Consultation response to the EU for the Sustainable Corporate Governance for the European Framework on Mandatory Human Rights and Environment Due Diligence

8 February 2021

Dear Sir/Madam

1. The International Bar Association (IBA), founded in 1947, is the world's leading organisation of international legal practitioners, bar associations, law firms and law societies. The IBA now has over 80,000 members, over 200 of the top legal firms in the world and corporate members from a diverse range of international companies. IBA membership presently spans over 170 countries with 195 individual associations. The work undertaken covers all areas of substantive law in addition to broader legal issues and ethics.

2. Change The Law was founded in 2003 and works to contribute to the observance throughout the world of human rights as set out in the Universal Declaration of Human Rights. The focus is on the change, progress and the influence on international policies and international legal systems on human rights, business and human rights, corporate sustainability and environmental, social and governance (ESG) factors. In April 2018, Change The Law founded an international group which now has 84 members who are lawyers, barristers, academics, non-governmental organisations (NGOs), members of the IBA and the United Nations (UN), expert practitioners and business leaders, from 26 countries. The mission of the group is to train law students and legal practitioners on the UN Guiding Principles on Business and Human Rights on the implications of human rights in their legal practice, to ensure standards are met globally consistently with best practice in ethics and professional standards.

3. We are submitting our comments on behalf of the IBA's Legal Policy & Research Unit (LPRU), the Business Human Rights Committee and Change the Law, who formed a Working Group to respond to this consultation (Working Group members are listed below).

4. The LPRU undertakes research projects and develops initiatives that are relevant to the rule of law, the legal profession and the broader global community. The LPRU engages with legal professionals, law firms, law societies and bar associations, governments, NGOs and international institutions to ensure innovative, collaborative and effective outcomes.

5. The Business Human Rights Committee aims to create awareness amongst lawyers in all fields of practice, of business and human rights, corporate sustainability and, more broadly, ESG principles (eg, conflict minerals and modern slavery transparency). It works to promote the development of legal skills required to advise clients and to support law firm management in the emerging area of law relating to business and human rights, and to facilitate education and dialogue among lawyers who practice business and human rights.

6. The comments made in this submission are the personal opinions of the Working Group members and should not be taken as representing the views of their firms, employers or any other person or body of persons apart from the IBA's Business Human Rights Committee, the LPRU and Change the Law of which they are a member.[1]

[1] Change the Law Limited, has already contributed to a previous consultation on this issue. The text of the submission and the list of contributors are available online at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/F1291451.

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Introduction

Political context

The Commission's political guidelines set the ambition of Europe becoming the world's first climate-neutral continent by 2050 and foresee strong focus on delivering on the UN Sustainable Development Goals,[2] which requires changing the way in which we produce and consume. Building on the political guidelines, in its Communication on the European Green Deal[3] (adopted in December 2019) and on A Strong Social Europe for Just Transition[4] (adopted in January 2020) the Commission committed to tackling climate and environmental-related challenges and set the ambition to upgrade Europe's social market economy.

The European Green Deal sets out that 'sustainability should be further embedded into the corporate governance framework, as many companies still focus too much on short-term financial performance compared to their long-term development and sustainability aspects'.

Sustainability in corporate governance encompasses encouraging businesses to frame decisions in terms of their environmental (including climate and biodiversity), social, human and economic impact, as well as in terms of the company's development in the longer term (beyond three–five years), rather than focusing on short-term gains.

As a follow-up to the European Green Deal, the Commission has announced a sustainable corporate governance initiative for 2021, and the initiative was listed among the deliverables of the Action Plan on a Circular Economy,[5] the Biodiversity strategy[6] and the Farm to Fork strategy.[7] This initiative would build on the results of the analytical and consultative work carried out under Action 10 of the Commission's 2018 Action Plan on Financing Sustainable Growth and would also be part of the Renewed Sustainable Finance Strategy.

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[2] UN Sustainable Development Goals, *Take Action for the Sustainable Development Goals,* available at: https://www.un.org/sustainabledevelopment/sustainable-development-goals/, last accessed 9 March 2021.

[3] Directorate-General for Communication, *Communication on The European Green Deal,* European Commission December 2019, available at: https://ec.europa.eu/info/publications/communication-european-green-deal_en, last accessed 9 March 2021.

[4] European Commission, *Communication and Annex on a Strong Social Europe for Just Transitions,* January 2020, available at: https://ec.europa.eu/commission/presscorner/detail/en/fs_20_49, last accessed 9 March 2021.

[5] European Commission, *Circular Economy Action Plan: For a cleaner and more competitive Europe,* 2020, available at: https://ec.europa.eu/environment/circular-economy/pdf/new_circular_economy_action_plan.pdf, last accessed 9 March 2021.

[6] European Commission, *Biodiversity strategy for 2030- concrete actions,* 2020 available at: https://ec.europa.eu/environment/strategy/biodiversity-strategy-2030_en, last accessed 9 March 2021.

[7] European Commission, *Farm to Fork Strategy- for a fair, healthy and environmentally-friendly food system,* 2020, available at: https://ec.europa.eu/food/farm2fork_en, last accessed 9 March 2021.

The recent communication 'Europe's moment: Repair and Prepare for the Next Generation (Recovery Plan)[8] (adopted in May 2020) also confirms the Commission's intention to put forward such an initiative with the objective to 'ensure environmental and social interests are fully embedded into business strategies'. This stands in the context of competitive sustainability contributing to the Covid-19 recovery and to the long-term development of companies. Relevant objectives are strengthening corporate resilience, improving predictability and management of risks, dependencies and disruptions including in the supply chains, with the ultimate aim for the European Union's economy to build back stronger.

This initiative is listed in the Commission Work program for 2021.[9]

European Union action in the area of sustainable corporate governance will complement the objectives of the upcoming Action Plan for the implementation of the European Pillar of Social Rights, to ensure that the transitions towards climate-neutrality and digitalisation are socially sustainable. It will also strengthen the EU's voice at the global scene and would contribute to the respect of human rights, including labour rights – and corporate social responsibility criteria throughout the value chains of European companies – an objective identified in the joint Communication of the Commission and the High Representative on the Global EU response to Covid-19.[10]

This initiative is complementary to the review of the Non-Financial Reporting Directive (NFRD) (Directive 2014/95/EU)[11] which currently requires large public-interest companies to disclose to the public certain information on how they are affected by non-financial issues, as well as on the company's own impacts on society and the environment. The NFRD also requires companies to report on their social and environmental policies and due diligence processes if they have them, or otherwise explain why they do not have any (comply or explain approach). While the NFRD is based on incentives 'to report', the sustainable corporate governance initiative aims to introduce duties 'to do'. Such concrete actions would therefore contribute to avoiding 'greenwashing' and reaching the objectives of the ongoing review of the NFRD too, in particular the aim of enhancing the reliability of information disclosed under the NFRD by ensuring that the reporting obligation is underpinned by adequate corporate and director duties, and the aim of mitigating systemic risks in the financial sector. Reporting to the public on the application of

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[8] European Commission, *Europe's moment: Repair and Prepare for the Next Generation,* May 2020, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1590732521013&uri=COM:2020:456:FIN, last accessed 9 March 2021.

[9] Directorate-General for Communication, *2021 Commission work programme- key documents*, European Commission October 2020, available at: https://ec.europa.eu/info/publications/2021-commission-work-programme-key-documents_en, last accessed 9 March 2021.

[10] European Commission, *Communication on the Global EU response to COVID-19,* 2020, available at: https://ec.europa.eu/info/sites/info/files/joint_communication_global_eu_covid-19_response_en.pdf, last accessed 9 March 2021.

[11] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ L 330, 15 Nov 2014, p 1.

sustainability in corporate governance and on the fulfilment of directors' and corporate duties would enable stakeholders to monitor compliance with these duties, thereby helping ensure that companies are accountable for how they mitigate their adverse environmental and social impacts.

The initiative would build upon relevant international standards on business and human rights and responsible business conduct, such as the UN Guiding Principles on Businesses and Human Rights and the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises and its Due Diligence Guidance for Responsible Business Conduct.

As regards environmental harm linked to deforestation, the Commission is also conducting a fitness check of the EU Timber Regulation and an impact assessment.

Finally, Covid-19 has put small and medium-sized companies under financial pressure, partly due to increased delay in the payments from their larger clients. This raises the importance of the role of board members of companies to duly take into account the interests of employees, including those in the supply chains as well as the interests of persons and suppliers affected by their operations. Further support measures for SMEs also require careful consideration.

Results of two studies conducted for the Commission

To integrate properly sustainability within corporate strategies and decisions, the High-Level Expert Group on Sustainable Finance[12] recommended in 2018 that the EU clarifies corporate board members' duties so that stakeholder interests are properly considered. Furthermore, they recommended for the EU to require that directors adopt a sustainability strategy with proper targets, have sufficient expertise in sustainability, and to improve regulation on remuneration.

In its 2018 Action Plan on Financing Sustainable Growth[13] the Commission announced that it would carry out analytical and consultative work on the possible need to legislate in this area.

The Commission has been looking at further obstacles that hinder the transition to an environmentally and socially sustainable economy, and at the possible root causes thereof in corporate governance regulation and practices. As part of this work, two studies have been conducted which show market failures and favour acting at the EU level.

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[12] High Level Expert Group on Sustainable Finance, *Financing a Sustainable European Economy,* European Commission 2018, available at: https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf, last accessed 9 March 2021.

[13] European Commission, *Communication from the Commission,* 2018, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018DC0097, last accessed 9 March 2021.

The *Study on directors' duties and sustainable corporate governance*[14] evidences that there is a trend in the last 30 years for listed companies within the EU to focus on short-term benefits of shareholders rather than on the long-term interests of the company. Data indicate an upward trend in shareholder payouts, which increased from 20 per cent to 60 per cent of net income while the ratio of investment (capital expenditure) and R&D spending to net income has declined by 45 per cent and 38 per cent respectively. The study argues that sustainability is too often overlooked by short-term financial motives and that to some extent, corporate short-termism finds its root causes in regulatory frameworks and market practices. Against these findings, the study argues that EU policy intervention is required to lengthen the time horizon in corporate decision-making and promote a corporate governance more conducive to sustainability. To achieve this, it spells out three specific objectives of any future EU intervention: strengthening the role of directors in pursuing their company's long-term interest by dispelling current misconceptions in relation to their duties, which lead them to prioritise short-term financial performance over the long-term interest of the company; improving directors' accountability towards integrating sustainability into corporate strategy and decision-making; and promoting corporate governance practices that contribute to company sustainability, by addressing relevant unfavourable practices (eg, in the area of board remuneration, board composition, stakeholder involvement).

