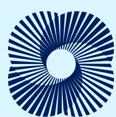
Analyzing CS3D

What the EU's Corporate Sustainability Due Diligence Directive Means for Business



U.S. Chamber of Commerce

Executive Summary

The U.S. Chamber of Commerce ("Chamber") agrees with the spirit of the Corporate Sustainability Due Diligence Directive ("CS3D" or "Directive") of the European Union ("EU"). The Directive seeks to improve the efficiency, resilience, and long-term sustainability of global supply chains. The Chamber is concerned, however, about the misalignment between CS3D's goals and potential requirements and what business can practically accomplish. Legal certainty and proportionality should be key tenets of any regulatory approach regarding due diligence.

The EU is currently engaged in a trialogue between the European Commission ("Commission"), the Council, and the European Parliament ("Parliament") on the final text of the proposed Directive. The proposal introduces specific due diligence requirements for about 17,000 EU and non-EU businesses, intended to mitigate adverse impacts on the environment and human rights within supply chains.CS3D principally consists of two pillars that introduce mandatory supply-chain due diligence requirements for companies and new duties for directors.

Under the due diligence component, companies will need to identify, mitigate, and prevent adverse human rights and environmental impacts to the extent that those activities are present in a company's value chain.

Under the governance component, directors assume direct responsibility for due diligence and must consider sustainability in their decisions. Additionally, the Parliament's proposal makes directors accountable to "stakeholders" (a vaguely defined term) via legal action if they fail to adequately identify or address risks. In case of noncompliance, the Directive proposes both administrative sanctions from supervising authorities and liability to third parties for damages.

If enacted without significant moderation, CS3D will impose heavy and potentially unfeasible burdens on companies—and risks the constant threat of frivolous, excessive, and expensive litigation. The Chamber therefore invites policymakers to carefully consider the following key elements to create final legislation that is meaningful, achievable, and fit for purpose:The extraterritorial scope of the Directive creates overly burdensome obligations for companies that may not have a geographical nexus with the EU. It further removes from U.S. regulators decision-making authority for U.S. firms.

- The proposed civil liability regime with its extraterritorial scope creates liability hazards in non-EU jurisdictions and risks infringing international law principles that relate to the applicability of international agreements. For U.S. companies, CS3D could result in liabilities for the same damages under different legal systems.

- The inclusion of directors' duties and obligations risks interfering with national company law and governance regimes, and these responsibilities ultimately lack coherence with the liability regime. The Chamber strongly supports the Council's position on the deletion of the directors' duties' provisions in the CS3D.

- The definition and scope of "value chain" under the Commission's and Parliaments' proposals expand the scope of the Directive

and widen the obligations and risk for companies, including in relation to their business partners. The legal obligations may introduce civil liability for noncompliance in relation to activities of the value chain over which companies have no visibility or control.

The Chamber welcomes the Council's pragmatic approach in replacing the term "value chain" with "chain of activities," which is limited to the production and supply of goods or the provision of services.

- The Directive must adopt risk-based prioritization in identifying and addressing potential adverse impacts to ensure the due diligence process is achievable. The Chamber supports both the Council's and the Parliament's approaches to this issue.

- The inclusion of transition plans on climate change in the due diligence assessment creates potential discrepancies with other international obligations and regimes, producing overlapping and possibly contradictory requirements and legal uncertainty.

- The inclusion of financial services companies in the scope of obligations is deeply problematic given the specific industry value chains, business models, and current regulatory framework governing financial services in the EU. The inclusion of financial institutions in the scope of the value chain creates undue burdens and obstacles in financial markets—without any contribution to the objectives of the Directive.

- The reliance on national law and litigation practices is quite likely to lead to material divergences between implementation regimes

- By imposing burdens that are excessive and disproportionate to the stated objective, the CS3D undermines the EU principle of proportionality.

The impact of CS3D on global political dynamics also must be carefully appraised, especially given recent statements about unintended consequences by officials from the U.S. and other countries. The Chamber strongly believes that trialogue discussions must appropriately consider and meaningfully address the extraterritorial impact of the Directive and subsequent consequences. The Chamber believes the EU should likewise use the trialogue to reduce the overall burden and litigation risk for companies to ensure the European market's continued competitiveness.

