



EU CS3D: impacts on Brazilian jurisdiction and companies

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European Union approves Social and Environmental Due Diligence Directive in the supply chain: is your company prepared?

The Corporate Sustainability Due Diligence Directive (“CS3D”) sets out obligations for companies to address current and potential adverse impacts on the environment and human rights violations in their direct operations and global supply chain.

In summary:

- ▶ The Directive establishes obligations for companies to implement due diligence in all their direct operations, encompassing their global chain of activities, to prevent, mitigate and remedy adverse impacts on the environment and human rights violations.
- ▶ In addition to European companies with operations in Brazil and Brazilian companies with revenue in the EU, the Directive will indirectly reach suppliers in Brazil - such as commodity origination and extraction, transportation, storage, manufacturing.

- ▶ The implementation period varies from 3 to 5 years depending on turnover and number of employees, and failures to perform due diligence will be sanctioned with fines, reparation and indemnity - including for acts of its suppliers in case of failure or negligence.
- ▶ We understand that duty of care actions will be “cascaded” through the supply chain through a lower risk appetite, strict criteria and more effective internal controls with business partners.
- ▶ In Brazil, a proposal for a similar rule is under discussion in the Chamber of Deputies, which will establish the responsibility of companies for their supply chain.

What is the CS3D about?

On 24 April 2024, the European Parliament approved the final text of the Corporate Sustainability Due Diligence Directive (CS3D). This Directive establishes a broad duty of care

obligation for European companies to prevent, mitigate and remedy negative impacts on the environment and human rights violations - whether in their operations in the European Union or through their suppliers globally.

The CS3D details the extent of this duty of care and responsibilities and establishes a mandatory adoption of a due diligence system by companies as the main tool for implementing the Directive. Although the official publication of the CS3D is expected for the upcoming month, the approved text allows companies and specialists to prepare to meet the new obligations.

Which companies are subject to CS3D and how does it reach operations in Brazil?

Although the Directive directly binds European companies, the regulation will reach Brazilian companies (or companies operating in Brazil) that are part of Europeans companies' chain of activities - for example, in the extraction of minerals and metals, in the sourcing of agricultural commodities, transportation, storage, and manufacture of products.

The European companies covered (and, indirectly, their business chains) are:

1. EU companies (or controlled subsidiaries) with more than 1,000 employees and global net sales of more than €450 million; and
2. Non-EU companies (or controlled subsidiaries) with net sales of more than €450 million in the EU, regardless of the number of employees.

At this first moment, financial institutions are only subject to due diligence obligations for their upstream chain, that is, it does not cover

customers (the companies that receive their financial services).

In Brazil, a similar proposal is under discussion in the Chamber of Deputies, which aims to establish the civil liability of companies for their supply chain (Bill of Law No. 572/2022 - National Framework on Human Rights and Business).

What are the due diligence obligations?

The CS3D has incorporated the OECD's good practices for Responsible Business Conduct, comprising a duty of care based on the following obligations to prevent human rights violations and negative impacts on the environment:

- ▶ Implement a risk-based due diligence policy that is integrated into business practices, reviewing it biennially.
- ▶ Conduct a detailed assessment of business activities to identify and prioritize actual or potential adverse social and environmental impacts, mobilizing sufficient resources and engaging stakeholders (business partners, local communities, consumers, etc.);
- ▶ Develop and execute a preventive action plan with a clear timeline and targets, using qualitative and quantitative indicators to monitor progress;
- ▶ Obtain contractual commitments from direct partners, including third-party compliance checks;
- ▶ Mitigate or neutralize identified adverse impacts through corrective actions, contractual and operational adjustments, and provide remediation in case of damages, acting directly or influencing business partners;





- ▶ Create and maintain a transparent and accessible channel for reports and complaints.

In addition, regarding climate change, large companies in the EU will be required to adopt a transition plan to ensure that their business model is compatible with limiting global warming to 1.5°C.

Impacts on corporate governance

We understand that, to comply with the “duty of care” established by the Directive, companies will have to engage their internal high level administration and decision-making bodies due to the need of integrate the due diligence system on corporate policies - such as risk management, supply chain, human rights, environment, procurement. In addition, companies will have to designate an internal “authorized representative”, who will be responsible for implementing the Directive and for collaborating with Member States’ supervisory bodies.

What are the penalties for non-compliance?

Companies may be held liable for full compensation for damages caused to an individual or legal entity in the event of undoing, intentionally or negligently, to prevent and mitigate its adverse impacts. This accountability is preceded by the broad duty of care to prevent and mitigate actual and potential impacts. Companies are also subject to fines and other forms of sanction to be set by Member States. It should be noted that a company cannot be held liable for damages caused exclusively by its business partners in its chain of activities. However, it may be held liable if it has failed on its duty of care and on the effective influence over its business partners.

Implementation and oversight

It will be up to each Member State to adapt its rules and administrative bodies for the implementation of the Directive, which must be done within two years. The Directive establishes various instruments to strengthen its implementation, such as the creation of channels for whistleblowing and complaints, a system for cooperation between national authorities and information sharing, and the creation of indicative lists of companies located in other countries that are subject to the standard. Future guidelines for implementation will be developed by the European Labour, Environment, and Fundamental Rights Agencies.

How should your company prepare for the Directive?

We understand that the duty of care obligation will be “cascaded” with the participants of the chain of activities in Brazil, obliging them to have effective controls to avoid and mitigate human rights violations and impacts on the environment.

We also expect a more active stance and greater role for EU companies in monitoring, verifying and collaborating with their suppliers - including a lower appetite for risk, which will translate into strict criterias and more effective internal controls with trading partners.

In practical terms, it will be necessary to develop and implement a robust and effective due diligence system to detect non-conformities and prevent actual and potential damages - including to demonstrate that the duty of care has been adopted, and that any adverse impact is due to the sole conduct of the business partner.

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