

# FROM BRUSSELS TO KUALA LUMPUR: UNDERSTANDING THE EU'S CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE

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**A**fter an interesting legislative journey, the European Union (“EU”) introduced the Corporate Sustainability Due Diligence Directive (hereinafter “CSDDD”), which came into effect last July. The CSDDD marks a significant milestone in the EU’s broader sustainability agenda by embedding responsible business conduct into corporate due diligence processes. While the CSDDD primarily targets EU-based companies, its ramifications extend globally and is likely to affect non-EU businesses, including those based in Malaysia. The primary objective of the CSDDD is to establish due diligence obligations for companies, requiring them to identify, prevent, mitigate, or bring an end to actual or potential adverse human rights and environmental impacts arising from their operations or those of their business partners within the value chain.

## **Companies Subject to the CSDDD**

The CSDDD targets large companies operating within the EU, as well as non-EU companies with significant operations in the EU market. It could also extend, in certain cases, to parent companies and other companies with franchising or licensing agreements in the EU, provided that these thresholds are met in two consecutive financial years:<sup>1</sup>

Types of Companies	Employee Threshold	Turnover Threshold
EU Companies <sup>2</sup>	More than 1,000 employees	More than €450 million turnover worldwide
Non-EU Companies <sup>3</sup>	N/A	More than €450 million turnover in the EU
Franchised Companies (EU) <sup>4</sup>	More than 1,000 employees	More than €80 million net turnover in the EU, and generating royalties of more than €22.5 million
Franchised Companies (Non-EU) <sup>5</sup>	N/A	

[1] Article 2(5) of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

[2] Article 2(1) of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

[3] Article 2(2) of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

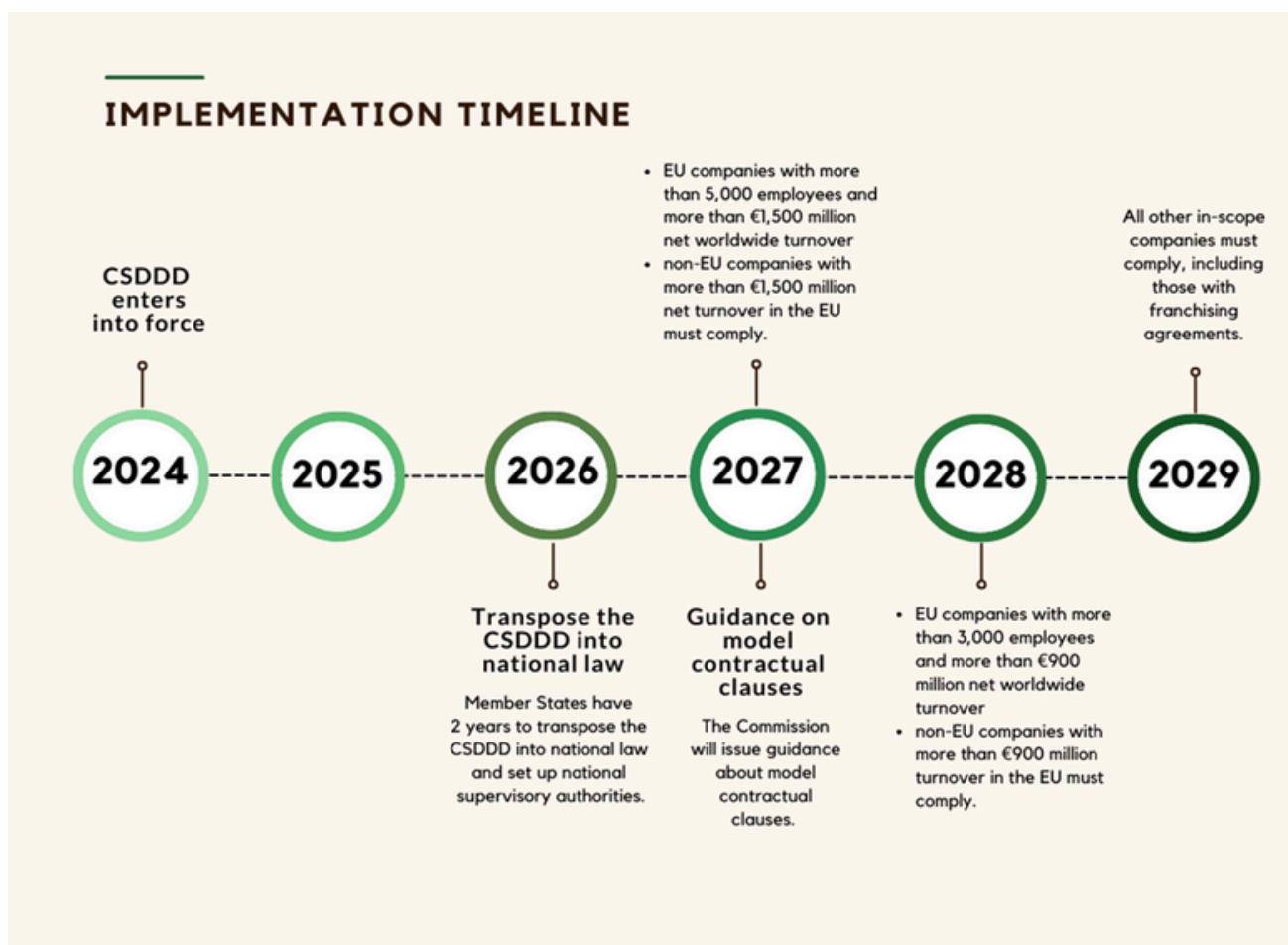
[4] Article 2(1) of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