About the Chamber

The Chamber is the world's largest business federation, directly representing approximately 300,000 direct members and, through its state and local chapters, indirectly representing an underlying membership of more than 3 million U.S. businesses and professional organizations of every size and in every economic sector and geographic region of the country. The U.S. Chamber also represents key multinational enterprises operating in the United States.

Chamber's introductory views on due diligence

The EU adoption of the CS3D constitutes a significant policy and regulatory milestone in the framework of recent regulatory efforts, particularly in the EU, that are focused on improving responsible business conduct and accountability by companies in their global activities.

The CS3D's objective to prevent companies from contributing to environmental degradation and human rights abuses in their business operations is commendable, and the Chamber supports due diligence measures that seek to improve the efficiency, resilience, and long-term sustainability of global supply chains. The Chamber agrees with the spirit of the Directive and recognizes the EU's ambition to create a harmonized due diligence framework aimed at improving companies' approaches to these challenging matters.

At the same time, the Chamber is concerned about the misalignment between the CS3D's goals and potential requirements and what business can practically accomplish. Any due diligence framework should be workable, proportionate, conducive to a level playing field, and respectful of due diligence preferences and approaches by other jurisdictions around the world. Legal certainty and proportionality should be at the core of any regulatory approach about due diligence, including the EU's CS3D regulatory efforts. We currently see a clear risk that CS3D provisions will be too wide-ranging, disproportionate, and unworkable for in-scope companies, as well as unduly extraterritorial in nature. Together, these provisions could have significant legal consequences and serious competitiveness implications for businesses within the scope of the forthcoming rules, as well as for the EU as a global economic player and for the transatlantic relationship.

We have noted with interest the statement by Commission President von der Leyen earlier this year in which she announced that, by the autumn, the Commission would have put forward concrete proposals to simplify reporting requirements for companies and in fact to reduce them by 25%.[1] We thus welcome recent initiatives by the Commission to postpone the implementation of sectoral and third-country European Sustainability Reporting Standards (ESRS) and to limit the scope of the Corporate Sustainability Reporting Directive (CSRD).

1. https://ec.europa.eu/commission/presscorner/detail/en/speech_23_1672.

Furthermore, the Chamber welcomes the reference to CS3D in the Commission work programme for 2024, where the Commission notes its intention to "support the proportionate application of the requirements, in particular in areas such as the role of groups, with a view to ensuring efficiency and avoiding unnecessary burden."[2] A reasonable and workable timeline for the implementation of tCS3D will be essential from a business perspective.

The following lays out the Chamber's views on some of the aspects of CS3D that we believe pose a challenge from political, policy, regulatory, and legal perspectives.

2. https://commission.europa.eu/system/files/2023-10/COM_2023_638_1_EN.pdf.

Extraterritorial Scope (Article 2[2])

The CS3D, as proposed by the Commission, requires non-EU companies meeting specific revenue thresholds to comply with the EU due diligence duties set out in the legal text, irrespective of their physical presence in the EU single market. Duties include the identification, prevention, and mitigation of any actual or potential adverse human rights and environmental impacts in their own operations, in their subsidiaries, and at the level of their established direct or indirect business relationships in their value chain.

Under the Commission's proposal, non-EU companies generating a net turnover of more than EUR 150 million in the EU, or a net turnover of more than EUR 40 million but not more than EUR 150 million in the EU, when 50% of their net worldwide turnover stems from sectors considered "high risk," must comply with due diligence obligations under CS3D.

The EU co-legislators have not considered the key consequences of broad extraterritorial application to EU and non-EU companies. Although the co-legislators have discussed the scope of the legislation at length, the focus has been on the size of companies captured rather than how non-EU firms, in particular, are captured. The Council advocates keeping the same thresholds butscoping in companies only if the relevant thresholds are met for two consecutive years. The Parliament supports revising the thresholds, proposing that non-EU companies fall under CS3D when "(i) the company generates a net worldwide turnover of more than EUR 150 million, provided that at least EUR 40 million was generated in the EU in the financial year preceding the last financial year, including turnover generated by third party companies with whom the company and/or its subsidiaries has entered into a vertical agreement in the Union in return for royalties; or (ii) the company did not reach the mentioned thresholds but is the ultimate parent company of a group that had 500 employees and a net worldwide turnover of more than 150 million and at least 40 million was generated in the EU in the last financial year, including turnover generated by third party companies with whom the company and/or its subsidiaries has entered into a vertical agreement in the EU in return for royalties."[3]

Non-EU companies that simply carry out cross-border activities in the EU and that meet a certain revenue threshold will have to comply with the CS3D due diligence obligations throughout their global value chain—that is, with regard to business or commercial activities and relationships that are completely unrelated to the EU internal market.