The *Study on due diligence requirements* through the supply chain[15] focuses on due diligence processes to address adverse sustainability impacts, such as climate change, environmental, human rights (including labour rights) harm in companies' own operations and in their value chain, by identifying and preventing relevant risks and mitigating negative impacts. The study shows that in a large sample of mostly big companies participating in the study survey, only one in three businesses claim to undertake due diligence which takes into account all human rights and environmental impacts. Therefore voluntary initiatives, even when backed by transparency, do not sufficiently incentivise good practice. The study shows wide stakeholder support, including from frontrunner businesses, for mandatory EU due diligence. Seventy per cent of businesses responding to the survey conducted for the study agreed that EU regulation might provide benefits for business, including legal certainty, level playing field and protection in case of litigation. The study shows that a number of EU Member States have adopted legislation or are considering action in this field. A potential patchwork of national legislation may jeopardise the single market and increase costs for businesses. A cross-sectoral regulatory measure, at EU level, was preferred to sector specific frameworks.

[14] European Commission, *Study on directors; duties and sustainable corporate governance,* 2020, available at: https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en, last accessed 9 March 2021.

[15] European Commission, *Study on due diligence requirements through the supply chain,* 2020, available at: https://op.europa.eu/en/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en, last accessed 9 March 2021.

Objectives of this public consultation

This public consultation aims to collect the views of stakeholders with regard to a possible Sustainable Corporate Governance Initiative. It builds on data collected in particular in the two studies mentioned above and on their conclusions, as well as on the feedback received in the public consultation on the Renewed Sustainable Finance Strategy[16]. It includes questions to allow the widest possible range of stakeholders to provide their views on relevant aspects of sustainable corporate governance.

Section I

Need and objectives for EU intervention on sustainable corporate governance

Questions 1 and 2 below, which seek views on the need and objectives for EU action, have already largely been included in the public consultation on the Renewed Sustainable Finance Strategy in 2020. The Commission is currently analysing those replies. In order to reach the broadest range of stakeholders possible, those questions are included again in the present consultation, also taking into account the two studies on due diligence requirements through the supply chain, as well as directors' duties and sustainable corporate governance.

Question 1: Due regard for stakeholder interests', such as the interests of employees, customers, etc, is expected of companies. In recent years, interests have expanded to include issues such as human rights violations, environmental pollution and climate change. **Do you think companies and their directors should take account of these interests in corporate decisions, alongside financial interests of shareholders, beyond what is currently required by EU law?**

✓ Yes, a more holistic approach should favour the maximisation of social, environmental, as well as economic/financial performance.

○ Yes, as these issues are relevant to the financial performance of the company in the long term.

○ No, companies and their directors should not take account of these sorts of interests.

○ Do not know.

[16] European Commission, *Consultation on the renewed sustainable finance strategy,* 2020, available at: https://ec.europa.eu/info/consultations/finance-2020-sustainable-finance-strategy_en, last accessed 9 March 2021.

Please provide reasons for your answer:

- There is a need for companies' positive and negative externalities on the environment and social aspects, such as respect for human rights, to be integrated into companies' valuation.
- Companies need to engage in a meaningful process with both internal and external stakeholders.
- Beyond externalities, companies' contribution to the environment and society should be valued per se and be reflected in companies' financial accounts.

Question 2: Human rights, social and environmental due diligence requires companies to put in place continuous processes to identify risks and adverse impacts on human rights, health and safety and environment and prevent, mitigate and account for such risks and impacts in their operations and through their value chain.

In the survey conducted in the context of the study on due diligence requirements through the supply chain, a broad range of respondents expressed their preference for a policy change, with an overall preference for establishing a mandatory duty at EU level.

Do you think that an EU legal framework for supply chain due diligence to address adverse impacts on human rights and environmental issues should be developed?

✓ Yes, an EU legal framework is needed.

○ No, it should be enough to focus on asking companies to follow existing guidelines and standards.

○ No action is necessary.

○ Do not know.

Please explain:

The UN Guiding Principles on Business and Human Rights ('UNGPs'), together with the OECD Guidelines for Multinational Enterprises and the OECD Due Diligence Guidelines, represent a landmark contribution to business and human rights.

Over the past decade, momentum has grown in the process of promoting more sustainable and responsible business conducts. In particular, different provisions have been introduced, nationally and internationally, mandating transparency and due diligence in global supply chains. To name a few: the EU Non-financial Reporting Directive, the UK Modern Slavery Act, the Australian Modern Slavery Act, the French Duty of Vigilance Law and the EU Conflict Minerals Regulations.

The existing framework is very fragmented, leading to an uneven playing field for the private sector. Moreover, this creates an uncertain legal framework, with challenges for rightsholders. The French Law on the Corporate Duty of Vigilance (the 'Vigilance Law') may have been perceived as putting the companies falling within its scope at a competitive disadvantage, especially within the context of international tender processes. Similar concerns may emerge with the Dutch Law on Child Labour and other national provisions, introducing human rights and environmental due diligence in global value chains. These legislative developments have also contributed to urge Member States to adopt similar laws and the proposed EU legal framework responds to this demand, in record time.

A mandatory due diligence framework on human rights (including health and environmental impacts), would allow the EU to act as a global leader and standard-setter, and is consistent with its commitments to human rights-focused sustainability articulated in the Green Deal and in relation to the Covid-19 recovery. Though the degree of consistency that the EU legislation can foster will depend on the form it takes, due diligence legislation (whether by way of a directive or a regulation) would promote a level regulatory playing field, at least within the EU.

It is assumed that companies will draft policies that show they are complying with mandatory human rights due diligence and with the UNGPs, and how they are aligned with the Sustainable Development Goals (SDGs). These commitments must be translated in good practices and we think that contract clauses could be a good instrument to that end. Worthy of mention, is the work of the American Bar Association's (ABA) Working Group Responsible to Draft Model Contract Clauses (MCCs) to Protect Human Rights in International Supply Chains. The Working Group is a part of the ABA Business Law Section, more specifically an ABA Business Law Section working group. The MCCs cannot be described as endorsed by the ABA or the ABA Business Law Section. Copies of the final drafts (in pdf), dated 25 January 2021, of: (1) MCCs 2.0; (2) the Building Blocks for Schedule P; and (3) Schedule Q, as approved, can be made available on demand for your future work. Future new versions may include minor changes. Their publication is expected later this year.

Question 3: If you think that an EU legal framework should be developed, please indicate which among the following possible benefits of an EU due diligence duty is important for you? *(tick the box/multiple choice)*

- ✓ Ensuring that the company is aware of its adverse human rights, social and environmental impacts and risks related to human rights violations, other social issues and the environment, and that it is in a better position to mitigate these risks and impacts.

- ✓ Contribute effectively to a more sustainable development, including in non-EU countries.

✓ Levelling the playing field, avoiding that some companies free-ride on the efforts of others.

✓ Increasing legal certainty about how companies should tackle their impacts, including in their value chain.

✓ A non-negotiable standard would help companies increase their leverage in the value chain.

✓ Harmonisation to avoid fragmentation in the EU, as emerging national laws are different.

□ Small and medium-sized enterprises (SMEs) would have better chances to be part of EU supply chains.

□ Other

Question 3a (drawbacks): Please indicate which among the following possible risks/drawbacks linked to the introduction of an EU due diligence duty are more important for you. *(tick the box/multiple choice)*

□ Increased administrative costs and procedural burden.

□ Penalisation of smaller companies with fewer resources.

□ Competitive disadvantage vis-à-vis third country companies not subject to a similar duty.

□ Responsibility for damages that the EU company cannot control.

□ Decreased attention to core corporate activities which might lead to increased turnover of employees and negative stock performance.

✓ Difficulty for buyers to find suitable suppliers which may cause lock-in effects (eg, exclusivity period/no shop clause) and have also negative impact on business performance of suppliers.

✓ Disengagement from risky markets, which might be detrimental for local economies.

✓ Other.

Please explain:

Drawing on the experience of corporate compliance with the Vigilance Law so far, there is a risk of falling into a box-ticking exercise, where companies may be inclined to adopt a minimum compliance approach to the legislation, rather than implementing measures in line with the Vigilance Law. Strict compliance would not properly focus on implementing effective due diligence processes. To mitigate this risk, future EU legislation should ensure that it contains specific mandatory measures (both for the implementation and sanctions) and standards so that, in addition to process-driven requirements (such as reporting requirements), certain minimum standards of due diligence are ensured. The EU should strongly consider how to best offer guidance to companies subject to the legislation, as well as to provide for a solid enforcement mechanism.

In order to avoid companies' disengagement from risky markets, which would be detrimental for local economies, companies should be given a transition period of grace to improve their standards in global supply chains. This will enable them to retain their workers, while they improve the conditions. This could be subjected to quarterly audits or similar (depending on their non-compliance).

Contrary to the conventional wisdom, it has been argued, more and more, that complying with human rights and environmental due diligence is becoming a competitive advantage.

Section II

Directors' duties

Question 5: Which of the following interests do you see as relevant for the long-term success and resilience of the company?

	Relevant	Not relevant	I do not know or I do not take position
The interests of shareholders	✓	○	○
The interests of employees	✓	○	○
The interests of employees in the company's supply chain	✓	○	○
The interests of customers	✓	○	○
The interests of persons and communities affected by the operations of the company	✓	○	○

	Relevant	Not relevant	I do not know or I do not take position
The interests of persons and communities affected by the company's supply chain	✓	○	○
The interests of local and global natural environment, including climate	✓	○	○
The likely consequences of any decision in the long term (beyond 3–5 years)	✓	○	○
The interests of society, please specify	✓	○	○
Other interests, please specify	○	○	○

Please specify:

The long-term success of a company is inextricably intertwined with the ability of the latter to take count of ESG/SDGs risks and opportunities.[17]

In the first instance, recent empirical and academic studies have shown that ESG factors are financially material.[18] This is particularly true when looking at the long-term economic success of companies.[19] Moreover, the pandemic has shown that sustainable companies have been more resilient amidst the crisis.[20]

These figures are supported by the increasing interest of investors and financial intermediaries in 'sustainable' financial products. Since the launch, in 2006, of the UN-backed Principles for Responsible Investment (PRI), over 3,000 signatories (including investment companies) have joined this initiative, amounting to a total of US$103.4tn.[21] PRI's signatories commit to incorporating ESG issues in their investment analysis and

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[17] L Fink's 2019 Letter to CEOs, *Profit and Purpose*, available at: www.blackrock.com/americas-offshore/en/2019-larry-fink-ceo-letter, last accessed 30 Jan 2021.