[5] Article 2(2) of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

The CSDDD could also extend to non-EU parent companies that, taken together as a group, meet the above thresholds. However, an exemption exists if the parent companies hold shares in their respective operational subsidiaries without engaging in management, operational, or financial decisions affecting the group, provided that one of its EU subsidiaries is designated to fulfil the parent company’s obligations under the CSDDD.

### CSDDD’s Transposition Period

The CSDDD’s entry into force on 25 July 2024 kickstarts a two-year transposition period during which EU Member States must integrate the CSDDD obligations into their national laws. The measures will become applicable in stages, based on whether the company is based in the EU, as well as its number of employees and turnover.



The CSDDD establishes minimum harmonisation, meaning Member States cannot lower the level of protection when incorporating the CSDDD into national law.<sup>6</sup> Likewise, national laws that provide a higher level of protection for human, employment, and social rights, as well as for the protection of the environment and climate than the CSDDD, shall prevail. Non-EU countries, such as Malaysia, should view this period as an opportunity to integrate and enhance their corporate due diligence practices and work towards mitigating their adverse human rights and environmental impacts.

### Due Diligence Obligations

The CSDDD will require in-scope companies to undertake risk-based human rights and environmental due diligence to identify and assess actual and potential adverse impacts of their business and those of their business partners, including to:

[6] Article 1(2) of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

## CSDDD OBLIGATIONS

- 1 **Article 5**  
Integrate due diligence into policies & risk management systems
- 2 **Article 6**  
Identify & assess actual and potential adverse impacts
- 3 **Article 7 - 8**  
Prevent & mitigate actual & potential adverse impacts and bring actual adverse impacts to an end
- 4 **Article 9**  
Establish & maintain a notification mechanism and complaints procedure
- 5 **Article 10**  
Monitor the effectiveness of company's due diligence policy & measures
- 6 **Article 11**  
Publicly communicate on due diligence

### Chain of Activities

All in-scope companies are required to actively manage the actual and potential adverse impacts of their activities on human rights and environmental matters arising from:

- (i) their own operations;
- (ii) the operations of their subsidiaries; and
- (iii) the operations of their business partners within their chain of activities.