Simply, business or commercial relationships established by companies that have no geographical nexus with the EU would be captured by the CS3D. For example, a financial

3. Art. 2(2), Amendments 94 and 95 of the European Parliament Position, 1 June 2023, https://www.europarl.europa.eu/doceo/document/TA-9-2023-0209_EN.pdf.

service (e.g., a loan) from an internationally focused U.S. financial services provider to a U.S. business whose activities are exclusively in the United States would be covered by the EU due diligence requirements, irrespective of applicable local rules, provided the relevant U.S. financial services provider falls within the CS3D's scope.

The Chamber understands that one of the key political objectives of the CS3D is to cover companies' global value chains and to push, directly and indirectly, businesses in the EU and beyond to adopt responsible human rights and environmental approaches to their operations. However, the current texts have an incredibly large extraterritorial reach that does not appear to be justified from a legal or a market standpoint. This approach appears contrary to the EU principle of proportionality as it imposes burdens that are excessive in comparison to the stated objective. Effectively, the CS3D is designed to require any non-EU business that wants to be part of the value chain of any large company operating in the EU single market that falls within the CS3D's scope to prioritize EU law—regardless of its location and the potential contradictions with domestic law.

Moreover, provisions in the CS3D risk triggering sanctions and/or litigation in the EU, even where all business activities occur exclusively outside the EU, if certain criteria are met. The inclusion of business activities and relationships with no EU geographical nexus in the CS3D scope would risk creating disproportionate burdens for non-EU companies that have activities in the EU—as well as an unlevel playing field, as regional competitors outside the EU will not be subject to the same CS3D obligations.

International fragmentation of due diligence standards would create significant complexity and compliance problems for global companies and not enhance human rights or sustainability protections. This is also likely to create legal uncertainty, jurisdictional conflicts, and enforcement challenges. If applied to non-EU companies for their business activities outside the EU, CS3D obligations will likely create conflicting and overlapping requirements with other obligations from other jurisdictions.

The CS3D would also constitute a case of excessive prescriptive jurisdiction that would encroach on the reserved prerogatives and rights of other jurisdictions, interfering with their right to develop their economies and natural resources as they see fit. It would also affect other jurisdictions' own approaches to environmental protection and human rights, given the broad room for interpretation associated with the numerous rights identified in CS3D's Annex.

Differences in due diligence approaches and standards across economies will negatively affect global value chains and trade relations. For example, in the United States, the Dodd–Frank Act already enacts some due diligence obligations for conflict minerals, and the U.K. and Australia have requirements for companies to examine and disclose impacts on human rights issues within their supply chains. Overall, overlapping and potentially conflicting internationally fragmented due diligence standards could create very significant compliance issues for global companies active in various jurisdictions. This situation not only might affect the companies themselves but also might eventually penalize investors and consumers. International (or at least transatlantic) dialogue and coordination on due diligence rules could be considered.

We thus invite the Commission, the Council, and the Parliament to seriously contemplate ways to address this issue during the trialogue negotiations. At minimum, the co-legislators should consider introducing a requirement that the legislation will apply only to non-EU companies operating in the EU and that a territorial link be created between the products or services offered by an in-scope company and the EU so that due diligence obligations for non-EU companies are limited to the value chain of the products or services sold in the EU single market.

Value Chain Definition and Scope (Article 3)

Due diligence obligations under the proposed CS3D apply to in-scope companies' value chain operations, covering both downstream and upstream activities.

The definition of the term "value chain" proposed by the Commission covers a business's own operations, operations of controlled subsidiaries, and entities with whom the company has an established (direct or indirect) business relationship. Moreover, no distinction is made between operations in the EU and operations outside of it.

