EUROCHAMBRES

Brussels, 4 March 2021
POSITION PAPER

EUROCHAMBRES position on Commission's upcoming initiative on sustainable corporate governance and due diligence

The European Union is at the forefront of the world's efforts to protect the environment and human rights and fight against climate change. Sustainability is crucial for ensuring that future generations take advantage of Europe's natural, manufactural, social, and human capitals. However, sustainability is also a complex challenge that needs to be addressed not only by companies but also by national authorities and consumers, among other stakeholders.

EUROCHAMBRES believes that the vast majority of businesses and their Boards of Directors already take into account ESG interests into the companies' decision making, following long-held responsible practices and national corporate governance codes. The business sector can positively contribute to the transition to a sustainable economic system as long as the right framework conditions exist.

Throughout the years, businesses overall have increasingly considered Environmental, Social and Governance (ESG) aspects in their business strategies and have contributed to Europe's dominance in the sustainable sphere in terms of environmental outperformance, addressing investors demand and societal shifts. Many EU companies already assess the risks and the impacts of their operations on society and environment, due to existing codes of conduct, responsible business practices and self-regulation, and intend to continue doing so. EUROCHAMBRES hopes that upcoming legislative initiatives in this regard are workable, tailored to the SMEs' position in supply chains, and offer innovative solutions instead of introducing more hurdles to businesses.

EUROCHAMBRES considers that the European Commission's conflation of two different concepts - sustainable corporate governance and due diligence across the supply chain - is inadequate, despite the potential linkages that may exist between them. Decoupling the concepts would achieve more legal certainty while allowing decision-makers to consider the "one in, one out" principle that should permeate EU law-making.

EUROCHAMBRES defends that the proliferation of national legal frameworks covering due diligence practices calls for the harmonisation of certain due diligence practices to promote single market and to achieve a wider convergence in terms of how to conduct responsible business within the EU and abroad. However, companies cannot be held responsible for the EU's failure to act when facing important challenges like climate change or the violation of human rights.

EUROCHAMBRES believes that the EU lawmakers should actively support and promote the positive role of businesses as creators of job opportunities, growth, and prosperity for Europe's economy and across the world.

ASSOCIATION OF EUROPEAN CHAMBERS OF COMMERCE AND INDUSTRY ASSOCIATION
DES CHAMBRES DE COMMERCE ET D'INDUSTRIE EUROPEENNES
Chamber House, Avenue des Arts, 19 A/D B - 1000 Brussels / Bruxelles • Belgium / Belgique
Tel. +32 2 282 08 50 • eurochambres@eurochambres.eu • www.eurochambres.eu
Transparency Register number: 0014082722-83

1. Sustainable corporate governance

EUROCHAMBRES believes that the European corporate governance landscape is quite heterogeneous, legally and politically, and often based on different philosophical approaches. Throughout the years, national corporate governance codes have proven to be a strength for businesses rather than a source of disputes. Together with a targeted legal framework operated through the Shareholder Rights Directive II (SRDII), the Non-Financial Reporting Directive (NFRD), and even companies' practices, this system has ensured that Boards of Directors, shareholders and even stakeholders focus on ensuring that companies create long-term value and contribute to a sustainable business environment.

However, the notion that important advancements in social and environmental reforms could be achieved through modifications to company law is baseless and could result in frivolous actions against the interest of companies, deflecting attention away from the real culpable.

EUROCHAMBRES defends that, due to such wide variety of different corporate governance rules in the EU, a binding law affecting how ownership structures and investors should behave will not lead to the intended outcome. The aim of enhancing transparency is extremely valuable, however changing the definition of companies' interests and directors' duties will not lead to the implementation of more sustainable actions because companies imbed sustainability initiatives and targets depending, for instance, on the sector they operate in.

1.1. Long term value vs short-termism

The Commission needs to be aware that the aim of increasing long-term value is enshrined in several Member States' legislation and is to the benefit of stakeholders. The study on "directors' duties and sustainable corporate governance" from July 2020 and conducted by EY on behalf of the European Commission selectively picked academic insights that supported its leading views on short-termism, while failing to engage substantial contrary literature – a clear example of a flawed evaluation process. EUROCHAMBRES also rejects the study's assumption built upon the assertion that companies tend to favour the short term maximisation of financial value for the shareholders whilst refraining to consider the interests of the other stakeholders, all that to the detriment of the long-term development of the company. The study has been severely criticized for amalgamating two distinct notions and extracting conclusions from a faulty direct analogy between them: short-term/long-term strategies and stakeholders' interests. The idea that implementing a long-term strategy would necessarily lead to serving all stakeholders' interests should not be taken as a fact.