The "chain of activities" does not include the disposal of products or the activities of a company's downstream business partners related to its services. However, it does cover the activities of a company's:

- Upstream business partners involved in production, including the design, extraction, sourcing, manufacture, transport, storage and supply of raw materials, products or parts of the products, and the development of the product or service;<sup>7</sup> and
- Downstream business partners involved in the distribution, transport, and storage of the product.<sup>8</sup>

### Transition Plans

In order to align corporate activities with global climate goals, Article 15 of the CSDDD requires in-scope companies to implement a transition plan for climate change mitigation which aims to ensure, through best efforts, that the company's business model and strategy are compatible with the transition to a sustainable economy and with limiting global warming to 1.5°C, in line with the Paris Agreement.

Specifically, the transition plan shall contain:

- (i) time-bound climate targets for 2030 and five-year increments up to 2050 based on scientific evidence;
- (ii) a description of decarbonisation levers and key actions planned to reach the aforementioned targets;
- (iii) an explanation and quantification of investments and funding supporting the implementation of the transition plan; and
- (iv) a description of the role of company management in connection with the plan.

[7] Article 3(1)(g) of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

[8] *ibid.*

## How Can Malaysian Companies Prepare

The CSDDD is expected to have significant impacts on Malaysian companies, with Malaysia being the EU's third-largest trading partner within the ASEAN region. In 2023, the EU imported goods worth €29.1 billion from Malaysia and exported €15.6 billion to the country.<sup>9</sup> Malaysian companies should first assess whether they fall within the scope of the CSDDD, considering the thresholds. Nevertheless, Malaysian companies that do not meet a threshold requiring compliance with the CSDDD are not necessarily in the clear. The CSDDD will have an impact well beyond the subject companies, as those companies impose heightened commercial requirements on their business partners. Hence, an assessment should also be made on where they lie in the chain of activities and how the scope of the CSDDD will impact their business relationships with both EU and non-EU companies that are required to comply with it. Companies should consider a review of existing supply chain arrangements and compare existing practices and disclosures against industry standards and best practices.<sup>10</sup> Next, a detailed gap analysis can be performed to identify discrepancies between current practices and the requirements of the CSDDD.<sup>11</sup> Once gaps are identified, a roadmap for improvement can be developed. Companies should work to establish or enhance grievance mechanisms to allow stakeholders to report concerns in relation to CSDDD compliance. These mechanisms should be accessible, transparent, and effective.<sup>12</sup>

### Supply Chain Compliance

Ensuring that a company's entire supply chain has minimal environmental and human rights issues can be challenging for Malaysian companies. Many companies hire foreign workers for primarily unskilled jobs, while Malaysians tend to occupy semi-skilled and skilled positions.<sup>13</sup> Issues such as forced labour among migrant workers, including debt bondage, wage theft, and restrictions of movement, continue to persist in Malaysia.

According to the "Skilled to Care, Forced to Work?" report released by the International Labour Organisation ("ILO") in June 2023, a survey of 1,201 domestic migrant workers revealed that 29% of migrant domestic workers in Malaysia faced forced labour conditions - a rate significantly higher than those in Singapore (7%) and Thailand (4%).<sup>14</sup>

However, the Government of Malaysia has plans to reduce forced labour incidences and eliminate all forms of forced labour by 2030.<sup>15</sup> The National Action Plan on Forced Labour ("NAPFL") 2021-2025, developed with technical assistance from the ILO, was introduced to prevent force labour, protect victims, ensure prosecution, and form partnerships to address this multifaceted and complex issue.<sup>16</sup> With increased scrutiny from the implementation of the NAPFL and the CSDDD, Malaysian companies will face heightened pressure. This will likely lead to more audits, certifications, and reporting requirements as evidence of compliance becomes increasingly necessary.