Generally, companies do not have control over certain parts of the process covered by the concept of value chain, such as the extraction of raw materials or disposal of products. Thus, the Commission set unrealistic expectations by requiring due diligence obligations to cover the whole value chain, which might affect in-scope companies' competitiveness, instead of proposing a more attainable and feasible approach, such as covering only contracted suppliers.Applying due diligence obligations to the whole value chain can also negatively affect the relationship a company has with its suppliers, contractors, and any other involved undertaking, due to the increased and regular demand for information and regulatory pressures of excessively granular scrutiny—which will weigh heavily on Small and Medium Enterprises (SMEs) in particular. In-scope companies may choose to disengage from non-EU suppliers (e.g., U.S. suppliers) that do not comply with the CS3D's requirements to mitigate risk—in turn economically harming perfectly legitimate and ethical non-EU domiciled businesses that rely on exports to the EU. Conversely, non-EU companies might decide to disengage from in-scope companies' value chains because of the excessive indirect regulatory scrutiny of their activities. This choice could result in serious consequences for the availability and affordability of goods and services within the EU market.

Moreover, the legal obligations enacted by the CS3D could introduce civil liability for noncompliance of activities in the value chain over which companies have no visibility or control.

In some cases, supply chains are extremely complex and may not be mapped to meet CS3D's envisioned due diligence requirements. Value chains are even more complex, as downstream activities can be very difficult to identify and evaluate. Member states that have already enacted national due diligence laws, such as Germany or France, generally limit the scope of due diligence obligations to the supply chain.

We believe the Council took a pragmatic approach in suggesting softer provisions than the Commission's proposal, including replacing the term "value chain" with "chain of activities." This is closer to the supply-chain concept and expressly excludes the use of a company's products or provision of services from the due diligence obligations. The definition of "chain of activities" proposed by the Council is limited to the production and supply of goods, or provision of services, taking into account the activities of direct and indirect business partners that design, extract, manufacture, transport, store, and supply raw materials, products, and/or parts of products or that provide the necessary services to the company to carry out its activities. Furthermore, the term covers activities of direct and indirect business partners that distribute, transport, store, and dispose of the product but excludes the disposal of the product by consumers. Additionally, a responsibility to assess indirect business partners' compliance with due diligence obligations would be impossible in some circumstances, strengthening the chance that companies cannot comply—and would therefore increase legal uncertainty.

While we support the Parliament's preference to exclude the use of the product by individual consumers from the definition of the "value chain," we reiterate our concerns regarding its overall definition, which is still effectively related to the value-chain concept and makes the Parliament's text still very unsatisfactory. To guarantee that in-scope companies have a reasonable chance to comply with the CS3D due diligence obligations without facing disproportionate burdens, due diligence obligations should be further narrowed, especially in the downstream part of business activities. Overall, due diligence obligations should be limited to business partners over which companies can have an effective view of their involvement in the chain of activities—namely, companies linked by an effective contractual relationship.

Risk-Based Approach (Proposed Art. 6a Council and Proposed Art. 8b Parliament and Stakeholder Engagement in the Due Diligence Process)

The Chamber strongly supports a risk-based prioritization in identifying and assessing potential adverse impacts, and we welcome both the Council's and the Parliament's approaches to this issue.

In-scope companies should be able, after carrying out the relevant assessment, to focus on main risks and address their due diligence obligations in a way that allows them to optimally allocate resources for due diligence compliance. Importantly, some parameters linked to the due diligence obligations may not have been measured in the past, so there are likely to be challenges in establishing a relevant baseline.

We particularly welcome the Council's addition of Article 6a, which would allow companies to prioritize adverse impacts arising from their own operations, those of their subsidiaries, or those of their business partners, where it is not feasible to concurrently address all identified adverse impacts to the full extent.

The added provision appears to shield companies from facing administrative sanctions or civil liability for noncompliance when the reason may be a lack of resources or realistic opportunity to address all potential adverse impacts at once rather than a disregard for the Directive's obligations.

Similarly, Article 8b of the Parliament text states that "companies may prioritize the order in which they take appropriate measures on the basis of the likelihood and severity of adverse impacts."

