

# The Corporate Sustainability Due Diligence Directive

How to prepare your company

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# Contents

1. About the CS3D and its practical implications [→ Know more](#)
2. Preparing my company for CS3D compliance: changes to corporate governance and procurement models [→ Know more](#)
3. Ensuring the implementation of CS3D: due diligence and environmental transition plan [→ Know more](#)
4. Consequences of non-compliance with the CS3D [→ Know more](#)
5. Can directors be held liable for violating the CS3D? [→ Know more](#)

The Corporate Sustainability Due Diligence Directive<sup>1</sup> (“CS3D”) was published in the Official Journal of the European Union on 5 July.

With the entry into force of the CS3D on 25 July 2024 and its incorporation into national law in EU countries:

- Companies covered by the CS3D will be required to implement due diligence processes to identify material adverse impacts (i) on human rights and (ii) on the environment.
- The due diligence process covers the activities of the company, its subsidiaries and the companies in its chain of activities.
- Companies covered by the CS3D are required to prepare and annually update a climate transition plan.

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The CS3D is one of the most important milestones in European regulation. It will require companies to make efforts in several areas, in particular in their corporate governance, internal audit, corporate culture, contracting and cooperation with partners. The compliance burden is significant and the best way to ensure compliance with the CS3D is to start preparing now to avoid unwelcome surprises.

In this checklist, PLMJ highlights the essential steps to prepare for the implementation of the CS3D in your organisation.

# I. About the CS3D and its practical implications

## STEP 1: DOES THE CS3D APPLY DIRECTLY TO MY COMPANY?

Whether a company is subject to the CS3D depends on two criteria – **turnover** and **number of employees**.

The following companies will be subject in stages:

CATEGORY	TURNOVER	NUMBER OF EMPLOYEES	DATE OF APPLICATION
<b>Companies in the EU</b>	≥ EUR 1,500 million (worldwide)	≥ 5.000	26 July 2027
	≥ EUR 900 million (worldwide)	≥ 3.000	26 July 2028
	≥ EUR 450 million (worldwide)	≥ 1.000	16 July 2029
<b>Companies outside the EU</b>	≥ EUR 1,500 million (in the EU)	N/A	26 July 2027
	≥ EUR 900 million (in the EU)	N/A	26 July 2028
	≥ EUR 450 million (in the EU)	N/A	16 July 2029
<b>Parties to franchising and licensing agreements in the EU</b>	Invoicing: ≥ EUR 80 million (worldwide)	N/A	16 July 2029
	Royalties: ≥ EUR 22.5 million (worldwide)		
<b>Parties to franchising and licensing agreements outside the EU</b>	Invoicing: ≥ EUR 80 million (in the EU)	N/A	26 July 2029
	Royalties: ≥ EUR 22.5 million (in the EU)		

<sup>1</sup> Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024, available [here](#).

## Are regulated entities in the financial sector subject to the CS3D?

Yes. Regulated financial institutions, including credit institutions, investment companies, management companies and insurance companies, are subject to the CS3D, albeit with limitations. Despite initial discussions that these institutions would be required to undertake additional due diligence, for example in their credit relationships, the solution that has emerged in the final version of the CS3D is much more limited.

### STEP 2: IF THE CS3D DOES NOT APPLY TO MY COMPANY, CHECK WHETHER IT COULD BE INDIRECTLY AFFECTED

The following are indirectly subject to the CS3D:

- Companies that are part of the chain of activities of a company subject to the CS3D
  - a) May be an SME;
  - b) May be a company from a third country;

These companies are subject to the due diligence process of the company subject to the CS3D. They are therefore materially bound by the CS3D and must avoid adverse environmental or human rights impacts.

- Third country parent companies with a subsidiary covered by the CS3D:
  - c) Depending on the jurisdiction, the duties of the directors of the foreign parent company may impose a duty to monitor compliance with the CS3D by the subsidiary to which it applies;
  - d) Ignorance and failure to monitor the level of compliance by the subsidiary could open the door to potential litigation.