In fact, the SRDII requires that listed companies include in the remuneration policy non-financial performance criteria relating to corporate social responsibility, if these are material for the company's strategy. In addition, interested investors monitor the integration of ESG criteria in executive directors' remuneration. The study's findings also deviate from the reports of ESMA, EBA and EIOPA on undue short-termism in the securities, banking, and insurance sectors respectively. As these reports did not highlight any major corporate governance-related issues which would merit rewriting of rules relating to directors' duties and liability, the findings of the EY study should largely be disregarded.

As highlighted before, companies already take into account sustainability considerations. However, the Commission cannot disregard the profit-making purpose of a company and the need to make decisions often based on confidential information. Interventions in corporate strategy should always be made with restraint. While seeking a broader stakeholder approach to strategy information, the Commission cannot undermine well-established EU shareholders' rights.

Corporate directors follow a long-term approach as it ensures the economic sustainability of their business choices, while allowing them to consider the interests of all relevant stakeholders, to comply with the existing applicable laws and to serve – before and above all – the interest of the company which they are mandated to administrate. Furthermore, the directors' duty of care should not be perceived as exonerating local actors from their own liability for prejudice caused or as placing the burden of liability solely on EU companies.

A corporate director's duty of care also bears the inadvertent risk of handing third country competitors, non-European governments and non-governmental organizations a powerful tool to put European companies under undue pressure. This could impair the global level playing field, results in high administrative costs, excessive bureaucracy, liability risks and inconsistencies with existing requirements for the members of the company management in certain sectors.

1.2. Consideration of stakeholders' interests

EUROCHAMBRES considers that stakeholders have largely diverging views and that Board of Directors often act as arbitrators between such parties. The Commission should refrain from questioning the legitimacy of directors and from allowing certain stakeholders to gain a more prominent role than others – an example being employees representatives - in order to avoid the creation of risk averseness (first step towards economic decline) and impacts on established safeguards regarding the liability of directors, who acted in consideration of their fiduciary duties. In addition, EU companies' directors acknowledge the increasing demand from investors, clients, employees and other stakeholders to factor sustainability criteria into the company strategy and the importance of such alignment for the financial prosperity of the company.

Nonetheless, the interests of different stakeholders do not necessarily align with each other which again leads to conflicting interests that the directors are often called to resolve. The currently applicable legal regimes across the EU allow directors to carefully consider all relevant interests before taking action, through the lens of the long-term performance of the company they manage and in view of their duty to account for their mandate to their shareholders. On the one hand, the proposed changes to such regime would exacerbate competitive disadvantages internationally, and on the other hand, they would restrict the company's entrepreneurial freedom.

Companies should be encouraged to make voluntary contributions, whereas legislative measures would have to place a balanced burden on all stakeholders involved. Risks can be mitigated through voluntary action and "control" by consumers in the form of demand response. Clearly, the objectives are fundamentally welcomed, but overregulation must be avoided in any case.

Furthermore, a legal requirement to take all stakeholders' interests into account combined with risk of personal liability would create significant legal uncertainties. The NFRD also obliges companies to publish a statement in the Management Report (i.e. under the responsibility of the Board of Directors), which certainly contains information about the engagement with stakeholders. Chambers believe that national frameworks and evolving case law provide rules that are flexible enough to allow for the redefinition of the company's long-term purposes and stakeholders' interests in an orderly, harmonious way.

EUROCHAMBRES encourages the Commission to explore the creation of an Expert Group on Sustainable Corporate Governance to identify best practices on stakeholder engagement and maximise sustainable value creation, based on already existing corporate government models, cooperation with business representatives, and the possible consultation channels.

2. Due Diligence across the supply chain

2.1. Scope and definitions

As mentioned before, EUROCHAMBRES believes that the proliferation of national legal frameworks covering due diligence practices calls for the harmonisation of certain due diligence practices to promote single market and to achieve a wider convergence in terms of how to conduct responsible business within the EU and abroad. However, the European Commission needs to be mindful of the critical impact on companies, on their operations and relationships in supply chains they are engaged in, as well as on their competitiveness on the global stage.