[18] UNEP FI and PRI, *Fiduciary Duty in the 21st Century: Final Report*, October 2019, available at: www.fiduciaryduty21.org/publications.html, last accessed 30 Jan 2021.

[19] UNEP FI and PRI, *Fiduciary Duty in the 21st Century: Final Report*, October 2019, p 17, available at: www.fiduciaryduty21.org/publications.html, last accessed 30 Jan 2021.

[20] Inception impact assessment, Sustainable Corporate Governance, p 4.

[21] According to the PRI's quarterly update of March 2020. See R Randazzo et al, Impact Economy Digital Edition 2021, Lexology, January 2021.

decision-making processes and, over the years, there has been a steady increase in the number of signatories.[22]

The interest of investors in sustainability has also been confirmed by Laurence D Fink, Chief Executive Officer of Blackrock, one of the biggest investors with a portfolio of US$600tn.[23] In his 2018 and 2019 letters to the CEOs of the companies in his portfolio, he called on companies to embody ‘purpose’ in their business model and corporate strategy. In particular, he clarified that ‘when a company truly understands and expresses its purpose, it functions with the focus and strategic discipline that drive long-term sustainability’.[24] As a response to this request, in 2019, an organisation of CEOs of the largest companies in the United States has published a statement in which the commitments to take into consideration the interests of stakeholders were expressed.[25]

Question 6. Do you consider that corporate directors should be required by law to: (1) identify the company’s stakeholders and their interests; (2) to manage the risks for the company in relation to stakeholders and their interests, including on the long run; and (3) to identify the opportunities arising from promoting stakeholders’ interests?

	I strongly agree	**I agree to some extent**	**I disagree to some extent**	**I strongly disagree**	**I do not know or I do not take position**
Identification of the company’s stakeholders and their interests	✓	○	○	○	○
Management of the risks for the company in relation to stakeholders and their interests, including on the long run	✓	○	○	○	○
Identification of the opportunities arising from promoting stakeholders’ interests	✓	○	○	○	○

[22] UNEP FI and PRI, *Fiduciary Duty in the 21st Century: Final Report*, October 2019, p 19, available at: www.fiduciaryduty21.org/publications.html last accessed 30.01.2021.

[23] A Jan A J Eijsbouts, ‘Corporate Governance and Responsibility for Sustainability’, p 22, in *Corporate Social Responsibility – Sustainable Business – Environmental, Social and Governance Frameworks for the 21st Century*, in R Lindsay and R Martella (eds), Wolters Kluwer and IBA, 2020.

[24] L Fink’s 2019 Letter to CEOs, *Profit and Purpose*, available at: www.blackrock.com/americas-offshore/en/2019-larry-fink-ceo-lette, last accessed 30 Jan 2021.

[25] Business Roundtable 2019b: ‘*Statement on the purpose of a corporation*’, available at: https://system.businessroundtable.org/app/uploads/sites/5/2021/02/BRT-Statement-on-the-Purpose-of-a-Corporation-Feburary-2021-compressed.pdf, last accessed 3 Feb 2021.

Please explain:

It is certainly significant to note that the urgent need to meet the objectives of sustainable development goals (SDG)s, as well as other important targets such as those set out in the Paris Agreement on Climate Change, does not currently receive a sufficient response from the private sector, without whose transition and adaptation to sustainability criteria it is not possible to achieve such objectives.

The increasing attention paid to sustainability by investors and businesses has raised important questions regarding the role of corporate governance and directors' duties. From a legal perspective, directors are thought to be responsible for the success of the company.[26] Apart from few exceptions, this duty has been interpreted in a narrow way, by identifying and equating the interests of the company to the interest of shareholders.[27] ESG investments are still, predominantly, voluntary and market-based mechanisms appear insufficient to promote the long-term value of businesses and society at large. In this context a regulatory intervention, with a clarification focused on directors' duties to identify and manage ESG risks, is a necessary action.

In addition, a similar intervention appears crucial, even in jurisdictions in which directors' duties have been interpreted in a broader sense. For instance, in the UK, Section 172 of the Companies Act clarifies that directors should consider the success of the company for the benefit of society as whole ('enlightened shareholder value' model).[28] Similarly, in the Netherlands, directors of Dutch companies have a duty to exercise due care with respect to the interests of 'external' stakeholders, which 'means that they may need to refrain from doing things that would unnecessarily or unduly harm those interests'.[29]

Even though these examples represent an important step towards a greater integration of societal considerations into business models, the practical implications of these provisions are still unclear. Consequently, more guidance is needed with regard to how directors can strike a balance between shareholders' and stakeholders' interests, when they diverge. Moreover, these 'enlightened' models represent the exception and the introduction of clear legal obligations, across the EU, would level the playing field, increase legal certainty, as well as cross-border sustainable investments.

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[26] European Commission, *Study on directors; duties and sustainable corporate governance,* 2020, p 32, available at: https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en, last accessed 3 Feb 2021.

[27] *Ibid*, p 9.

[28] In doing so, they have to regard the following aspects: '(a) the likely consequences of any decision in the long term, (b) the interests of the company's employees, (c) the need to foster the company's business relationships with suppliers, customers and others, (d) the impact of the company's operations on the community and the environment, (e) the desirability of the company maintaining a reputation for high standards of business conduct, and (f) the need to act fairly as between members of the company.'

[29] EU Study on due diligence requirements through the supply chain: Final Report, p 174.

Notice that a distinction should be drawn between responsible companies that aim to integrate ESG factors (risks and opportunities) into their strategy and those companies intentionally pursuing a positive, social and environmental impact as part of their mission – the latter being the case of purpose-driven companies and profit-with-purpose companies (among the several models and legal forms of enterprises which belong to the impact economy and the so-called 'fourth sector').[30] Directors' duties should be regulated, taking this difference into account.

This distinction would also be consistent with the EU Regulation 2019/2088 on sustainability-related disclosures in the financial services sector. Such Regulation combines the two typical approaches of sustainable finance. On the one hand, starting from the definition of sustainability risks and adverse sustainability impacts, the Regulation imposes transparency obligations on sustainability (Articles 3–7) following the typical 'negative' ESG approach. On the other hand, through the definition of sustainable investments, it endorses and regulates (Articles 8–11) the 'positive' approach typical of impact investors.[31]

In parallel, Regulation (EU) 2020/852, partly amending Regulation (EU) 2019/2088 and establishing a framework to facilitate sustainable investment, defines which economic activities can be legally considered environmentally sustainable. It sets a common language for sustainability, namely a taxonomy, made of technical criteria and a classification system (Article 3) under which an activity is considered sustainable whether:

- it makes a substantial contribution to one of the six listed environmental objectives; and
- it does not significantly harm the other objectives.

Once again, the two sides of sustainability and stakeholder engagement, the risk-based and the opportunity-based approaches, come to the fore. In the end, the integration, by law, of stakeholders' interests within the company's interest, as well as part of directors' duty of care, would be coherent with the current EU approach on sustainable finance[32] and with the evolution in terms of fiduciary duties of financial actors, which is also aimed at encompassing stakeholders' interests.[33]

Finally, directors' duty of care shall not be understood, strictly speaking, as a common law concept. This obligation should be understood more widely and should not contradict equivalent notions/standards of conduct in civil law jurisdictions.

Question 7: Do you believe that corporate directors should be viewed as tools to allow companies to be in position to contribute to a more holistic approach

[30] For a distinction between these categories, see: Global Sustainable Investment Alliance, Global Sustainable Investment Review, 2018, available at: http://www.gsi-alliance.org, last accessed 31 Jan 2021.

[31] Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector, available at https://eur-lex.europa.eu/eli/reg/2019/2088/oj, last accessed 03 Feb 2021.

[32] Directorate-General for Communication, *Sustainable Finance*, European Commission, 4 July 2020, available at: ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en, last accessed 03 Feb 2021.

[33] UNEP FI and PRI, *Fiduciary Duty in the 21st Century: Final Report*, October 2019, available at: www.fiduciaryduty21.org/publications.html, last accessed 30 Jan 2021.

to business, taking into account the maximisation of social, environmental, as well as economic/impacts are identified, prevented and addressed?

- ✓ I strongly agree
- ○ I agree to some extent
- ○ I disagree to some extent
- ○ I strongly disagree
- ○ I do not know
- ○ I do not take position

Please explain:

An approach based on procedures and measurable (science-based) targets would be key to assess, on the basis of objective elements, qualitatively and quantitatively determinable, the real impact of the company on society and stakeholders. This approach based on measurability would ensure that, besides possible risks, the positive impacts are identified and addressed. Measuring and reporting on a company's impact would make it easier to assess other key aspects of a company's sustainable corporate governance, such as, for example, the strategic perspective for the company over sustainability, board remuneration linked to the achievement of impact objectives, compliance between directors' duties and the company's interest, adequate involvement of stakeholders, as well as any liability of directors in the event of failure to fulfil their duty of care over sustainability.

The existence of measurable targets would make companies more attractive to investments, which are increasingly sensitive to ESG issues. As recently stated by Larry Fink in his 2021 letter to CEOs, '[a]ssessing sustainability risks requires that investors have access to consistent, high-quality, and material public information'.[34] In the absence of a regulatory intervention, companies have been adopting private standards. To name a few, those developed by the Sustainability Accounting Standards Board; the Task Force on Climate-related Financial Disclosures; Climate Disclosure Standards Board; the Global Reporting Initiative (GRI); and International Integrated Reporting Council.

However, the absence of a common language regarding sustainability creates legal uncertainty, increases risks for greenwashing and reduces the opportunity for comparability and cross-national investments. Consequently, the law should clarify which procedures and targets are necessary, in the context of sustainability, for both companies and directors. This should be coordinated with the current attempt to set a classification system to establish, based on technical criteria, which economic activities can be considered environmentally

[34] L Fink's 2019 Letter to CEOs, *Profit and Purpose,* available at: www.blackrock.com/americas-offshore/en/2019-larry-fink-ceo-letter, last accessed 30 Jan 2021.

sustainable (EU Taxonomy).[35] In this sense, the delegated acts[36] under discussion by the European Commission and implementing the taxonomy Regulation, represent a first regulatory and science-based step towards the definition of common standards and certifications that would facilitate the measurement, verification and comparison of the outcomes/impacts of economic activities under a social and environmental perspective.[37]

Question 8: Do you believe that corporate directors should balance the interests of all stakeholders, instead of focusing on the short-term financial performance interests of shareholders, and that this should be clarified in legislation as part of directors' duty of care?

