



Update on the Corporate Sustainability Due Diligence Directive (CSDDD)

European Council adopts its general approach on the Corporate Sustainability Due Diligence Directive

Last February, the European Commission published its [proposal](#) (hereafter: Proposed Directive) on the Corporate Sustainability Due Diligence Directive (CSDDD), outlined in [this](#) article. On December 1st, the European Council (hereafter: Council) [adopted](#) its general approach (hereafter: General Approach) on the CSDDD, constituting the Council's starting position in negotiations of the CSDDD with the European Parliament (hereafter: Parliament).

The General Approach contains a few key deviations (discussed below) which may significantly impact the final text of the CSDDD.

1. Altered scope of applicability

The first key change concerns the scope of the directive, determining which companies need to carry out the due diligence. Under the Proposed Directive, companies are in scope if they meet certain criteria. It is, however, unclear how long those companies need to meet those criteria for them to fall under the scope of the directive. The General Approach proposes a clarification that only companies that meet the criteria during two consecutive financial years fall within the scope of the directive.

The General Approach also adds that Member States may decide to apply the directive (i) to pension institutions that are considered to be social security schemes under EU law and (ii) to regulated financial undertakings (e.g. a credit institution or an alternative investment fund manager (AIFM)).

2. Definition changes

The General Approach includes alternative definitions compared to the Proposed Directive. Key definitions under the Proposed Directive are “*established business relationship*” and “*value chain*”, as the Proposed Directive requires companies to:

- i) identify actual or potential adverse impacts on human rights and the environment arising from their own operations or those of their subsidiaries and, where related to their “*value chains*”, from their “*established business relationships*”; and to
- ii) take measures to prevent, mitigate or end the identified adverse impacts to the extent possible.

Therefore, the Proposed Directive requires companies to take measures if any adverse impacts arise from the activities from an “*established business relationship*” in the “*value chain*”.

The General Approach, however, uses “*chain of activities*” instead of “*value chain*”, in order to reflect the divergent view of Member States on the issue of whether to cover the whole “*value chain*” or limit the scope to “*supply chain*”. With the change, the Council intends to move from the concept of a full “*value chain*” more towards the supply-chain concept by leaving out the phase of the company’s products or provision of services entirely. In addition, the General Approach prefers “*business partner*” over “*established business partner*”, which definition aligns with the definition of “*business relationship*” under the Proposed Directive.

3. Due diligence at a group level

The General Approach introduces the possibility for parent companies falling within the scope to fulfill the main due-diligence related obligations under the directive (also) on behalf of their subsidiaries within the scope. The fulfilment of the due diligence obligations by a parent company is, however, subject to several conditions. For example, the subsidiary must provide all necessary information to its parent company and must cooperate with its parent company in fulfilling the obligations resulting from this directive.

4. Risk based approach when addressing adverse impacts

As mentioned above, companies must identify actual and potential adverse impacts on human rights and the environment under the Proposed Directive. After identification, companies must prevent, mitigate or end the adverse impacts to the extent possible. The situation may arise that a company is not capable of addressing all identified adverse impacts at the same time to the fullest extent. For that situation, the General Approach proposes the possibility for companies to prioritise adverse impacts by using a risk-based approach. The prioritisation of adverse impacts shall be based on severity and likelihood of the adverse impact. Severity of an adverse impact is based on its gravity, the number of persons or the extent of the environment affected, and difficulty to restore the situation prevailing prior to the impact. Once the most significant adverse impacts are prevented, mitigated or ended to the extent possible, the company must address the less significant adverse impacts.

5. Combating climate change

In the General Approach, the text of the provision on combating climate change has been aligned as much as possible with the recently adopted [Corporate Sustainability Reporting Directive](#) (CSRD), including a specific reference to that directive, in order to avoid problems with its legal interpretation, while avoiding broadening the obligations of companies under this provision.

Under the Proposed Directive, the provision is included that the variable remuneration of directors is linked to directors' contributions to the company's business strategy and long-term interests and sustainability. The Council, however, has deleted this provision in its General Approach because it deems the form and structure of directors' remuneration as matters primarily falling within the competence of the company and its relevant bodies or shareholders.