Moreover, while we recognize the need to involve relevant external stakeholders in some parts of the due diligence process, we note that the current Parliament text (in particular, Article 8d—Carrying Out Meaningful Engagement with Affected Stakeholders) is proposing very broad and far-reaching obligations for companies to engage with numerous stakeholders at all stages of the due diligence process. These provisions are overly burdensome and potentially unworkable for companies, and we note that the Council adopted a more reasonable approach in this respect. We would thus suggest a more reasonable approach whereby the obligations suggested by Parliament are scaled down and generally applicable to only relevant, key stakeholders.

Due Diligence at Group Level (Article 4a)

The Commission's proposal lacks clarity about due diligence obligations at group level. Companies with business activities in various EU member states must be able to follow the same regulatory requirements without risk of overlaps and contradictions between jurisdictions, including obligations in the United States.

Therefore, the Chamber strongly supports the proposed addition from both the Council and the Parliament of new provisions (Article 4a) allowing companies to accomplish some of the due diligence obligations at group level. This addition would resolve the concern that the Commission's proposal raised—that individual subsidiaries within a group could be separately responsible for compliance, preventing parent companies from organizing compliance efforts at group level. Therefore, when relevant, allowing the parent company to perform certain actions that fulfill obligations of its subsidies will ensure more efficient compliance with the obligations and allow companies to better allocate resources, provided that the supervisory authority shall not have authority over a parent company that has no operational activities in the EU, nor the subject of any related civil liability.

Transition Plans: Climate Change

According with Article 15 of the CS3D proposal, “Companies (…) shall adopt a plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement. “It is important to note that non-EU companies might already be subject to obligations regarding climate change and transition plans in their home jurisdictions, including those requirements resulting from the Paris Agreement. For example, Switzerland agreed to mandatory disclosures from the Task Force on Climate-related Financial Disclosures (TCFD) that will apply from January 1, 2024, and include transition plans “that are comparable with the Swiss climate goals.”

On April 6, 2022, similar provisions entered into force in the United Kingdom, requiring companies and limited liability partnerships to meet mandatory climate-related financial disclosure requirements in line with the TCFD recommendations. In addition, the EU already imposes transition plan disclosure obligations under the CSRD.

Moreover, the transition paths of other jurisdictions around the world might not be fully aligned with the EU’s in terms of the requirements and the timeline. For example, not every jurisdiction has interim net-zero targets and/or 2050 targets. For in-scope companies, mandating compliance with climate change obligations in the framework of the CS3D, as well as with the obligations of their home jurisdiction that might be significantly different or even incompatible, can create overlapping and possibly contradictive requirements and, consequently, legal uncertainty. For publicly held companies, this phenomenon may lead to investor confusion and potential additional legal exposure under various country investment reporting regulations.

Although we acknowledge the EU’s willingness to provide guidance and global leadership on this issue, applying such obligations to third-country companies could make it more difficult for non-EU firms to develop a coherent and consistent plan to align their business models and operations with a net-zero economy, undermining the overall decarbonization effort.

From a compliance perspective, we note that the Parliament’s text includes wording referencing CSRD in amended Article 15: Member States Shall Ensure that Companies Referred to in Article 2 Develop and Implement a Transition Plan in Line with the Reporting Requirements in Article 19a of Regulation (EU) 2021/0104 (CSRD). Because this amendment relates to the implementation of transition plans, it is a helpful element to CS3D and CSRD. We call on the co-legislators to ensure that the CS3D will not exceed the specifications of transition plans included in the ESRS.

We are further concerned about the third paragraph of Article 15, supported by the Parliament but deleted by the Council, whereby a director’s variable remuneration should be linked to the company’s business strategy and long-term interests and sustainability.

Linking the very long-term objective of a transition plan to the shorter period applicable to directors' remuneration would be difficult to achieve. The current European climate policy framework does not enable a precise level of sensitivity for the formulation of these short-term climate objectives. We support the Council's position on this issue: CS3D should not legislate the form and structure of directors' remuneration, as these are matters that should fall to the company and its bodies' or shareholders' competencies and jurisdictional rules.