- ✓ I strongly agree
- ○ I agree to some extent
- ○ I disagree to some extent
- ○ I strongly disagree
- ○ I do not know
- ○ I do not take position

Please provide an explanation or comment:

See our response to Question 5 above.

Question 9: Which risks do you see, if any, should the directors' duty of care be spelled out in law as described in Question 8?

Please comment:

Risks to consider would be, inter alia:

- Risk of legal uncertainty in the event of imprecise wording and absence of defined terms that would leave a large margin of appreciation to the courts (ie, what are long terms interests? What are stakeholders for the purpose of identifying the law?). Moreover, this uncertainty, could lead to potential conflicts between stakeholders'/shareholders' interests and impose an excessive burden in balancing

[35] Directorate-General for Communication, *EU Taxonomy for Sustainable Activities*, European Commission, 23 Dec 2020, available at: ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en, last accessed 30 Jan 2021.

[36] Directorate-General for Financial Stability, Financial Services and Capital Markets Union, *Draft DELEGATED REGULATION to Regulation (EU) 2020/852 on Criteria for Climate Change Mitigation or Adaptation*, EUR, European Commission, Nov 2020, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=PI_COM:Ares(2020)6979284, last accessed 30 Jan 2021.

[37] *Ibid.*

such interests upon directors. This could generate a lot of case law (increasing litigation costs), in the attempt to clarify the meaning of such provisions, with possible delays in the actual enforcement of these provisions.

- On the other hand, excessively prescriptive provisions, could lead to a checklist approach, with the risk of turning companies' and directors' obligations in a box-ticking exercise and the consequent risks of 'greenwashing'.
- There has been an ongoing discussion over the years about the role of directors' and officers' liability insurance (D&O liability insurance). We believe that, especially if a legal framework on mandatory human rights and environmental due diligence – as the proposed one – is adopted, insurance companies will increasingly demand that boards and their officers comply with their obligations (if they want to be insured). We believe it is premature to discuss who would be responsible to watch proper compliance.

How could these possible risks be mitigated?

Please explain:

In order to mitigate the first two risks, the law should clarify the duty of directors on the basis of a process-based approach. In this way, directors and stakeholders would have sufficient clarity in relation to the necessary steps to integrate ESG factors in their decision-making process. This would reduce the risks of uncertainty and would provide sufficient guidance, in case of litigation. At the same time, this approach would provide directors with a sufficiently discretionary power of balancing such different interests. This choice would be consistent with a risk-based approach, defined by due diligence standards and would reduce the opportunity for a box-ticking exercise.

Moreover, this approach would reduce the potential conflicts of interests between stakeholders/shareholders. It would be equally important to attribute functions of supervision/control over such balancing acts in the hands of the competent bodies, as well as specific advisory bodies, with specific competence over sustainability. In this regard, it might be appropriate, drawing on what has been proposed in relation to due diligence and corporate accountability,[38] to expressly provide for an obligation for Member States to ensure that the companies' governing body has the necessary qualifications, knowledge and expertise with regard to sustainability. In addition, companies might be required to disclose and audit their sustainability procedures, measurement and objectives, on an ongoing basis.

Lastly, companies might be required to define their sustainability objectives and procedures in their bylaws or, alternatively, in internal documents/policies, depending on the degree of transparency/commitment deemed preferable. Similar obligations have already been

[38] See Motion for a European Parliament Resolution with Recommendations to the Commission on Corporate Due Diligence and Corporate Accountability, Article 12 on '*Expertise on due diligence*', which states that: '1. Member States shall ensure that the governing body of the undertaking has the necessary qualifications, knowledge and expertise as regards due diligence.'

introduced in the context of specific companies, such as the benefit corporations[39] and social enterprises.[40]

Where directors widely integrate stakeholder interest into their decisions already today, did this gather support from shareholders as well?

Please explain:

If, on the one hand, there might be the risk of conflicts between stakeholders'/shareholders' interests, on the other hand, such interests might overlap. The second hypothesis arises when shareholders include subjects who, for example in fulfilment of their fiduciary duties, require the company to consider ESG risks and opportunities.

In this sense, the recent ESG and impact investing regulation in the financial sector, and the evolution of fiduciary duties, encourage a rapid overlap of shareholders'/stakeholders' interests, especially in large companies with institutional or professional investors. See response to Question 5 above.

Question 10: As companies often do not have a strategic orientation on sustainability risks, impacts and opportunities, as referred to in questions 6 and 7, do you believe that such considerations should be integrated into the company's strategy, decisions and oversight within the company?

✓ I strongly agree

○ I agree to some extent

○ I disagree to some extent

○ I strongly disagree

○ I do not know

○ I do not take position

Please explain:

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39 See the Italian *Societàa Benefit* (Law 208/2015, Art 1, paras 376–384 and, in particular, with regard to impact measurement, Annexes 4 and 5, on the *External Assessment Standard* and *Assessment Areas* respectively). See also, on a similar basis, the French mission-driven company (or *Société à mission*), adopted in France in 2019 and requiring the mission-driven companies to add a 'purpose' ('*raison d'être*'), based on specific social and/or environmental objectives, into the bylaws.

40 See for instance the *Impresa sociale* (Italy, Legislative Decree 112/2017); the *Société d'impact societal*, (Luxemburg, Law 12 December 2016); the *Community Interest Company* (United Kingdom, the Companies Act 2006, Part 1, Section 6); the *Entreprise de l'économie sociale et solidaire* and the *Enterprise solidaire d'utilité sociale* (France, Law 2014-856). See also the EU Parliament 2018 recommendation to the EU Commission for adoption of a *Statute for Social and Solidarity-based Enterprises*.

In addition to intervening with respect to the scope of the directors' duty of care, it would certainly be appropriate to intervene also at the level of strategy, decisions and oversight within the company. A greater integration of ESG factors into business models is, in fact, necessary to change corporate culture and limit the risks of greenwashing. Moreover, a more cohesive approach to ESG should also be reflected in the internal governance of businesses. These elements should be considered by, not only, corporate social responsibility (CSR) departments but also procurement, legal and compliance teams should be involved.

In this sense, the discipline of benefit corporations[41] once again serves as a model, as it incorporates a strategic orientation on sustainability risks, impacts and opportunities, integrating them into decision-making processes and relying on the principles of transparency and inclusion of stakeholders, as well as on reporting and measurement tools. Benefit corporations are impact organisations expressively regulated by the law and firstly introduced, since 2010, in 36 states in the US. This legal model is now legally recognised also in Italy (the first non-US country to adopt a specific legislation, in 2016), Colombia (2018), Puerto Rico (2018), British Columbia, Canada (2019) and, on a similar basis, France (2019). Similarly, more than 12 countries have ongoing legislative processes aimed at such recognition (ie, Argentina, Australia, Chile, Korea, Peru, Spain, Taiwan and Uruguay).

As an example, the Italian law on benefit corporation, establishing the so called *società benefit*, rests on two fundamental pillars, deliberately and appropriately left 'open' in their structure: the definition of common benefit objectives in the bylaws and the implementation of an impact assessment in the annual report.

This deliberately leaves it up to the company to select its own sustainability strategy, while at the same time introducing a measurement and disclosure mechanism that ensures transparency and verifiability, in objective terms, of a company's sustainability. This second aspect, measurement, is certainly key to a positive evolution of corporate sustainability and, on this point, it should be noted that the Italian law on *società benefit*, with regard to impact assessment, introduces specific guidelines that are partly inspired by the B Impact Assessment of B Corps.[42]

Enforcement of directors' duty of care be insurable? Could this duty be devolved to a compliance officer (with associated responsibility)?

Today, enforcement of directors' duty of care is largely limited to possible intervention by the board of directors, the supervisory board (where such a separate board exists) and the general meeting of shareholders. This has arguably contributed to a narrow understanding of the duty of care according to which directors are required to act predominantly in the short-term financial interests of shareholders. In addition, currently, action to enforce directors' duties is rare in all Member States.

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[41] See Question 9.

[42] The B Corp label, registered by the non-profit organisation B Lab, certifies organisations that pass a complex assessment – the B Impact Assessment – of their governance, community, employee, customer and environmental impacts (see Honeyman, Jana e Marcario, *The B Corp Handbook: How You Can Use Business as a Force for Good*, 2nd edition, Berrett-Koehler Publishers, Oakland, CA, 2019).

Question 11: Are you aware of cases where certain stakeholders or groups (such as shareholders representing a certain percentage of voting rights, employees, civil society organisations or others) acted to enforce the directors' duty of care on behalf of the company? How many cases? In which Member States? Which stakeholders? What was the outcome?

As discussed under Question 13, stakeholders are not entitled to bring a direct action against directors. Failure to meet sustainability standards and to prevent human rights and environmental violations in the context of business operations can have negative impacts on businesses. The regulatory and reputational costs associated with these events can be seen as a failure of directors to act in the interest of the company. In this context, shareholders can bring legal actions against directors on behalf of the company (derivative actions). However, these actions are characterised by several constraints (eg, business judgement rule, they are often secondary to direct actions of the board, minimum percentage of shareholders).[43] For these reasons shareholders suits remain rare in Europe.[44]

Additional legal actions can be brought against publicly listed companies and their directors, for untrue, misleading or wrongfully omitted statements (either in a company's prospectus, or in a public statement made during normal day-to-day running of business, eg, under Directive 2004/109/EC). A recent example is represented by the so called 'Dieselgate scandal', which had cost the company a 37 per cent drop in its share price and more than €30bn in damages and regulatory fines, mainly imposed in the US.[45] In March 2019, the US Securities and Exchange Commission charged Volkswagen AG, two of its subsidiaries and its former CEO, Martin Winterkorn, 'for defrauding US investors, raising billions of dollars through the corporate bond and fixed income markets while making a series of deceptive claims about the environmental impact of the company's "clean diesel" fleet.'[46] However, in 2020, a US District Judge granted VW's motion to dismiss claims that it had misinformed investors when issuing around US$13bn of bonds and asset-based securities between the years 2014 and 2015.[47] Similarly, the charges against Volkswagen's CEO were dismissed by a German Court in May 2020, after the company agreed to pay a fine of €9m (US$9.9m)

[43] Gelter, Martin, *Mapping Types of Shareholder Lawsuits Across Jurisdictions* (July 2, 2018). *Research Handbook on Shareholder Litigation* by Jessica Erickson, Sean Griffith, David Webber and Verity Winship, eds, 2018, Fordham Law Legal Studies Research Paper No 3011444, ECGI – Law Working Paper No 363/2017, available at SSRN: https://ssrn.com/abstract=3011444.