The legal definition of "due diligence across the supply chain", or using a more accurate term "value chain", should also be carefully considered in case the Commission decides to include such a provision. Companies have varying degree of influence along their value chains and issues that are not directly within the sphere of influence of companies cannot be assigned to their responsibility. A draft definition that implies the imposition of obligations on companies which, as a rule, they are unable to comply with, is unacceptable. The responsibility for compliance with the respective legal framework must lie with the respective local companies on site. In the same vein, if no legal framework exists locally in order to coerce local companies into abiding with human rights and social and environmental standards that inspired EU's initiative on corporate due diligence and corporate accountability, then action should be taken first locally, e.g. by the relevant governmental authorities, and the EU should direct future initiatives towards such well-targeted policies instead.

EUROCHAMBRES believes that smaller firms cannot implement complex due diligence and reporting systems like large undertakings do, due to their size and financial capacity constraints, nor can be expected to implement expensive traceability and compliance requirements. EUROCHAMBRES considers that the Non-Financial Reporting Directive (NFRD) scope could serve as benchmark, limiting mandatory due diligence legislation to large public interest companies, i.e. with more than 500 employees. Thus, any upcoming legal framework should not cover SMEs, while making sure that larger contractual partners, or first-tier companies, do not simply pass their reporting obligations down the supply chain.

Naturally, information considered to be strategic or commercially sensitive should remain confidential in order to guarantee competitiveness amongst economic actors.

2.2. Risk assessment

EUROCHAMBRES understands that certain sectors are more at risk of contributing to potential adverse impacts on the environment and human rights. As such, a proportional approach could be addressed by weighing in the different elements related to specific supply chains vis-à-vis the special challenges or issues faced by companies in those sectors, while respecting the principle of materiality for the selection of the risks in order to achieve a level playing field.

Developing a material approach for the selection of severe risks is important to ensure legal certainty, considering that it is impossible to mitigate every single risk along the supply chains. If the Commission decides to adopt an EU-wide due diligence duty, they should be limited to selected high-risk industries and direct contractual partners (“first tier only”) in order to minimise the economic impact to the Union's economic fabric.

2.3. Role of SMEs

However, EUROCHAMBRES is aware that SMEs will be impacted regardless of the scope of the legislation. The extension to SMEs operating in high-risk sectors should be carefully considered as long as this approach covers only first-tier contract partners (as most SMEs are unable to extend their potential influence over additional tiers of the supply chain) as to ensure that more vulnerable links are not hit hard by overzealous legislative oversight. Such due diligence effort should be undertaken with the support of NGOs present on the ground, whenever these partners are located outside the EU, and with additional guidance provided by EASME and national authorities.

It could be appropriate to consider the establishment of transitional periods for large companies to incorporate the new reporting requirements so that there is time to identify and mitigate the collateral effects for SMEs. Exempting SMEs from compliance and protecting them from being excluded from larger companies’ supply chains during this period would allow them to notify upstream the reporting challenges they may be facing without losing their position.

The Commission should take into consideration existing, internationally recognised guidance for companies, e.g. UN Guiding Principles on Business and Human Rights and OECD Due Diligence Guidance for Responsible Business Conduct, despite the latter covering only multinationals and largely being inappropriate to fit SMEs' interests. EASME and national governments should thus work towards providing tailor-made guidance on how to consider SMEs in this discussion.

Instead of targeting businesses with the possibility of sanctions and civil liability, in the case of potentially unintended consequences, Chambers believe that incentives should be considered as more effective tools. Those who are able and willing to take on the administrative burden can prove that they have fulfilled their due diligence obligations and thus should receive a benefit, to be determined in concertation with national authorities and the business community. In addition, it would be preferable to leave any decision with regards to liability to the Member States.

ASSOCIATION OF EUROPEAN CHAMBERS OF COMMERCE AND INDUSTRY ASSOCIATION
DES CHAMBRES DE COMMERCE ET D’INDUSTRIE EUROPEENNES
Chamber House, Avenue des Arts, 19 A/D B - 1000 Brussels / Bruxelles • Belgium / Belgique
Tel. +32 2 282 08 50 • eurochambres@eurochambres.eu • www.eurochambres.eu
Transparency Register number: 0014082722-83

More comprehensive measures could be discussed at a later stage, preceded by a thorough impact assessment study that carefully analyses whether the existing due diligence practices are imposing unsurmountable obligations and administrative burdens on companies that largely outweighs the expected benefits.

EUROCHAMBRES – The Association of European Chambers of Commerce and Industry represents over 20 million enterprises in Europe – 98% of which are SMEs – through 45 members and a European network of 1700 regional and local Chambers.

Further information: Mr. Frederico Martins, Tel. +32 2 282 08 54, martins@eurochambres.eu
Press contact: Ms. Agatha Latorre, Tel. +32 2 282 08 62, latorre@eurochambres.eu