[9] 'EU trade relations with Malaysia. Facts, figures and latest developments' (European Commission) <[https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/malaysia\\_en#:~:text=Trade%20picture,%E2%82%AC11%20billion%20in%202022](https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/malaysia_en#:~:text=Trade%20picture,%E2%82%AC11%20billion%20in%202022)> accessed 25 August 2024.

[10] Article 7(3) of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

[11] Article 8 of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

[12] Article 14 of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

[13] Allen Ng and Tan Kar Man, 'Economic Impact of Foreign Workers in Malaysia: An Objective Review' (Khazanah Research Institute, 9 January 2019) <[https://www.krinstitute.org/Views-@-Economic\\_Impact\\_of\\_Foreign\\_Workers\\_in\\_Malaysia-;\\_An\\_Objective\\_Review.aspx](https://www.krinstitute.org/Views-@-Economic_Impact_of_Foreign_Workers_in_Malaysia-;_An_Objective_Review.aspx)> accessed 25 August 2024.

[14] Steven Needham, 'Study highlights forced labour amongst migrant domestic workers in Southeast Asia' (International Labour Organization, 15 June 2023) <<https://www.ilo.org/resource/news/study-highlights-forced-labour-amongst-migrant-domestic-workers-southeast#:~:text=Findings%20indicate%20that%2029%20per,4%20per%20cent%20in%20Thailand>> accessed 25 August 2024.

[15] Ministry of Human Resources, *The National Action Plan on Forced Labour 2021-2025*, page 47 <<https://mohr.gov.my/images/NAPFLFINAL/mobile/index.html>> accessed 25 August 2024.

[16] *ibid*, page 46.



obligations of the CSDDD brings its own benefits. The process of evaluating and implementing CSDDD practices ensures greater awareness of a business’s negative environmental and human rights impacts. Additionally, it enhances attractiveness to sustainability-oriented investors and public procedures. The CSDDD will also draw more attention to innovation for a greener environment, naturally improving access to green financing.

For developing countries like Malaysia, companies that practice better protection of human rights and implement environmental initiatives will benefit from sustainable investment, ultimately ensuring improved and more comfortable living conditions for people. Lastly, enhanced stakeholder awareness of key sustainability issues will allow organisations to anticipate potential challenges and risks before making decisions.<sup>20</sup>

### Enforcement and Penalties

EU national authorities are responsible for ensuring compliance with the CSDDD and can impose fines of no less than 5% of a company’s net worldwide turnover.<sup>17</sup> Furthermore, the CSDDD provides claimants with the ability to seek civil remedies against companies for alleged breaches of human rights. While a company will not incur civil liability for damage caused solely by a business partner within its chain of activities, the CSDDD does provide for joint and several liability where damage is caused jointly by the company and its subsidiary, direct, or indirect business partner.<sup>18</sup> The CSDDD also allows for a five-year period for such actions to be brought.<sup>19</sup> While this may or may not directly impact Malaysian companies, the presence of monitoring and penalties serves as a deterrent for companies subject to the CSDDD. This pressure may lead companies to adopt stricter requirements to maintain or establish business relationships.

### The Bigger Picture

Companies must develop robust mechanisms to trace and monitor their environmental and human rights impacts. While this will incur costs and require significant effort, meeting the

### Closing Thoughts

The CSDDD represents a significant shift toward greater accountability in global supply chains. Malaysian companies must recognise the CSDDD’s far-reaching implications, as it sets new standards for corporate activities that could impact international trade dynamics and investment patterns. While the CSDDD presents challenges, particularly in terms of compliance costs and legal risks, it also offers opportunities for Malaysian businesses to enhance their sustainability practices and improve their market positioning. Embracing this shift will not only enhance their own economic resilience but also contribute to a more sustainable future for all.

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[17] Article 27(4) of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

[18] Article 29(5) of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

[19] Article 29(3)(a) of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.

[20] Article 10(2) of the Corporate Sustainability Due Diligence, Directive (EU) 2024/1760.