[44] Gelter, Martin, *Why do Shareholder Derivative Suits Remain Rare in Continental Europe*? (7 February 2012), Brooklyn Journal of International Law, vol 37, no 3, 2012, Fordham Law Legal Studies Research Paper No 2000814, ECGI – Law Working Paper No 190/2012, Available at SSRN: https://ssrn.com/abstract=2000814 or http://dx.doi.org/10.2139/ssrn.2000814.

[45] P Herbert & E Herbel, Business Case for CSR, ESG and Responsible Business, p 58, in R Lindsay and R Martella (Eds), *Corporate Social Responsibility – Sustainable Business: Environmental, Social and Governance Frameworks for the 21st Century*, Wolters Kluwer, 2020.

[46] 'SEC Charges Volkswagen, Former CEO With Defrauding Bond Investors During "Clean Diesel" Emissions Fraud', *US Securities and Exchange Commission*, United States Government, 14 Mar 2019, www.sec.gov/news/press-release/2019-34.

[47] Stempel, Jonathan, and David Shepardson, 'Judge Narrows U.S. Securities Lawsuit against VW over Diesel Emissions', *Automotive News Europe*, Reuters, 20 Aug 2020, available at: europe.autonews.com/automakers/judge-narrows-us-securities-lawsuit-against-vw-over-diesel-emissions.

over the diesel emissions scandal.[48] Criminal investigations for fraud are still pending against several top executives and the former CEO has been indicted.[49]

Finally, shareholders can take actions against directors for breach of their fiduciary duty, through their activism. A recent example is represented by the *Rio Tinto* case. The mining corporation Rio Tinto blasted rock shelters that held significance to the Indigenous Puutu Kunti Kurrama and Pinikura peoples of Australia. The consequent publication of the Board Review indicated that only financial penalties were to be imposed upon the senior executives that were involved. Displeased with the lack of consequences, stakeholders applied pressure for executive accountability, a move that ultimately led to the stepping down of three senior executives (including the CEO of Rio Tinto).[50]

Question 12: What was the effect of such enforcement rights/actions? Did it give rise to case law/ was it followed by other cases? If not, why?

Please describe:

See answer to Question 11.

Question 13: Do you consider that stakeholders, such as for example employees, the environment or people affected by the operations of the company as represented by civil society organisations, should be given a role in the enforcement of directors' duty of care?

- ✓ I strongly agree
- ○ I agree to some extent
- ○ I disagree to some extent
- ○ I strongly disagree
- ○ I do not know
- ○ I do not take position

Please explain your answer:

[48] Reuters Staff, 'German Court Ends Diesel Case against Volkswagen CEO, Chairman' *Reuters*, Thomson Reuters, 20 May 2020, www.reuters.com/article/us-volkswagen-court-idUSKBN22W1UZ.

[49] P Herbert & E Herbel, 'Business Case for CSR, ESG and Responsible Business', p 58, in R. Lindsay and R. Martella (Eds), *Corporate Social Responsibility – Sustainable Business: Environmental, Social and Governance Frameworks for the 21st Century*, Wolters Kluwer, 2020.

[50] Johnson, Rachael, *Juukan Gorge Incident and Covid-19 Pandemic Highlight Focus on ESG*, IBA, 2 Dec 2020, www.ibanet.org/Article/NewDetail.aspx?ArticleUid=0B0F4134-F037-4C73-9456-DBF89429CEE2.

Even though the scope of directors' duties is slowly expanding to include sustainability (see response to Question 11), stakeholders do not have a direct right to enforce these duties. They can only seek remedies to the environmental and human rights harm, caused by companies, their subsidiary or supply chain partner. These legal actions could, potentially, affect directors through direct or derivative actions by the company or by shareholders. However, tort law litigations against transnational corporations have proven to be challenging, in providing access to remedy to victims.[51]

This is, particularly, true when considering that human rights and environmental harm often occur in third countries. As highlighted in the study published by the EU Fundamental Rights Agency in October 2020[52] (and as discussed in Question 19b below), these challenges are: access to court for victims (eg, scarce financial resources; power imbalance; inadequate access to information; lack or insufficient legal representation; and issue related to burden of proof); barriers related to international private law (eg, jurisdictional issues in relation to harm that occurred abroad) and protection of human rights defenders.

For this reason, we welcome the opportunity to ensure that stakeholders have the legal right to enforce directors' duty of care. This right should, not only, amount to the possibility for affected rightsholders to seek justice, but it should include the possibility to intervene before harm occurs, in case of failure to undertake meaningful due diligence steps. For example, the French Duty of Vigilance Law has introduced the possibility for stakeholders to bring actions against companies for failing to comply with the provisions of the Vigilance Law, irrespective of whether any actual damage has been sustained (injunction).[53] The EU Directive could expand this provision, including the right of stakeholders to directly, enforce directors' duty of care.

In this context, particular attention should be paid to the empowerment and protection of rights holders. Consistent with UNGP 26, 'States should take appropriate steps to ensure the effectiveness of domestic judicial mechanisms when addressing business-related human rights abuses, including considering ways to reduce legal, practical and other relevant barriers that could lead to a denial of access to remedy'. Consequently, barriers to access to remedy (whether financial, cultural, or procedural) should be removed. In addition, the remedial process has to provide a safe space for rights holders (and human rights defenders), protecting them from the risk of reprisal and building trust that solutions will be offered to them (as part of showing good faith).

The IBA, through the Human Rights Institute,[54] and the ABA Justice Defenders Program have conducted important activities to support human rights defenders and lawyers at risk.

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[51] European Union Agency for Fundamental Rights, *Business and Human Rights – Access to Remedy*, 8 Oct 2020, available at: fra.europa.eu/en/publication/2020/business-human-rights-remedies.

[52] *Ibid*.

[53] Brabant, Stephane, and Elsa Savourey, *All Eyes on France – French Vigilance Law First Enforcement Cases (1/2) Current Cases and Trends*, Cambridge University Press, 28 Jan 2020, available at: www.cambridge.org/core/blog/2020/01/24/all-eyes-on-france-french-vigilance-law-first-enforcement-cases-1-2-current-cases-and-trends/#_edn13.

[54] IBA, 'International Bar Association's Human Rights Institute (IBAHRI) Home', www.ibanet.org/IBAHRI.aspx.

Moreover, the publication *Shared Space under Pressure*,[55] endorsed by the ABA in the summer of 2018, clarifies the importance of building trust between rightsholders, states and civil society organisations.

Question 13a: In case you consider that stakeholders should be involved in the enforcement of the duty of care, please explain which stakeholders should play a role in your view and how.

Please comment:

There are two types of stakeholders: internal (eg, workers) and external ones (eg, affected communities). Internal stakeholders in some jurisdictions (eg, France, Germany and the Netherlands) are already given a voice at the board level and are provided with significant protection. As far as external stakeholders are concerned, affected rightsholders and civil society representing their interests should be entitled to bring legal actions against directors. As discussed in our response to Question 13, clarity regarding which stakeholders are entitled is key to make the process manageable and meaningful and to ensure legal certainty. To this end, at this stage, we would not favour establishing a regime of strict liability but would rather recommend considering a regime of liability where a link of causality with the harm sustained is established. The onus should rest on the company to establish that it did follow the requirements of mandatory due diligence in the way it is managing its value chain/big footprint projects.

Section III: Due diligence duty

For the purposes of this consultation, 'due diligence duty' refers to a legal requirement for companies to establish and implement adequate processes with a view to prevent, mitigate and account for human rights (including labour rights and working conditions), health and environmental impacts, including relating to climate change, both in the company's own operations and in the company's supply chain. 'Supply chain' is understood within the broad definition of a company's 'business relationships' and includes subsidiaries as well as suppliers and subcontractors. The company is expected to make reasonable efforts, for example, with respect to identifying suppliers and subcontractors. Furthermore, due diligence is inherently risk-based, proportionate and context specific. This implies that the extent of implementing preventing or mitigating actions should depend on the risks of adverse impacts the company has identified as possibly causing, contributing to or should foresee.

Question 14: Please explain whether you agree with this definition and provide reasons for your answer.

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[55] 'Shared Space under Pressure: Business Support for Civic Freedoms and Human Rights Defenders', *Business and Human Rights Gateway*, 18 Oct 2018, available at: humanrights.wbcsd.org/project/share-space-under-pressure-business-support-for-civic-freedoms-and-human-rights-defenders.

Please comment:

Clarification should be needed:

Scope:

- Building on the experience of the Vigilance Law, the scope of the due diligence duty (and hence of the legislation on the topic) would need to be as precise as possible, to limit interpretation debates and avoid a differentiated implementation of the law by companies falling in its scope.

- What are the 'companies' subject to such a due diligence duty? Are state entities to be included or only private commercial entities? An EU legal framework could potentially reach a large number of companies. The greater the number of companies engaging in due diligence, the greater the number of supply chains surveyed.

- The definition of the 'supply chain' would need to be clarified. 'Business relationships' is a term used by the UNGPs to mean all business relationships, whether in the supply chain or value chain. While the terms 'value chain' and 'supply chain' are often used interchangeably, they don't have the same meaning. The UNGPs and the Corporate Due Diligence and Corporate Accountability European Added Value Assessment from the European Parliament, when referring to the corporate due diligence duty, use the 'value chain' concept rather than the supply chain concept. The UNGPs, Guiding Principle 13(b), note businesses should '[s]eek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts.' The Commentary to Guiding Principle 13 highlights that 'business enterprises may be involved in adverse human rights impacts either through their own activities, or as a result of their business relationships with other parties', where 'business relationships' are understood to include also relationships with 'entities in its value chain, and any other non-State or State entity directly linked to its business operations, products or services'.[56]

- What exactly is the term 'business relationships' intended to mean in this context? The definition adopted for the purposes of the consultation indicates that it 'includes' both 'suppliers and subcontractors'. However, if the intention is to exclude entities in the value chain, this needs to be expressed, since some businesses (eg, those implementing the UNGPs) will already have processes in places which integrate the wider definition. Further, for suppliers and subcontractors, should a threshold, referable to either size or the significance of the supplier/subcontractor, be included (similarly to the Vigilance Law)?

Substance:

- The fact that 'health and environmental impacts' are put together raises the possibility that one will be defined and appreciated by reference to the other. While environmental impacts undeniably have impacts on human health, environmental impacts should also be captured independently regardless of any immediate impact they may have on human

[56] *Supply Chains*, National Action Plans on Business and Human Rights, 15 Sept 2020, available at: globalnaps.org/issue/supply-chains.

beings. This point would be consistent with some jurisdictions, such as France, where the Vigilance Law applies specifically to risks and severe impacts to the environment.