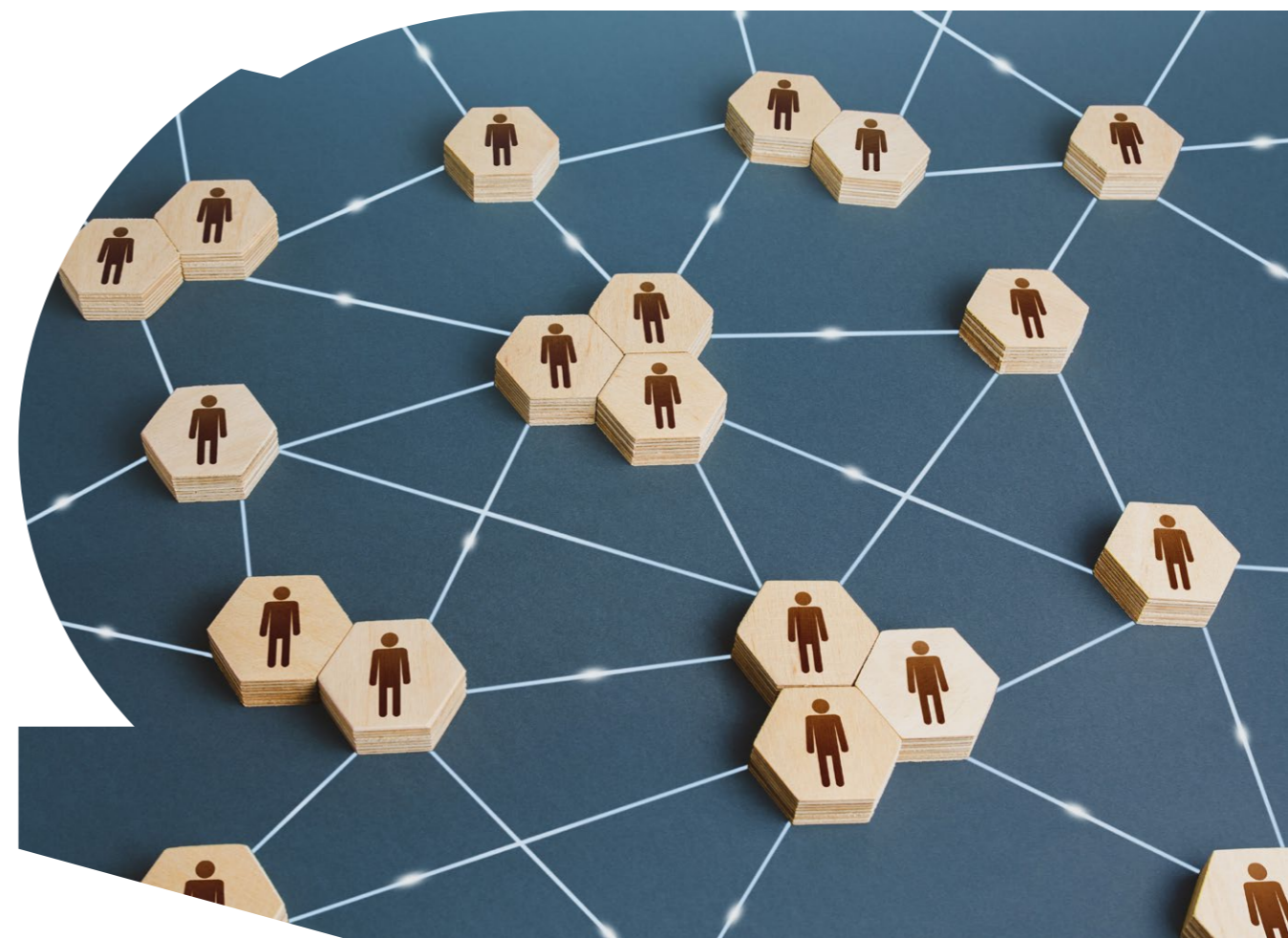
<sup>2</sup> See the International Covenant on Economic, Social and Cultural Rights [here](#).

<sup>3</sup> See the International Covenant on Civil and Political Rights [here](#).

<sup>4</sup> See ILO C138 - Minimum Age Convention [here](#).

### STEP 3: KNOWING HOW TO IDENTIFY ENVIRONMENTAL AND HUMAN RIGHTS IMPACTS

- What is an adverse human rights impact?
  - a) A violation of specific rights or obligations under international human rights treaties, as listed in Section I of Part I of the Annex to the Corporate Sustainability Reporting Directive (“CSRD”), for example:
    - i) The right to just and favourable working conditions<sup>2</sup>;
    - ii) The right to liberty and security<sup>3</sup>
    - iii) The ban on the use of child labour<sup>4</sup>;



- b) The violation of a human right not listed in Section 1 of Part I of the Annex to the CS3D, but included in the international conventions listed in general terms in Section 2 of Part I of the Annex to the CS3D, provided that:
  - i) The human right may be violated by a company or other legal entity,
  - ii) The violation of the human right directly harms a legal interest protected by those international conventions<sup>5</sup>, and
  - iii) The company could reasonably have foreseen the risk of that human right being affected, taking into account the circumstances of the specific case, including the nature and extent of the company's business operations and its chain of activities, the characteristics of the business sector, and the geographical and operational context.
- o **What is an adverse environmental impact?**
  - a) A violation of the prohibitions and obligations listed in points 15 and 16 of Section 1 of Part I and Part II of the Annex to the CS3D, for example:
    - i) A prohibition on causing any significant environmental degradation, such as water or air pollution, harmful emissions, soil degradation, which jeopardises food production or access to drinking water or sanitation facilities<sup>6</sup>;
    - ii) The ban on the illegal handling, collection, transportation and storage of waste<sup>7</sup>;
    - iii) Obligation to prevent pollution from ships<sup>8</sup>.



Companies based in third countries that fall directly or indirectly within the scope of the CS3D will need to ensure compliance with international conventions and declarations that have not been ratified and are not in force in their country.

## 2. Preparing my company for CS3D compliance: changes to corporate governance and procurement models

### STEP 4: MAPPING (AND UPDATING) MY COMPANY'S CHAIN OF ACTIVITIES AND IDENTIFYING UNDERLYING RISK FACTORS

The requirement for companies subject to CS3D to comply with the due diligence obligations applies not only to their own operations and those of their subsidiaries, but also to the operations of their direct and indirect business partners along their chain of activities, regardless of their location or country of origin.

The chain of activities includes:

- o **The activities of upstream business partners:** relating to the production of goods or the provision of services by that company, including the design, extraction, procurement, manufacture, transport, storage and supply of raw materials, products or parts of products, and the development of the product or service; and
- o **The activities of downstream business partners:** relating to the distribution, transport and storage of a product of that enterprise, when the business partners carry out these activities for or on behalf of the enterprise.

<sup>5</sup> For example, the Convention on the Rights of the Child, available [here](#).

<sup>6</sup> See the International Covenant on Civil and Political Rights.

<sup>7</sup> See the Stockholm Convention [here](#).

<sup>8</sup> See The International Convention for the Prevention of Pollution from Ships (MARPOL), of 2 November 1973, available [here](#).

Once the chain of activities has been mapped, companies should conduct a review of all the operations in that chain and identify the areas where adverse impacts are more likely to occur and become more severe.

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#### **STEP 5: ASSIGN RESPONSIBILITIES AND PROVIDE TRAINING**

To comply with the CS3D, companies will have to:

- Clearly identify the internal bodies or teams responsible for ensuring compliance with the obligations set out in the CS3D, which should be subject to oversight by senior management and audit;
- Given the potential administrative or civil liability to which the company may be exposed in the event of non-compliance with the CS3D, the relevant legal departments should also be involved;
- Ensure that all employees of the company who are directly or indirectly involved in the scope of application of the CS3D receive specific training in this regard.

#### **STEP 6: PREPARE OR REVIEW INTERNAL POLICIES AND PROCEDURES**

Companies need to:


- Start preparing or reviewing their internal policies and procedures, including sustainability policies, outsourcing policies, and policies for engaging suppliers and business partners, to ensure that these documents incorporate due diligence. As noted above, the CS3D includes obligations under international legal instruments that may not have been ratified by the countries in which companies are located and are therefore not currently considered for compliance purposes, but which will become relevant with the CS3D;
- Develop or adapt information and record-keeping systems to collect data on due diligence processes and to support decision making;
- Establish channels of communication between senior management and departments that implement contracting decisions or dialogue with contractual partners.

#### **STEP 7: INVOLVE BUSINESS PARTNERS**

Companies need to ensure that their business partners are aware of the CS3D obligations, are able to comply with them and are able to influence their own business partners to do the same. In this context, companies need to:

- Review contracts with service providers or suppliers in their chain of operations;
- Establish open channels of communication and information dissemination throughout their chain of activities;

- Seek to understand and identify barriers arising from the way the company operates that prevent contractual partners from adopting practices that avoid negative impacts (for example, demanding excessively short or unreasonable delivery times);
- Where appropriate, organise training and awareness-raising activities on the need to comply with human rights and environmental obligations.

 Where business partners are **SMEs**, companies should also provide specific and proportionate support, including access to capacity building activities, training or updating of management systems and, in specific and limited cases, financial support (e.g. direct financing, low interest loans, guarantees of continued supply or assistance in obtaining financing)<sup>9</sup>.

### STEP 8: CONSIDER HOW CS3D OBLIGATIONS RELATE TO OTHER SUSTAINABILITY-RELATED OBLIGATIONS

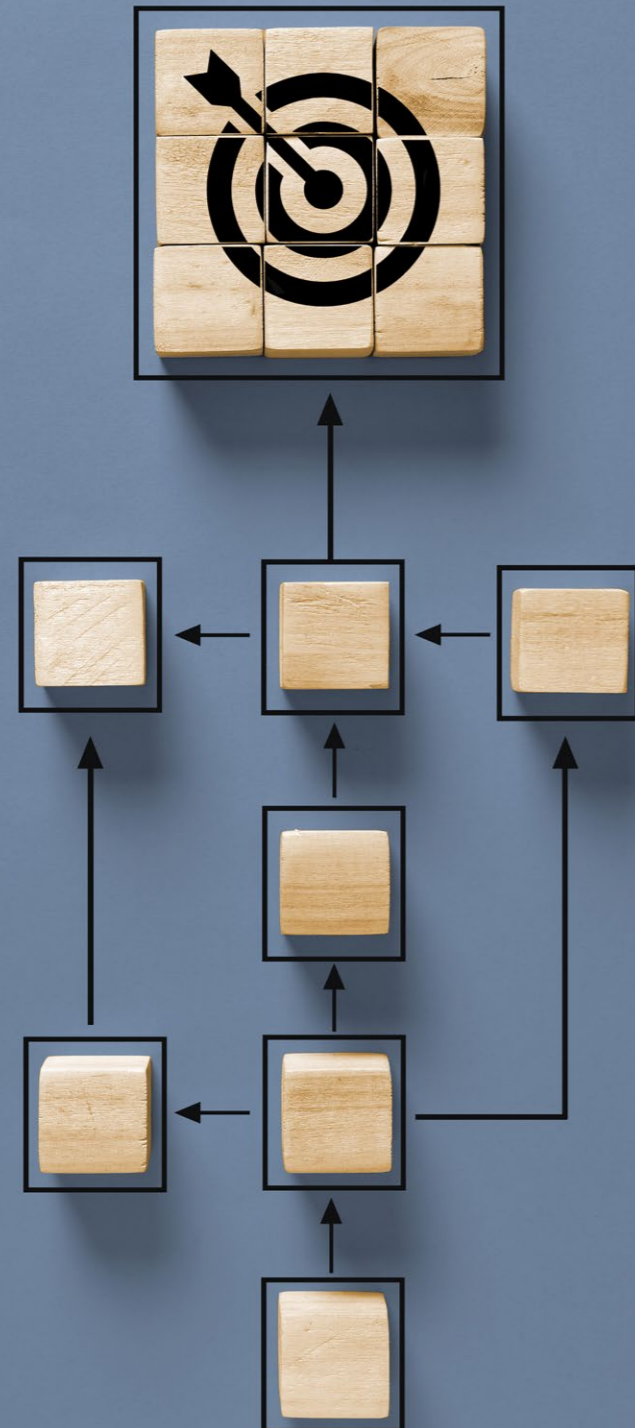
The obligations arising from the CS3D should be considered together with the obligations and responsibilities for sustainability and the protection of human rights imposed by other European or national regulations. For example, Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 on corporate sustainability reporting (the “**CSRD**”).

The CSRD, which entered into force at the beginning of this year and is awaiting incorporation into Portuguese law, establishes disclosure requirements on sustainability, including environmental, social and governance issues.

Although the CSRD and the CS3D have different scopes and deadlines for incorporation, companies will need to implement the two directives in parallel, as several of the obligations resulting from them are related, overlapping or complementary. Examples include:

TYPE OF OBLIGATION	CSRD	CS3D
<b>Disclosure of sustainability impacts</b>	Companies must include in their annual report the information necessary to understand their impact on sustainability issues and how sustainability issues affect the development, performance and position of the company <sup>10</sup> .	Companies must disclose annually on their website their human rights and environmental due diligence processes, as well as the material adverse impacts related to their operations and the operations of their chain of activities <sup>11</sup> .
	Companies subject to the CSRD disclosure requirements are exempt from the CS3D disclosure requirements.	
<b>Climate transition plan</b>	Companies must include in their annual report their business plans and strategy for ensuring the transition to a sustainable economy, with the aim of limiting global warming to 1.5°C and achieving climate neutrality by 2050 <sup>12</sup> .	Companies must draw up a plan to combat climate change and identify the targets to which they are committed.  This plan must be updated annually and the company must report on the progress made in the previous year <sup>13</sup> .
	Both directives require that the climate change plan is consistent with the objective of the Paris Agreement (limiting the global temperature increase to 1.5°C) and with the 2050 carbon neutrality target set out in Regulation (EU) 2021/1119.	
	Companies that disclose a plan under the CSRD will be deemed to have met the requirement to adopt a transition plan under the CS3D.	

9 See articles 10(2)(e) and 11(3)(f) of the CS3D.  
 10 See Article 19a of Directive 2013/34/EU.  
 11 See Article 16 of the CSRD.  
 12 See Article 29a of Directive 2013/34/EU.  
 13 See Article 22 of the CS3D.



### 3. Ensuring the implementation of CS3D: due diligence and environmental transition plan

#### STEP 9: PUTTING DUE DILIGENCE INTO PRACTICE

To ensure compliance with the due diligence requirements, companies must put into place an ongoing risk-based monitoring process to identify and assess the likelihood, severity and urgency of adverse human rights and environmental impacts of their operations, the operations of their subsidiaries or business partners. Specifically, companies covered by the CS3D must<sup>14</sup>:

- **Implement internal policies** and procedures that include due diligence as defined above;
- **Identify the adverse impacts** they cause and those that their operations (or those of their business partners) could potentially cause;
- **Prevent, mitigate, cease or minimise the identified potential or actual adverse impacts** by taking appropriate measures to do so, namely:
  - a) If the measures are of a complex nature and so require, adopt an **action plan** (preventive or corrective) with reasonable and clearly defined action deadlines for the implementation of appropriate measures;

<sup>14</sup> See Article 5 of the CS3D.



- b) **Obtain contractual assurances** from direct or indirect business partners that their activities are in compliance with the company's code of conduct;
  - c) Make the necessary **financial and non-financial investments**, adjustments and improvements to production, infrastructure and operational processes;
  - d) Make the necessary **changes to its own strategy and business plan**, changing inappropriate purchasing, design or distribution practices.
  - e) Provide **specific and proportionate support to the SMEs** with which it has a relationship where the adverse impacts are caused by its activities. Where compliance with the company's code of conduct or corrective action plan **jeopardise the viability of the SME<sup>15</sup>**, the company must provide financial support (including direct financing, low-interest loans, guarantees of continued supply or assistance in obtaining financing);
  - f) **Cooperate with supervisory authorities** and other relevant competent authorities;
  - g) **Only as a last resort, temporarily suspend or terminate business relationships** where adverse impacts cannot be adequately prevented or mitigated through the conduct described above.
- **Prioritise** the prevention, mitigation, cessation or minimisation of adverse impacts according to their severity or likelihood;
  - **Provide redress** for actual adverse impacts caused by the company.
  - **Ensure meaningful stakeholder engagement** throughout the due diligence process, including, for example, workers and local communities affected by the company's operations;
- **Establish and maintain a reporting mechanism and grievance procedure** whenever stakeholders have legitimate concerns about actual or potential adverse impacts related to their own operations, the operations of their subsidiaries, or the operations of their business partners in their respective chains of operations; and

**Companies must periodically assess the effectiveness and adequacy of the measures adopted and disclose annually on their implementation.**

- **Periodically assess the effectiveness and adequacy of the measures adopted** and disclose annually on their implementation, without prejudice to the provisions of Step 8 regarding disclosure requirements under the CSRD.

**Due diligence obligations at group level** must be fulfilled by the parent company, provided that:

- a) All necessary information is shared between the parent and the subsidiary;
- b) The subsidiary follows the due diligence policy implemented by the parent company, with the necessary adaptations;
- c) The subsidiary integrates due diligence into all its policies and risk monitoring systems, specifying the obligations to be fulfilled by the parent company (and involving stakeholders where appropriate);

<sup>15</sup> The concept of 'jeopardising the viability of an SME' should be interpreted as likely to cause the insolvency of the SME or place it in a situation of imminent insolvency (see Recital 47 of the CS3D).

## Companies subject to the CS3D must draw up a climate change plan.

- d) The subsidiary continues to take prompt, appropriate and proportionate action to prevent, mitigate or stop the identified adverse impacts, taking into account, in particular, emergency situations; and
- e) Whenever necessary, the subsidiary will seek contractual guarantees in its direct and indirect business relationships and will continue to be obliged to suspend or terminate contractual relationships in the event of the above-mentioned situations that require it.

### STEP 10: DESIGN AND ADOPT AN ENVIRONMENTAL TRANSITION PLAN

Companies subject to the CS3D must **draw up a climate change plan** that meets the following conditions:

- It must focus on the objective of reducing greenhouse gas emissions and identify the targets to which the company is committed;
- It must also include, where relevant, the exposure of the company's operations to activities related to coal, oil and natural gas;
- It must be consistent with the objective set out in the Paris Agreement (limiting the global temperature increase to 1.5°C) and with the objective of carbon neutrality by 2050.

The plan must be updated annually and progress made in the previous year must be reported. Companies disclosing a plan under the CSRD are deemed to have fulfilled the obligation to adopt a transition plan under the CS3D.



## 4. Consequences of non-compliance with the CS3D

Member States must **designate one or more national supervisory authorities** with the power to:

- Bring infringements to an end;
- Take remedial action to prevent future infringements;
- Take interim measures in the event of serious, imminent and irreparable risk. In particular, the competent authorities must carry out investigations as part of their activities, either on their own initiative or on the basis of substantiated complaints.

### Companies can be held liable for damage caused to a natural or legal person.

The supervisory regime is complemented by a **civil liability regime for companies**. Under the CS3D, companies can be held liable for damage caused to a natural or legal person. In cases where companies are found liable for damage, full compensation will be awarded, but overcompensation through punitive, multiple or other types of compensation is prohibited.

A company is liable for the damage caused in all cases where:

- It intentionally or negligently **fails to comply with its obligations** to prevent, mitigate, cease and minimise adverse impacts on human rights and the environment; and
- As a result of non-compliance, the **protected legal interests** of natural or legal persons protected by the CS3D have been **harmed**.

The powers of the supervisory bodies include the ability to impose **penalties** on non-compliant companies. As a minimum, supervisory bodies should be able to impose two types of sanctions:

- Fines of up to 5% of their worldwide net turnover; and
- If the company fails to comply with the financial penalty imposed, the authorities will be able to make a public statement identifying the company responsible for the breach and the nature of the breach (naming and shaming)<sup>16</sup>.

## 5. Can directors be held liable for violating the CS3D?

The initial draft of the CS3D text expressly outlined the duties of directors, emphasising their responsibility to ensure compliance with the Directive's obligations.

While the final version no longer contains this specific provision, directors remain the primary individuals responsible for adhering to the Directive, as they are the company's official representatives. Directors will therefore be bound to more demanding duties and, within the framework of applicable national law, directors will be subject to liability in the event of non-compliance. In Portugal, in principle, this liability is established only towards the company, with direct liability to shareholders and third parties being an exception.

<sup>16</sup> See Article 27(3).

# More updates on Corporate Sustainability?

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