6. Civil liability

The General Approach also addresses the civil liability of companies differently compared to the Proposed Directive. The General Approach contains more clarified criteria for liability and introduces the element of fault and the possibility for victims of adverse impacts to be fully compensated without them being overcompensated.

7. Directors' duties

The Proposed Directive contains a provision requiring directors of companies to take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, when fulfilling their duty to act in the best interest of the company, in each case in the short, medium and long term. This provision could - under Dutch law - potentially lead to a personal liability for directors. The Council, however, has deleted this provision in its General Approach due to strong concerns expressed by Member States that consider this provision to be an inappropriate interference with national provisions regarding directors' duty of care and potentially undermining the duty of directors to act in the best interest of the company.

8. Other important changes

In the above, we discussed the key deviations by the General Approach from the Proposed Directive. In addition, the following other proposed deviations are worth mentioning:

- The General Approach envisages a broader transposition period, giving companies more time to prepare for the coming obligations under the directive.
- The definitions of adverse and human rights impacts are further clarified in the General Approach.
- The General Approach proposes that companies must update their due-diligence policy after a significant change occurs but at least every 24 months, instead of annually as included in the Proposed Directive.
- The General Approach gives more guidance to companies when assessing which appropriate measures they need to take to prevent, mitigate or end adverse impacts.
- The General Approach contains broader rules on the temporary suspension or termination of business relationships by companies.
- The monitoring and communicating obligations are less strict under the General Approach.
- The General Approach requires the Commission to issue guidelines in order to provide support to companies or to Member State authorities no later than two years after the entry into force of this directive.
- Under the General Approach, supervisory authorities may only carry out investigations related to compliance with a few obligations, whilst under the Proposed Directive such investigations can be carried out in order to investigate compliance with all obligations.

9. View of the Commission and the Netherlands on the General Approach

The Commission's response to the General Approach is interesting given the significant differences between the Proposed Directive and the General Approach. It shows that the Commission is happy that the proposed scope of applicability is largely maintained, and that the Council's approach towards the due-diligence obligations and their content stay close by their international framework. As usual, the Commission hold its position regarding the civil liability provisions until the European Parliament has adopted its position.

The Dutch Minister of Economic Affairs and Climate Policy has also responded to the General Approach on behalf of the Netherlands. She appreciates the introduction of the risk-based approach, which is similar to existing international standards on responsible business conduct. In other areas, however, the General Approach falls short of the ambitions of the Netherlands. For example, the Netherlands aimed for better alignment with the closely related CSRD in terms of scope of applicability and climate provisions. Also, the Netherlands had hoped that the definition of "value chain" would not be changed, as this change – according to the view of the Netherlands – disables the directive to reach its full potential. In addition, the Netherlands would have liked to see the directive to mandatorily apply to regulated financial undertakings rather than optionally.

10. Our view

It is with great interest that we familiarised ourselves with the General Approach, because the Council has adopted a different view on several matters compared to the Proposed Directive and because it constitutes an extra step towards the finalisation of the CSDDD. We look forward to the position of the Parliament and the subsequent debate between the Commission, the Council and the Parliament as this will ultimately determine the obligations that will apply to (certain) companies.

11. Next steps

The General Approach gives the Council's Presidency a mandate to enter into negotiations with the Parliament (and the Commission) on the final text of the CSDDD. Those negotiations will start after the Parliament adopts its own position on the Proposed Directive, which is expected in the first quarter of 2023.

Contact



Rozemarijn Bloemendal

Partner Corporate Law

T: +31 (0)88 288 3661 | M:+31(0)6 10 20 27 13

RBloemendal@deloitte.nl



Ruben Y. Kamerling

Manager Corporate Law

T: +31 (0)88 288 7649 | M: +31 (0)6 29 66 61 47

rkamerling@deloitte.nl



Boudewijn Renshof

Junior Legal Consultant

T: +31 88 288 9575 | M: +31 (0) 6 21 82 06 68

BRenshof@deloitte.nl

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