Others:

- 'Reasonable efforts': a test of reasonableness should be considered to offer guidance as to the meaning of this concept.

- '… should depend on the risks of adverse impacts the company is possibly causing, contributing to or should foresee': while causing and contributing are concepts taken from the UNGPs it is unclear what 'foresee' refers to and how it should be appreciated. These different terms should be defined. Furthermore, in the event a remediation mechanism was connected to the due diligence duty, how would the concepts of 'possibly causing', 'contributing' to, 'or should foresee' be translated into the domestic tort law of EU Member States? In accordance with the UNGPs, a business enterprise can be involved with an adverse human rights impact, either through its own activities or as a result of its business relationships. With regards to this latter form, the enterprise might contribute to a harm caused by a third party or when its operations, products or services are directly linked through its business relationship to a harm. As specified above, cause and contribute are taken from the UNGPs. The expression 'should foresee' needs to be defined and should be interpreted as 'directly linked' to the harm, as defined by UNGP 19.

- '… due diligence is… proportionate': does this concept refer to the idea of proportionality mentioned in comment under principle 14 of the UNGPs? Within a European context, this term could be an invitation to apply established proportionality tests under EU law to a company' due diligence obligations, perhaps an unintended consequence with that choice of words. Hence the need to define this term carefully.

Question 15: **Please indicate your preference as regards the content of such possible corporate due diligence duty.** *(tick the box, only one answer possible)*

Please note that all approaches are meant to rely on existing due diligence standards, such as the OECD guidance on due diligence or the UNGPs.

Please note that Options 1, 2 and 3 are horizontal, that is, cross-sectorial and cross-thematic, covering human rights, social and environmental matters. They are mutually exclusive. Options 4 and 5 are not horizontal, but theme- or sector-specific approaches. Such theme-specific or sectorial approaches can be combined with a horizontal approach (see Question 15a). If you are in favour of a combination of a horizontal approach with a theme- or sector-specific approach, you are requested to choose one horizontal approach (Option 1, 2 or 3) in this question.

- ○ *Option 1. ‘Principles-based approach’*:

  A general due diligence duty based on key process requirements (such as for example identification and assessment of risks, evaluation of the operations and of the supply chain, risk and impact mitigation actions, alert mechanism, evaluation of the effectiveness of measures, grievance mechanism, etc.) should be defined at EU level regarding identification, prevention and mitigation of relevant human rights, social and environmental risks and negative impact. These should be applicable across all sectors. This could be complemented by EU-level general or sector specific guidance or rules, where necessary.

- ○ *Option 2. ‘Minimum process and definitions approach’:*

  The EU should define a minimum set of requirements with regard to the necessary processes (see in option 1) which should be applicable across all sectors. Furthermore, this approach would provide harmonised definitions for example as regards the coverage of adverse impacts that should be the subject of the due diligence obligation and could rely on EU and international human rights conventions, including International Labour Organization (ILO) labour conventions, or other conventions, where relevant. Minimum requirements could be complemented by sector specific guidance or further rules, where necessary.

- ✓ ***Option 3. ‘Minimum process and definitions approach as presented in Option 2 complemented with further requirements in particular for environmental issues’.***

  This approach would largely encompass what is included in option 2 but would complement it as regards, in particular, environmental issues. It could require alignment with the goals of international treaties and conventions based on the agreement of scientific communities, where relevant and where they exist, on certain key environmental sustainability matters, such as for example the 2050 climate neutrality objective, or the net zero biodiversity loss objective, and could reflect also EU goals. Further guidance and sector specific rules could complement the due diligence duty, where necessary.

- ○ *Option 4 ‘Sector-specific approach’:*

  The EU should continue focusing on adopting due diligence requirements for key sectors only.

- ○ *Option 5 ‘Thematic approach’:*

  The EU should focus on certain key themes only, such as for example slavery or child labour.

Please comment:

Question 15a: If you have chosen Option 1, 2 or 3 in Question 15 and you are in favour of combining a horizontal approach with a theme or sector specific approach, please explain which horizontal approach should be combined with regulation of which theme or sector?

Please comment:

See answer to Question 15 b, below.

Question 15b: Please provide explanations as regards your preferred option, including whether it would bring the necessary legal certainty and whether complementary guidance would also be necessary.

Directive 2014/95/EU of 22 October 2014, on the disclosure of non-financial information by certain large undertakings and groups,[57] indeed, imposes large companies to disclose non-financial information in the management report. The mandatory corporate due diligence should be coherent to the above-mentioned Directive in the sense that it should not be sector-specific. The thematic approach should be discouraged as this would be too fragmented and might result in a disproportionate focus on certain themes rather than others.

Also, as it did for the NFRD, the European Commission should provide public guidance on how to discharge the obligations specified by the corporate mandatory due diligence directive. A complementary guidance is crucial. With the idea to level the playing field among EU Member States, the more harmonisation that can be provided at EU level, the better. Key processes and definitions should be the same across the EU. It will also minimise the risk of divergent interpretation and implementation of the due diligence provisions across Member States.

Incorporating minimum requirements which refer to EU and internationally recognised human rights and conventions is appropriate. Firstly, there are minimum internationally recognised human rights laws referred to in the UNGPs (at a minimum, those expressed in the International Bill of Human Rights and the principles concerning fundamental rights set out in the International Labour Organization's Declaration on Fundamental Principles and Rights at Work). Some businesses will already be working to align with these international standards. Second, Member States are bound by EU laws and most minimum internationally recognised human rights standards (eg, as articulated in the UNGPs). The expectation would be that such regional and international law should be incorporated in or should be broadly consistent with national laws on human rights related issues. On this basis, it does not seem onerous to link the duty to carry out due diligence to these international laws and standards. Further, as mentioned above, incorporating minimum requirements is likely to promote a level playing field and may help reduce the likelihood of ineffective due diligence

[57] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ L 330, 15 Nov 2014, p 1.

compliance, if businesses choose to adopt a tick-box compliance approach to the due diligence duty.

Clear guidance – but not too detail-oriented – should also be provided for companies to implement the legislation. As we have seen with the Vigilance Law, there is no guidance provided by public bodies on how to implement the Vigilance Law. A guidance may have helped to promote a better understanding of the Vigilance Law, eased the learning curve in order to generate more quality vigilance plans. However, a very detailed approach will invariably lead to a very narrow reading and process and favour a tick the box exercise. Guidance has to be flexible and open to creativity, according to size and sector. Moreover, transparency cannot overlook trademarks and patent laws. The process to prepare possible guidance, including whether it should entail stakeholders' consultations, should also be considered.

We understand that there is a case for more specificity in relation to environmental standards and further that national legislation on such issues across the EU may be more sophisticated and to date than international standards. However, note that both human rights and the environment should be key elements of a due diligence duty. Option 3 should not introduce a hierarchy between human rights and environmental issues. Alternatively, the EU should consider introducing option 2, complemented by further requirements in terms of human rights (including for alignment purpose with a 'just and socially fair' green transition).

Sector specific guidance will be key to operationalising the duty. The consultation states that the initiative intends to build on the OECD Guidelines for Multinational Enterprises, the OECD's Due Diligence Guidance on Responsible Business Conduct and the UNGPs. If the EU can bolster the launch of the legislation with practical guidance in a timely manner, this will assist the understanding of business and other stakeholders as to how, practically, to meet the requirements of the due diligence duty. To this end, the sector-specific due diligence guidelines, published by the OECD, represent an important example of practical policies.[58] These can be referred to by the EU Commissioner, so greater clarity on actions to be taken is provided to companies and their Directors. However, it is worth noticing that some OECD sector-specific guidelines are not free of charge and, alternatively, the EU should come up with free policies accessible to all stakeholders, so that there is consistency in the approach to practical actions companies can take.

Question 16: How could companies' – in particular smaller ones – burden be reduced with respect to due diligence? Please indicate the most effective options (*tick the box, multiple choice possible*)

This question is being asked in addition to Question 48 of the Consultation on the Renewed Sustainable Finance Strategy, the answers to which the Commission is currently analysing.

- ◻ All SMEs (SME definition) should be excluded.

[58] *OECD Due Diligence Guidance for Responsible Business Conduct*, OECD, www.oecd.org/investment/due-diligence-guidance-for-responsible-business-conduct.htm.

- ☐ SMEs should be excluded with some exceptions (eg, most risky sectors or other).
- ✓ Micro and small-sized enterprises (less than 50 people employed) should be excluded.
- ☐ Microenterprises (less than 10 people employed) should be excluded.
- ✓ SMEs should be subject to lighter requirements (‘principles-based’ or ‘minimum process and definitions’ approaches as indicated in Question 15).
- ✓ SMEs should have lighter reporting requirements.
- ✓ Capacity building support, including funding.
- ☐ Detailed non-binding guidelines catering for the needs of SMEs in particular.
- ✓ Toolbox/dedicated national helpdesk for companies to translate due diligence criteria into business practices.
- ☐ Other option, please specify.
- ☐ None of these options should be pursued.

Please explain your choice, if necessary:

As the European Added Value Assessment has stated most of the companies in the EU are SMEs or microbusinesses, many have international activities and are present in sectors traditionally considered risky. According to a 2015 Eurobarometer, a little more than half of SMEs (52 per cent) in the EU are involved in international business inside or outside the internal market. At least one in ten has used a subcontractor based abroad (16 per cent) or worked as a subcontractor for a company based abroad (13 per cent).

However, note that many SMEs may not have publicly available websites and may not necessarily publish annual reports in the way that large multinational publicly-traded companies do. Therefore, having SMEs subject to the same reporting regime as larger companies necessarily means that an agency, government body or other public entity should assume a role in collecting and publishing annual disclosures. In addition, SMEs may not have the experience and internal capacity to implement the internal processes pertaining to a due diligence duty and prepare the associated disclosure. It may be worth considering the establishment of a dedicated governmental agency to issues specific guidelines for SMEs, as well as to provide technical assistance, capacity building and training. Attention should also be placed on how the due diligence duty applied to SMEs would articulate with the numerous public or private CSR-related labels/certification schemes that apply to SMEs.

For these reasons, SMEs should be subject to lighter requirements (‘principles-based’ or ‘minimum process and definitions’ approaches, as indicated in Question 15). In any event, it should be recognised that due diligence obligations for SMEs and microbusinesses (and indeed all business) need to be proportionate to the potential risks risk that the company generates, which depends in turn on several factors, including sector, type of activity, international nature of activities, etc.

Question 17: In your view, should the due diligence rules apply also to certain third-country companies which are not established in the EU but carry out (certain) activities in the EU?