The Chamber thus urges a specific a carve-out in the legislation that exempts non-EU, in-scope companies from the provisions of Article 15 of the CS3D.

Directors’ Duties (Articles 25 and 26)

We would further like to stress our support for the Council’s position on the deletion of the directors’ duties’ provisions in the CS3D.

Regulating directors’ duty of care is unnecessary for achieving the objective set out under the CS3D and due diligence rules. Moreover, such regulation can strongly interfere with national company law and corporate governance rules—without adding any value to the ultimate objective of creating better and more protected global value chains. By imposing a duty of care, Article 25 would pave the way for directors to be held liable for the company’s management decisions, raising questions about the scope of the obligations imposed and the rules governing the company’s civil liability (outlined in Article 22). This concern would be strengthened by the provisions of Article 26, making directors also responsible for the due diligence actions of the company and therefore imposing further obligations on company’s managers.

Additionally, the director liability regime under the CS3D proposal, combined with the frequency with which derivative suits are brought about in the United States, could have particularly adverse implications for U.S. companies. The CS3D extraterritorial reach has the potential to significantly affect corporate law and responsibilities in the U.S., as in cases where CS3D-related claims are litigated as breaches of fiduciary duty and oversight liability (“Caremark” claims[4]).

Caremark is the standard for director oversight duties under Delaware corporate law, which governs a great number of U.S. companies; it requires taking proactive measures to facilitate compliance and to detect, mitigate, and remedy any failure.[5] In a situation where a U.S. parent company will effectively be required to indirectly engage in the EU due diligence duties because of an EU subsidiary, failure to do so may trigger Caremark liability. Therefore, EU procedural duties could affect elements of the fiduciary duties of directors of a U.S. (Delaware) corporation. The resulting liability risk in the United States may call into question the company’s presence in the EU. To avoid this outcome, policymakers should remove CS3D’s Article 25 (and 26, if it is a subject of discussion during the trialogues).

As outlined in the Council’s general approach (p. 10), the two articles represent “an inappropriate interference with national provisions regarding directors’ duty of care” and would potentially undermine “directors’ duty to act in the best interest of the company.” We therefore welcome the Council’s decision to delete both articles and urge co-legislators to do the same in the final draft in the interests of removing great legal uncertainty for EU and non-EU companies and avoiding undermining directors’ duty to act in the best interest of the company.

4. https://h2o.law.harvard.edu/cases/5773.
5. https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/extraterritorial-impact-proposed-eu-directive-corporate.

Civil Liability (Article 22) and Enforcement Challenges

Civil liability provisions under the CS3D and the extraterritorial scope of the legislation risk triggering litigation in the EU for activities that have no geographical connection to the EU. Under the proposed regime, EU procedural rules would increase the risks of activating non-EU legal proceedings for civil liability issues; this goes beyond the objective of imposing civil liability on companies for due diligence noncompliance.

It could also result in non-EU companies being held liable for the same damages under different legal systems, which would create heavy legal uncertainty and burden for affected businesses.

The Chamber supports the deletion or at least a significant revision of Article 22 so that CS3D does not create new duties for the purposes of establishing civil liability—in line, for example, with the existing German "Act on Corporate Due Diligence Obligations in Supply Chains."

A. Harmonisation of EU member states' transposition

The levels of legal uncertainty are aggravated by the potential discrepancies after EU member states transpose the Directive in their national legal frameworks.

To that extent, the Commission should work extremely closely with the EU member states on the transposition of the Directive to ensure the maximum level of harmonization—especially on critical topics such as scope, definitions, due diligence process, and civil liability provisions. We specifically urge that any possibility of "double jeopardy" be avoided—that is, of companies potentially facing parallel and overlapping enforcement actions or civil actions in different member states under different systems—and that efforts be made to clarify which member state is supposed to take jurisdiction over identified breaching occurring in third countries and without any particular nexus to one member state over another. Unless such enforcement overlaps are eliminated and legal certainty achieved, a quagmire of jurisdictional disputes—which will undermine the very purpose of the legislation—can be expected.

While we note that Article 3a (Single Market Clause) of the Parliament text calls for coordination during the directive's transposition and calls on the Commission to assess, six years after the CS3D entry into force, whether changes to the level of harmonization of the Directive are required, it is unlikely that the current provisions will help to ensure full harmonization of the CS3D provisions across the EU single market.

Furthermore, as previously mentioned, the strong penalties set out in the CS3D for noncompliance and civil liability mean that an in-scope business might be held liable for environmental or human rights harms caused by actions that are outside of its control—for example, when performed by contractors, suppliers, or indirect business partners. The potential extensive civil liability that in-scope companies face under the proposed CS3D thus appears vastly disproportionate; it would create uncertainty and burden for companies, especially for those lacking resources.

B. International conventions and agreements

An additional point of concern is the lists of international conventions and agreements on human rights, fundamental freedoms, and the environment contained in the CS3D's Annex. We believe there are several problems with these lists.

First, adverse human rights and environmental impacts are linked to violations of the extensive number of obligations contained in these international conventions and agreements. These lists are too expansive, and we are particularly concerned that the Parliament's position added further items to the Commission's original proposal, including due diligence related to greenhouse gas (GHG; i.e., assessing companies' climate-related adverse human rights and environmental impacts in relation to their GHG emissions), which is extremely burdensome.

Second, the lists include several nonbinding international instruments, which are not intended to be instruments of law creating individual obligations, including government-to-government standards that are unclear or unfit to apply to private companies.

These international conventions and agreements are typically not drafted or framed in a way intended to be directly actionable or enforceable against individual companies, especially through actions brought by private parties, or to assign direct legal responsibility without further specification and contextualization. Making in-scope companies directly responsible, via fines and damages, for the enforcement of obligations that cannot be sufficiently specified undermines their ability to ensure compliance, vulnerable to matters that are genuinely outside their control at threat of litigation. Third, under the CS3D framework, obligations included in these international conventions and agreements will apply irrespective of whether they are ratified in the non-EU jurisdiction where an alleged due diligence violation takes place. Several liberal democratic states, including key EU trading partners, have not signed on to some of the conventions and agreements listed in the CS3D Annex. We can thus foresee an alarming situation in which a non-EU company that is part of the value chain of a CS3D in-scope company would be pressured to comply with vague rules set out by international agreements and conventions not otherwise present in its non-EU country of origin.

Therefore, we invite the EU co-legislators to reconsider these international conventions and agreements—with a strong underlying focus on legal proportionality and compliance workability. Accordingly, we support the Council's position under Article 22 that a company cannot be held liable when damages are caused only by business partners in its chain of activities. As proposed by the Council, removal of liability for the actions of third parties is the least problematic course and adheres to traditional principles of liability. If an exclusion of liability for third parties' actions (as rightly proposed by Council) is not achieved, at a minimum it is essential that any liability principles take account of what is actually within the control of the party in question. The Commission's original proposal included a defense that would be available to a company, allowing it to show that it made the necessary efforts to comply (in which case it could not be held liable). The Parliament suggested the deletion of this defense. We would strongly oppose Parliament's suggestion. In light of the technical inability for in-scope companies to exercise direct supervision over third parties in their supply chain, it is imperative that if any liability is to be assigned, it can be determined based only on what is actually possible for an in-scope company to do. Where an in-scope company has made the necessary efforts to

conduct diligence but, for example, information is kept withheld from them, it would be wholly unreasonable to allow liability to be assigned. More specifically, we welcome the Parliament's inclusion of Article 6's point 4a, which states that when all necessary information regarding a company's value chain is not available, the company can report and explain efforts made to obtain the necessary information about its value chain and the reasons all of the necessary information could not be gathered.

We also support the Council's clarification in Article 22 of the four conditions that must be met for a company to be held liable: a damage caused to a natural or legal person, a breach of the duty, a causal link between the damage and the breach of the duty, and a fault (intention or negligence). Inclusion of these conditions would help to achieve legal certainty for companies. We also welcome the Council's clarification that the right of victims of human rights or environmental adverse impacts to full compensation should not lead to overcompensation—for example, by means of punitive or multiple damages.

Impact on Financial Services Sector

Although businesses from all sectors of the economy will be severely affected by the CS3D, financial services companies and, in particular, non-EU-headquartered financial institutions are likely to face very specific and serious challenges under the proposed legislation.

CS3D's extraterritorial application implies that value chains for the provision of financial services located entirely outside the EU might be directly or indirectly in the CS3D's scope—and thus might have to comply with EU due diligence obligations. For example, in practice, a financial service (e.g., a loan) from a U.S. financial services provider (that meets the CS3D thresholds) to a U.S. business (which has activities exclusively outside of the EU) would be covered by the CS3D's due diligence requirements irrespective of applicable local rules. Imposing due diligence obligations to activities that are not connected to the EU single market will affect the competitiveness of non-EU in-scope financial institutions, especially when they compete for business in other third countries. In-scope financial institutions subject to CS3D requirements will lose competitiveness vis-à-vis other large regional banks that may not be bound by the same obligations.

We are further deeply concerned that the downstream business relationships of financial services firms are included in the scope of the obligations in the Commission's proposal, in the Parliament's position, and in the Council position (subject to the member state optional carve-out detailed later). Downstream value chains include the provision of financial services such as trading, derivatives, custody, clearing, and payments to clients. Financial institutions cannot effectively influence the behavior of their corporate clients and trading counterparties through the provision of these financial services, and their inclusion in the scope of the value chain thus creates undue burdens and obstacles in financial markets—without any contribution to the objectives of the Directive. As mentioned by the Council in its general approach (p. 7), member states should solely be responsible to take the "decision of whether or not to include the provisions of financial services by regulated financial undertakings." This option would leave to each jurisdiction the choice of whether to include or exclude certain financial services from the value chain of financial institutions, although those firms would still be included in the scope of the CS3D for the rest of their value chain.

In the same vein, we warn against the inclusion of a new Article 8a, proposed by the Parliament that sets out provisions for institutional investors and asset managers to compel their investee companies to end actual adverse impacts. Asset managers' value chains greatly differ from traditional value chains, and there is no classic contractual relationship between the investee company and the investor. We thereby call for the exclusion of the investor–investee company relationship from the scope of the CS3D.

U.S.-Specific Risks

The extraterritorial scope of CS3D opens the possibility of retaliatory measures against the EU and its partner companies, whether in the U.S. or in a different country, including, for example, by potentially using “blocking regulations” whereby other countries could make it impermissible for companies within their jurisdiction to comply with the obligations extraterritorially imposed on them by the EU. Lawmakers in the U.S. have recently called on the Treasury Department to take measures to protect U.S. companies from the extraterritorial impact of CS3D.[6,7] Further, at a recent hearing before the House Financial Services Committee, U.S. Treasury Secretary Janet Yellen expressed concerns about the extraterritorial impact of the CS3D and unintended consequences affecting U.S. firms.[8]

We hope that the extraterritoriality issues raised by the CS3D will be appropriately considered and meaningfully addressed in the framework of the EU–U.S. financial regulatory forum. Left unresolved, the CS3D’s extraterritorial application could invite U.S. policymakers to take action against European firms, re-evaluating long-standing equivalency agreements or subjecting foreign private issuers in the U.S. marketplace to comply with regulation from which they are currently exempted. In a war of regulatory application, it is the consumer who ultimately loses, through either passed-through compliance costs or reduction of choice.

Lastly, the EU´s approach to due diligence and the way it affects non-EU companies may hamper EU capital markets, as EU-headquartered international companies could decide to leave the EU due to the burden and cost of complying with these obligations. Such exits would have significant competitiveness implications for the EU at a moment when the bloc is facing challenges of deindustrialization and loss of innovation, and considering concrete steps to boost competitiveness of its market.

6. https://oversight.house.gov/wp-content/uploads/2023/06/6.5.23-Letter-to-Treasury-on-CSRD-CS3D-FINAL_.pdf.
7. https://files.constantcontact.com/27ea5431901/788314cf-3f39-4897-9608-f05a29a65588.pdf?rdr=true.
8. https://www.youtube.com/watch?v=NCY7-W5GEDs.

Conclusion

Access to capital formation and investment opportunities is important for both the EU and the U.S., especially at a moment when geopolitical instability and global trade frictions would require like-minded partners to develop joint policies and approaches. The CS3D risks seriously harming the transatlantic relationship.