certain states, both within and outside the EU, that prioritize human rights, have already implemented similar supply chain laws. Upon full implementation, Member States must align their national laws with the directive within two years.

The directive also forms an essential part of the Green Deal and the Fit for 55 initiatives. It complements regulatory initiatives such as the Corporate Sustainability Reporting Directive (CSRD), the Sustainable Finance Disclosure Regulation, and the Taxonomy Regulation. Additionally, the directive references key international due diligence frameworks, including the UN Guiding Principles on Business and Human Rights (UNGPs), OECD Guidelines for Multinational Enterprises, and the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy. The provisional agreement also adds references to the International Covenant on Civil and Political Rights, the International Covenant on Economic, Social and Cultural Rights, and the Convention on the Rights of the Child. Covered impacts include not only those in the guiding principles but also factors such as slavery, labor exploitation, child labor, pollution, deforestation, excessive water consumption, and harm to ecosystems. The provisional agreement explicitly defines the nature of environmental impacts included in the directive, covering measurable environmental degradations such as harmful soil alterations, water or air pollution, harmful emissions, excessive water consumption, or other adverse effects on natural resources.

Scope

groups based on turnover, including non-EU turnover. It also applies to non-EU companies (third-country companies) operating within the EU that meet the turnover criteria of Group 1 and Group 2. Group 2 includes designated high-impact sectors. SMEs are not directly covered, but they may be affected if they are part of the value chains of covered companies. Group 2's effective date will be two years after Group 1's.

The directive covers companies of significant size, divided into two main EU and Non-EU Companies:

- Group 1: All EU limited companies with a net turnover exceeding EUR 150 million globally and more than 500 employees.
- Group 2: Other EU limited companies with a net turnover exceeding EUR 40 million globally and more than 250 employees, operating in designated high-impact sectors such as textiles, agriculture, and mineral extraction.

Financial Sector

Under the agreement, the financial services sector is temporarily excluded. However, a review clause based on a sufficient impact assessment has been planned, considering the possibility of future inclusion.

Benefits of the CSDDD

For citizens, the CSDDD ensures better protection of human rights, including workers' rights, a healthier environment for present and future generations, increased trust in businesses, greater transparency enabling informed choices, and better access to justice for victims.

For developing countries, the CSDDD offers a range of benefits: protecting human rights and the environment, raising awareness on key sustainability issues, encouraging sustainable investments, improving practices, and promoting adoption of international standards, thereby enhancing living conditions.

Direktifin kapsama giren şirketlere sağladığı faydalar ise şu şekildedir.

Benefits for covered companies include:

1. Legal Certainty and Level Playing Field:
    - The CSDDD provides companies with legal certainty and equal competitive conditions through a harmonized legal framework across the EU.
2. Customer Trust and Employee Engagement:
    - Companies complying with the CSDDD can enhance customer trust and strengthen employee engagement.
3. Environmental and Human Rights Awareness:
    - The directive raises companies' awareness of their environmental and human rights impacts.
4. Risk Management and Adaptability:
    - The directive enables better risk management and faster adaptation to changing conditions, ensuring business continuity.
5. Increased Attractiveness:
    - A focus on sustainability increases attractiveness to sustainability-oriented investors and public procurement bodies, expanding investment opportunities.
6. Innovation-Oriented Business Model:
    - The directive encourages companies to focus on innovation, potentially providing a competitive advantage.
7. Financial Access Opportunities:
    - Compliance with the CSDDD improves access to finance, strengthening funding for sustainable projects.

Due Diligence and Obligations

The CSDDD mandates companies to conduct due diligence concerning human rights and environmental impacts, reinforcing their sustainability responsibilities. Companies are required to adopt a compliance approach with fundamental human rights and environmental legislation. Businesses must identify and disclose adverse impacts in their operations, subsidiaries, and supply chains, develop mitigation and prevention strategies, engage in continuous monitoring, and regularly report. Ending a business relationship with a company unable to address adverse impacts, despite all efforts, should be considered a last resort. Moreover, initiating, implementing, and monitoring due diligence processes is the responsibility of directors, who are also required to adopt and implement a climate transition plan aligning large companies' business models with the Paris Agreement's 1.5°C limit.

The CSDDD aims to increase companies' and directors' sustainability responsibilities, incorporating the following key elements:

1. Corporate Due Diligence:
    - Companies are required to identify actual and potential adverse human rights and environmental impacts in their operations, subsidiaries, and supply chains.
    - They must establish processes to terminate, prevent, mitigate, and account for these impacts.
2. Climate Change Targets:
    - Certain large companies must align their business strategies with a plan to limit global warming to 1.5°C.
3. Directors' Duties:
    - Directors are responsible for initiating, implementing, and monitoring due diligence processes.
    - Integrating due diligence into the company's overall corporate strategy is part of directors' responsibilities.
4. Contribution to Sustainability and Climate Goals:
    - Directors are encouraged to actively contribute to sustainability and climate mitigation goals.
5. Factors to Consider in Decision-Making:
    - Directors must consider human rights, climate change, and environmental impacts when making decisions in the company's best interests.

Due diligence processes may include the following steps:

Implementation

To ensure the effectiveness of corporate sustainability due diligence, the following mechanisms will be activated:

Administrative Oversight

- Member States will designate a supervisory authority responsible for enforcing the rules. This authority will have the power to impose financial penalties and compliance orders, including effective, proportionate, and dissuasive sanctions.
- At the European level, a European Network of Supervisory Authorities will be established by the Commission to enhance coordination among national authorities, ensuring a harmonized and consistent approach.

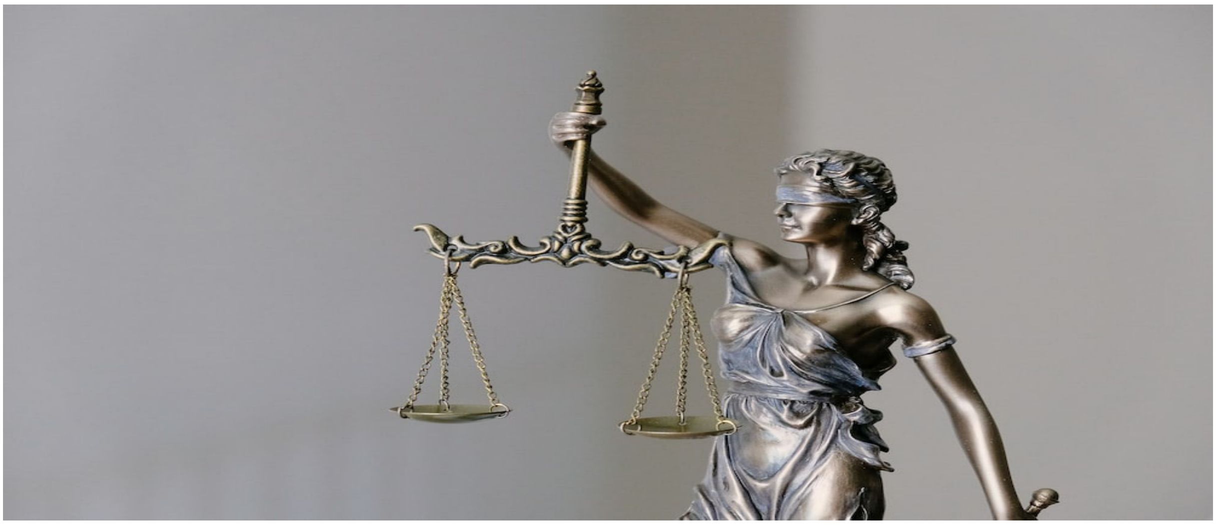
Legal Liability

- Member States must ensure victims' right to seek compensation for damages resulting from non-compliance with the new obligations.

Directors' Duties

- Rules concerning directors' duties will be based on Member States' existing legal frameworks. The directive does not introduce a separate enforcement regime for directors' obligations.

These mechanisms aim to establish a robust framework combining administrative oversight and legal consequences for effectively managing corporate sustainability due diligence practices. The involvement of both national and European supervisory bodies is expected to enhance the consistency and effectiveness of implementation across the EU.



Sanctions

The provisional agreement includes precautionary measures for non-payment of penalties and considers company turnover when determining financial penalties, with consensus that fines should be at least 5% of the company's net turnover. The agreement also imposes on companies an obligation to develop meaningful cooperation through dialogue and consultation with affected stakeholders as part of the due diligence process.

Public Procurement

The directive states that corporate sustainability obligations can be considered as evaluation criteria in public procurement and concessions. Whether companies comply with sustainability obligations could become a significant factor in public procurement and tendering processes, encouraging companies to focus on sustainable practices to gain a competitive advantage and adopt sustainability principles.

Conclusion

Focusing on achieving net zero emissions by 2050, the EU is taking a leading role in global sustainability regulations. The CSDDD mandates companies to address their operations from human rights and environmental perspectives, aiming to mitigate both current and potential adverse impacts and base their social performance on more consistent foundations, promoting global adoption of sustainability and encouraging economic transformation.

In this context, the CSDDD stands out from other similar supply chain regulations by obligating large companies to focus not only on human rights but also on serious environmental targets aligned with the 1.5°C goal. The directive requires companies to conduct human rights and environmental due diligence throughout their value chains, develop policies consistent with the Paris Agreement, integrate them into corporate governance processes, take actions to mitigate impacts, monitor, disclose, and report them.

By introducing legal liability, the directive imposes sanctions for companies' failure to exercise due diligence. It also entails severe outcomes, such as terminating business relationships involving significant risks that cannot be mitigated in the value chain. Moreover, it affects non-EU companies through their value chains. Therefore, businesses collaborating with the EU must understand the directive's requirements and adopt the standards it sets, focusing on creating a sustainable business model. Preparing for due diligence practices, effectively integrating internal processes, and operating in compliance with sustainability principles are critical for success.

Through these regulations, the EU is setting the standards of the new economic order, building the foundation of sustainable development on the principles of human rights respect and environmental protection. It calls upon businesses to restructure their activities incorporating these elements and to assume responsibility across their value chains. The directive's entry into force will mark a significant global turning point. Companies must operate in alignment with sustainability standards to ensure business continuity and sustainable growth. Understanding accepted international guiding principles will enhance global awareness and contribute to sustainable economic development and prosperity.

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