✓ Yes

○ No

○ I do not know

Question 17a: what link should be required to make these companies subject to those obligations and how (eg, what activities should be in the EU, could it be linked to certain turnover generated in the EU, other)?

Please specify:

Links could be:

- Placing services and products on the EU market. A link with a turnover generated in the EU over a certain number of consecutive years could also be applied. From a consumer perspective, this ensures that goods and services available in the EU have been subject to some form of human rights and environmental due diligence.
- Companies taking part in public procurement contracts for markets with the EU with an expected generated income over a given threshold.
- Another link could be with companies not operating within the EU but receiving funds/export credits above a certain threshold from the EU or from its Member States (eg, in the context of funding infrastructure projects).

Due diligence obligations could also be integrated in future international trade and investment agreements between the EU and third countries, a recommendation also in line with the opinion of the Committee on International Trade, in the European Parliament Report on sustainable corporate governance (2020/2137(INI)).

Question 17b: Please also explain what kind of obligations could be imposed on these companies and how they would be enforced.

Please comment:

Question 18: Should the EU due diligence duty be accompanied by other measures to foster more level playing field between EU and third country companies?

- ✓ Yes
- ○ No
- ○ I do not know

Please explain:

The introduction of a due diligence duty should be accompanied by other measures (such as trade agreements, trade requirements and restrictions) to level the playing field outside the EU. These measures have been mentioned in the draft legislative initiative adopted by the EU Parliament's Legal Affairs Committee on 27 January 2021[59] and would be consistent with the opinion of the Committee on International Trade in the European Parliament Report on sustainable corporate governance (2020/2137(INI)).

In particular, it has been clarified that '[a]ll companies that want to access the EU internal market, including those established outside the EU, would have to prove that they comply with environmental and human rights due diligence obligations' and that human rights and environmental provisions 'should be included in trade and sustainable development chapters of EU trade agreements'.

Similar measures have been adopted by the US, with Section 307 of the Tariff Act of 1930 (19 USC section 1307), which prohibits the importation of products mined, produced or manufactured, wholly or in part, in any foreign country by forced labour, including forced child labour. In addition, the UK government has recently announced a package of measures to help ensure that British organisations, including from the private sector, are not complicit with the severe human rights violations happening in Xinjiang. Against this backdrop, the decision and a regulation establishing a global human rights sanctions regime, adopted by the EU Council on 7 December 2020, represent an additional tool to exercise leverage over individuals and businesses outside the EU.

Contracts are also an excellent tool to address this issue (see our response to Question 2 above).

Question 19: Enforcement of the due diligence duty

Question 19a: If a mandatory due diligence duty is to be introduced, it should be accompanied by an enforcement mechanism to make it effective. In your view, which of the following mechanisms would be the most appropriate one(s) to enforce the possible obligation? *(tick the box, multiple choice)*

[59] *MEPs: Hold Companies Accountable for Harm Caused to People and Planet:* News: European Parliament, 27 Jan 2021, www.europarl.europa.eu/news/en/press-room/20210122IPR96215/meps-hold-companies-accountable-for-harm-caused-to-people-and-planet.

✓ Judicial enforcement with liability and compensation in case of harm caused by not fulfilling the due diligence obligations.

That should also be included.

□ Supervision by competent national authorities based on complaints (and/or reporting, where relevant) about non-compliance with setting up and implementing due diligence measures, etc, with effective sanctions (such as for example fines).

✓ Supervision by competent national authorities (Option 2) with a mechanism of EU cooperation/coordination to ensure consistency throughout the EU.

□ Other, please specify.

Please provide explanation:

The answer to this question could benefit from the experience of the Vigilance Law.

As exemplified with the enforcement mechanism of the Vigilance Law and the first enforcement cases, the proceedings (also in the event of an appeal) can take several months, if not years. As these proceedings take place, the enforcement of the Vigilance Law in a given case is delayed, in a context where several human rights or environmental impacts can be urgently at stake. Besides, the judicial enforcement mechanism of the Vigilance Law still leaves open a number of questions (amount of periodic penalty payment, content of the injunction, courts' appreciation of whether a company has complied with its obligations before the injunction is served, and after the injunction is served to decide to lift the potential periodic penalty payment). Last but not least, the enforcement mechanism, as it exists to date, heavily relies on civil society organisations bringing actions, in a context where a number of these organisations may have limited means (both material and financial) to bring such actions. (For more developments on the issue at stake related to the enforcement mechanism of the Vigilance Law, see: *All Eyes on France – French Vigilance First Enforcement Cases (2/2) The Challenges Ahead*.)[60]

Other comments:

- Enforcement and remediation mechanisms should be distinct, but should the EU legislation also include a remediation mechanism, it is key that the link between both mechanisms is clarified.

- The enforcement would require an agency staffed with individuals knowledgeable about business and human rights in general and not just about EU legislation on due diligence.

[60] Savourey, Elsa, *All Eyes on France – French Vigilance Law First Enforcement Cases (2/2) The Challenges Ahead,* Cambridge University Press, 2020, www.cambridge.org/core/blog/2020/01/24/all-eyes-on-france-french-vigilance-law-first-enforcement-cases-2-2-current-cases-and-trends.

- EU cooperation/coordination is crucial to make sure guidance and norm setting by authorities is consistent/harmonised across the EU, in order for due diligence obligations to remain the same for all companies regardless of the Member State in which they are registered/established/operating.

Question 19b: In case you have experience with cases or Court proceedings in which the liability of a European company was at stake with respect to human rights or environmental harm caused by its subsidiary or supply chain partner located in a third country, did you encounter or do you have information about difficulties to get access to remedy that have arisen?

✓ Yes

○ No

In case you answered yes, please indicate what type of difficulties you have encountered or have information about:

- Access to court for victims (ie, onus of the burden of proof), gathering evidence.
- Protection of human rights defenders. This is also where anonymous complaints to a supervising authority with powers could play a role in protecting whistleblowers and affected individuals or groups.
- Barriers related to private international law (applicable law in the event of a harm occurring aboard).

If you encountered difficulties, how and in which context do you consider they could (should) be addressed?

There are many countries where the vast majority have no access to the internet. Access to justice, for many, will be the only source of help available. How the technology is provided is of extreme importance. Secure and safe technology, access to justice and remote hearings should be accessible for all.

Proposals on a worldwide expansion of achievable, accessible, affordable and secure technology to enable and ensure better access to justice are to be considered.

Section IV: Other elements of sustainable corporate governance

Question 20: Stakeholder engagement

Better involvement of stakeholders (such as for example employees, civil society organisations representing the interests of the environment, affected people or communities) in defining how stakeholder interests and sustainability are included into the corporate strategy and in the implementation of the company's due diligence processes could contribute to boards and companies fulfilling these duties more effectively.

Question 20a: Do you believe that the EU should require directors to establish and apply mechanisms or, where they already exist for employees for example, use existing information and consultation channels for engaging with stakeholders in this area?

- ○ I strongly agree
- ✓ I agree to some extent
- ○ I disagree to some extent
- ○ I strongly disagree
- ○ I do not know
- ○ I do not take position

Please explain:

In order to embed sustainability into their business model, directors have to engage with stakeholders. According to the G20 OECD Principles on Corporate Governance, it is 'in the long-term interest of corporations to foster wealth-creating co-operation among stakeholders. The governance framework should recognise the interests of stakeholders and their contribution to the long-term success of the corporation' (IV). This engagement should happen, on an ongoing basis and in a meaningful manner. The channels for this engagement should differ from those adopted for engaging with employees, when available. It is, in fact, important to consider the power imbalance and the different cultural and financial barriers, often in place at the level of external stakeholders. This engagement mechanism should be available in addition to those applicable to the due diligence and remedial mechanisms and should be aimed at strengthening the social license of businesses to operate, as well as at shaping business priorities.[61]

Question 20b: If you agree, which stakeholders should be represented?

Please explain:

Internal and external stakeholders. The concept of stakeholders should go beyond the identification of groups and actors established by law or by contractual relations. It is important to include rights holders, identified through the due diligence process, on the basis of the company activity, its structure, and its locations. In addition, firms should engage with stakeholders to which companies have committed, through their code of conducts, financial

[61] Johnson, Rachae, *Juukan Gorge Incident and Covid-19 Pandemic Highlight Focus on ESG*, IBA, 2 Dec 2020, www.ibanet.org/Article/NewDetail.aspx?ArticleUid=0B0F4134-F037-4C73-9456-DBF89429CEE2.

prospectus, and other statements. The G20 OECD Principles on Corporate Governance refer to this broader category as well.

Question 20c: What are best practices for such mechanisms today? Which mechanisms should in your view be promoted at EU level? (tick the box, multiple choice)

	Is best practice	Should be promoted at EU level
Advisory body	○	○
Stakeholder general meeting	○	○
Complaint mechanism as part of due diligence	✓	○
Other, please specify	○	✓

Different mechanisms should be available depending on the types of stakeholders that companies have to engage with. With regard to rightsholders identified by the due diligence process, particular attention should be paid to the power imbalance, and efforts are necessary to build trust and promote a meaningful dialogue. As discussed in our answer to Question 13, these mechanisms have to create safe spaces for rights holders, in order to limit the risk of retaliation. In addition, these mechanisms have to be effective in the achievement of tangible outcomes. The effectiveness criteria set out in UNGP 31 can represent an important benchmark. Even though these principles refer to both, state-based and non-state-based grievance mechanisms, they can guide companies in the establishment of effective channels for engaging with rights holders, before harm occurs.

Question 21: Remuneration of directors

Current executive remuneration schemes, in particular share-based remuneration and variable performance criteria, promote focus on short-term financial value maximisation (see: Study on directors' duties and sustainable corporate governance).

Please rank the following options in terms of their effectiveness to contribute to countering remuneration incentivising short-term focus in your view.

	☆☆☆☆☆☆☆
Restricting executive directors' ability to sell the shares they receive as pay for a certain period (eg, requiring shares to be held for a certain period after they were granted, after a share buy-back by the company)	★★★★★★★

	★★★★★★★
Regulating the maximum percentage of share-based remuneration in the total remuneration of directors	★★★★★★★
Regulating or limiting possible types of variable remuneration of directors (eg, only shares but not share options)	★★★★★★★
Making compulsory the inclusion of sustainability metrics linked, for example, to the company's sustainability targets or performance in the variable remuneration	★★★★★★★
Mandatory proportion of variable remuneration linked to non-financial performance criteria	★★★★★★★
Requirement to include carbon emission reductions, where applicable, in the lists of sustainability factors affecting directors' variable remuneration	★★★★★★★
Taking into account workforce remuneration and related policies when setting director remuneration	★★★★★★★
Other option, please specify	
None of these options should be pursued, please explain	

Please explain:

Businesses must embed sustainability (ESG factors; SDGs) into their business models and, in particular, this objective has to be reflected in their financial incentives. A study published in the Harvard Business Review on S&P 500 has shown that only two per cent of companies tied executive compensations to environmental metrics.[62] The existence of financial incentives based on short-term objectives creates a tension between sustainability and financial performance. This tension is also reflected in the increased inequalities we have witnessed over the past decades. The pandemic has exacerbated this divide, as it has disproportionately affected the poorest in society.[63] As we have seen, social inequality has become a huge risk to the rule of law and democracy and the EU has the potential to be a global leader in tackling these challenges.

A regulatory intervention to limit short-termism is, therefore, necessary to promote a holistic approach to sustainability. Corporate governance, regulatory obligations and financial incentives must go in the same direction. Sustainability criteria should not only be linked to executive compensation but should also affect the remuneration policies of other managers and actors operating in the organisation. In addition, if directors refuse to comply with due

[62] Burchman, Seymour and Barry Sullivan, *It's Time to Tie Executive Compensation to Sustainability,* Harvard Business Review, 17 Aug 2017, available at: hbr.org/2017/08/its-time-to-tie-executive-compensation-to-sustainability.

[63] Stiglitz, Joseph, *COVID-19 and Global Inequality – IMF F&D*, International Monetary Fund – Homepage, 2020, available at: www.imf.org/external/pubs/ft/fandd/2020/09/COVID19-and-global-inequality-joseph-stiglitz.htm.

diligence obligations, their remuneration shall be affected and they shall be sanctioned by businesses.[64] (See our comments on the *Rio Tinto* case).

Moreover, companies should be transparent about the metrics they have adopted to measure these targets. To this end, the G20 OECD Principles of Corporate Governance (2015) clarify that: 'It is regarded as good practice for boards to develop and disclose a remuneration policy statement covering board members and key executives. Such policy statements specify the relationship between remuneration and performance, and include measurable standards that emphasise the longer run interests of the company over short term considerations'.

Question 22: Enhancing sustainability expertise in the board

Current level of expertise of boards of directors does not fully support a shift towards sustainability, so action to enhance directors' competence in this area could be envisaged (see: Study on directors' duties and sustainable corporate governance).

Please indicate which of these options are in your view effective to achieve this objective. *(tick the box, multiple choice)*

- □ Requirement for companies to consider environmental, social and/or human rights expertise in the directors' nomination and selection process
- □ Requirement for companies to have a certain number/percentage of directors with relevant environmental, social and/or human rights expertise
- □ Requirement for companies to have at least one director with relevant environmental, social and/or human rights expertise
- □ Requirement for the board to regularly assess its level of expertise on environmental, social and/or human rights matters and take appropriate follow-up, including regular trainings
- □ Other option, please specify
- □ None of these are effective options

Please explain:

A study recently published by NYU Stern Centre for Sustainable Business on Fortune 100 ESG credentials, has shown that directors have very limited expertise on ESG issues.[65]

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[64] A Jan A J Eijsbouts, 'Corporate Governance and Responsibility for Sustainability', p 99, in *Corporate Social Responsibility – Sustainable Business – Environmental, Social and Governance Frameworks for the 21st Century*, in R Lindsay and R Martella (eds), Wolters Kluwer and IBA, 2020.

[65] Whelan, Tensie, US, *Corporate Boards Suffer from Inadequate Expertise in Financially Material ESG Matters* (1 January 2021). Available at SSRN: https://ssrn.com/abstract=3758584.

Even when the figures are positive (eg, 29 per cent of 1,188 directors), they refer to a very narrow interpretation of sustainability, primarily related to health and safety, diversity and inclusion. This leads to a very limited understanding, by board members, of the footprint of their work on society.

Studies have shown that corporate culture and corporate behaviour are heavily affected by tone at the top and the lack of a clear vision from management leads to narrow-minded, short-term decisions. Not surprisingly, the NYU study has also shown that many companies with ESG issues had very limited relevant expertise among board members.[66] Consequently, we believe that companies should pay greater attention to ESG expertise among directors, in the selection process, as well as on an ongoing basis. In particular, boards should be more diverse, in their academic background and professional experience, including environmental and human rights experts.

Training programmes on ESG cannot become a box-ticking exercise and greater attention should be paid to corporate culture and the way this translates into actions. Senior management should be open to engage in a meaningful dialogue with stakeholders, on an ongoing (rather than ad hoc) basis. The legal profession has a key role to play in this transition[67] and, since 2013, the IBA has supported lawyers and bar associations in their knowledge and understanding of the UNGPs and their impact for lawyers' and business associations' activity as business entities, as well as providers of legal services to other businesses.[68] We believe that, in particular, the younger generation shall progressively influence a change of mindset and that time shall make the difference for a cultural shift.

Question 23: Share buybacks

Corporate pay outs to shareholders (in the form of both dividends and share buybacks) compared to the company's net income have increased from 20 to 60 per cent in the last 30 years in listed companies as an indicator of corporate short-termism. This arguably reduces the company's resources to make longer-term investments including into new technologies, resilience, sustainable business models and supply chains (see: Study on directors' duties and sustainable corporate governance). (A share buyback means that the company buys back its own shares, either directly from the open market or by offering shareholders the option to sell their shares to the company at a fixed price, as a result of which the number of outstanding shares is reduced, making each share worth a greater percentage of the company, thereby increasing both the price of the shares and the earnings per share.) EU law regulates the use of share-buybacks (Regulation 596/2014 on market abuse and Directive 77/91, second company law Directive).

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[66] Whelan, Tensie, US, *Corporate Boards Suffer from Inadequate Expertise in Financially Material ESG Matters* (1 January 2021). Available at SSRN: https://ssrn.com/abstract=3758584.

[67] *Legal Advisers and the Transition to a Sustainable Economy*, IBA, www.ibanet.org/Article/NewDetail.aspx?ArticleUid=f326e0ef-5549-40cf-9352-b1a346a8d6d1.

[68] For further information: *IBA Business and Human Rights*, IBA, www.ibanet.org/LPRU/Business-and-Human-Rights-for-the-Legal-Profession.aspx.

In your view, should the EU take further action in this area?

- ○ I strongly agree
- ○ I agree to some extent
- ○ I disagree to some extent
- ○ I strongly disagree
- ○ I do not know
- ✓ I do not take position

Question 23a: If you agree, what measure could be taken?

Please comment:

N/A

Question 24: Do you consider that any other measure should be taken at EU level to foster more sustainable corporate governance?

If so, please specify:

Corporate governance should be part of a more holistic governance approach, including rights-holders, civil society organisations and Member States. A shift is needed from a narrow interpretation of corporate governance, as based on binding and enforceable principles, to a consensus building process among different parties, with an intensified focus on the social license of business to operate.[69] This 'inclusive corporate governance' approach is mentioned in the G20/OECD Corporate Governance Principles 2015[70] and the EU can play a leading role in promoting this model.

In addition, we recommend considering the introduction of a mechanism of labelling for activities performed in the EU and for companies incorporated in the EU. Finally, Member States could create a special section or chamber in the court system, dedicated to issues related to human rights, ESG/SDGs.

Section V: Impacts of possible measures

N/A

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[69] A Jan A J Eijsbouts, 'Corporate Governance and Responsibility for Sustainability', *p 19, in Corporate Social Responsibility – Sustainable Business – Environmental, Social and Governance Frameworks for the 21st Century*, in R Lindsay and R Martella (eds), Wolters Kluwer and IBA, 2020.

[70] *G20/OECD Principles of Corporate Governance*, OECD 2015, www.oecd.org/corporate/principles-corporate-governance.

Question 25: Impact of the spelling out of the content of directors' duty of care and of the due diligence duty on the company

Please estimate the impacts of a possible spelling out of the content of directors' duty of care as well as a due diligence duty compared to the current situation. In your understanding and own assessment, to what extent will the impacts/effects increase on a scale from 0–10? In addition, please quantify/estimate in quantitative terms (ideally as percentage of annual revenues) the increase of costs and benefits, if possible, in particular if your company already complies with such possible requirements.

	Non-binding guidance. Rating 0 – 10	Introduction of these duties in binding law, cost and benefits linked to setting up/improving external impacts' identification and mitigation processes Rating 0 (lowest impact) – 10 (highest impact) and quantitative data	Introduction of these duties in binding law, annual cost linked to the fulfilment of possible requirements aligned with science-based targets (such as for example climate neutrality by 2050, net zero biodiversity loss, etc) and possible reorganisation of supply chains Rating 0 (lowest impact) – 10 (highest impact) and quantitative data
Administrative costs including costs related to new staff required to deal with new obligations			
Litigation costs			
Other costs including potential indirect costs linked to higher prices in the supply chain, costs liked to drawbacks as explained in Question 3, other than administrative and litigation costs, etc. Please specify.			
Better performance stemming from increased employee loyalty, better employee performance, resource efficiency			
Competitiveness advantages stemming from new customers, customer loyalty, sustainable technologies or other opportunities			
Better risk management and resilience			
Innovation and improved productivity			

	Non-binding guidance. Rating 0 – 10	Introduction of these duties in binding law, cost and benefits linked to setting up/improving external impacts' identification and mitigation processes Rating 0 (lowest impact) – 10 (highest impact) and quantitative data	Introduction of these duties in binding law, annual cost linked to the fulfilment of possible requirements aligned with science-based targets (such as for example climate neutrality by 2050, net zero biodiversity loss, etc) and possible reorganisation of supply chains Rating 0 (lowest impact) – 10 (highest impact) and quantitative data
Better environmental and social performance and more reliable reporting attracting investors			
Other impact, please specify			

Please explain:

Question 26: Estimation of impacts on stakeholders and the environment

A clarified duty of care and the requirement of a due diligence duty would be expected to have positive impacts on stakeholders and the environment, including in the supply chain. According to your own understanding and assessment, if your company complies with such requirements or conducts due diligence already, please quantify/estimate in quantitative terms the positive or negative impact annually since the introduction of the policy, by using examples such as:

- Improvements on health and safety of workers in the supply chain, such as reduction of the number of accidents at work, other improvement on working conditions, better wages, eradicating child labour, etc.
- Benefits for the environment through more efficient use of resources, recycling of waste, reduction in greenhouse gas emissions, reduced pollution, reduction in the use of hazardous material, etc.
- Improvements in the respect of human rights, including those of local communities along the supply chain
- Positive/negative impact on consumers
- Positive/negative impact on trade
- Positive/negative impact on the economy (EU/third country).

Please comment:

Other comments: