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Consultation Document Proposal for an Initiative on Sustainable Corporate Governance

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The views reflected on this consultation paper provide an indication on the approach the Commission services may take but do not constitute a final policy position or a formal proposal by the European Commission.
Please note that in order to ensure a fair and transparent consultation process only responses received through the online questionnaire will be taken into account and included in the report summarising the responses.

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[1], which requires changing the way in which we produce and consume. Building on the political guidelines, in its Communication on the European Green Deal[2] (adopted in December 2019) and on A Strong Social Europe for Just Transition[3] (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, biodiversity), social, human and economic impact, as well as in terms of the company's development in the longer term (beyond 3-5 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[4], the Biodiversity strategy[5] and the Farm to Fork strategy[6]. 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.

The recent Communication “Europe's moment: Repair and Prepare for the Next Generation” (Recovery Plan)[7] (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 EU economy to build back stronger.

This initiative is listed in the Commission Work program for 2021 [8].

EU 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[9].

This initiative is complementary to the review of the Non-Financial Reporting Directive (NFRD, Directive 2014/95/EU[10]) 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). Whilst 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 on-going 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 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 United Nations’ Guiding Principles on Businesses and Human Rights and the 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[11] 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[12] 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.

The *study on directors' duties and sustainable corporate governance* [13] 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 pay-outs, which increased from 20% to 60% of net income while the ratio of investment (capital expenditure) and R&D spending to net income has declined by 45% and 38% 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 (e.g. in the area of board remuneration, board composition, stakeholder involvement).

The *study on due diligence requirements* through the supply chain[14] 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. 70% 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.

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[15]. It includes questions to allow the widest possible range of stakeholders to provide their views on relevant aspects of sustainable corporate governance.

About you

* Language of my contribution

- Bulgarian
- Croatian
- Czech
- Danish
- Dutch
- English (selected)
- Estonian
- Finnish
- French
- German
- Greek
- Hungarian
- Irish
- Italian
- Latvian
- Lithuanian
- Maltese
- Polish
- Portuguese
- Romanian
- Slovak
- Slovenian
- Spanish
- Swedish

* Surname

Blecher

* I am giving my contribution as

- ( ) Academic/research institution
- ( ) Business association
- ( ) Company/business organisation
- ( ) Consumer organisation
- ( ) EU citizen
- ( ) Environmental organisation
- ( ) Non-EU citizen
- ( ) Non-governmental organisation (NGO)
- ( ) Public authority
- ( ) Trade union
- (•) Other

* First name

Lara

* Email (this won't be published)

lara.blecher@pirc.co.uk

* Organisation name

255 character(s) maximum

Local Authorit Pension Fund Forum (LAPFF)

* Organisation size

- (•) Micro (1 to 9 employees)
- ( ) Small (10 to 49 employees)
- ( ) Medium (50 to 249 employees)
- ( ) Large (250 or more)

Transparency register number

255 character(s) maximum

Check if your organisation is on the [transparency register](). It's a voluntary database for organisations seeking to influence EU decision-making.

* Country of origin

Please add your country of origin, or that of your organisation.

- Afghanistan
- Åland Islands
- Albania
- Algeria
- American Samoa
- Andorra
- Angola
- Anguilla
- Antarctica
- Antigua and Barbuda
- Argentina
- Armenia
- Aruba
- Australia
- Austria
- Azerbaijan
- Bahamas
- Bahrain
- Bangladesh
- Djibouti
- Dominica
- Dominican Republic
- Ecuador
- Egypt
- El Salvador
- Equatorial Guinea
- Eritrea
- Estonia
- Eswatini
- Ethiopia
- Falkland Islands
- Faroe Islands
- Fiji
- Finland
- France
- French Guiana
- French Polynesia
-
- Libya
- Liechtenstein
- Lithuania
- Luxembourg
- Macau
- Madagascar
- Malawi
- Malaysia
- Maldives
- Mali
- Malta
- Marshall Islands
- Martinique
- Mauritania
- Mauritius
- Mayotte
- Mexico
- Micronesia
- Moldova
- Saint Martin
- Saint Pierre and Miquelon
- Saint Vincent and the Grenadines
- Samoa
- San Marino
- São Tomé and Príncipe
- Saudi Arabia
- Senegal
- Serbia
- Seychelles
- Sierra Leone
- Singapore
- Sint Maarten
- Slovakia
- Slovenia
- Solomon Islands
- Somalia
- South Africa
- South Georgia and the South

- Barbados
- Belarus
- Belgium
- Belize
- Benin
- Bermuda
- Bhutan
- Bolivia
- Bonaire Saint Eustatius and Saba
- Bosnia and Herzegovina
- Botswana
- Bouvet Island
- Brazil
- British Indian Ocean Territory
- British Virgin Islands
- Brunei
- Bulgaria
- Burkina Faso
- Burundi
- Cambodia
- Cameroon

French Southern and Antarctic Lands

- Gabon
- Georgia
- Germany
- Ghana
- Gibraltar
- Greece
- Greenland
- Grenada
- Guadeloupe
- Guam
- Guatemala
- Guernsey
- Guinea
- Guinea-Bissau
- Guyana
- Haiti
- Heard Island and McDonald Islands
- Honduras
- Hong Kong
- Hungary
- Iceland

- Monaco
- Mongolia
- Montenegro
- Montserrat
- Morocco
- Mozambique
- Myanmar /Burma
- Namibia
- Nauru
- Nepal
- Netherlands
- New Caledonia
- New Zealand
- Nicaragua
- Niger
- Nigeria
- Niue
- Norfolk Island
- Northern Mariana Islands
- North Korea
- North Macedonia

Sandwich Islands

- South Korea
- South Sudan
- Spain
- Sri Lanka
- Sudan
- Suriname
- Svalbard and Jan Mayen
- Sweden
- Switzerland
- Syria
- Taiwan
- Tajikistan
- Tanzania
- Thailand
- The Gambia
- Timor-Leste
- Togo
- Tokelau
- Tonga
- Trinidad and Tobago
- Tunisia

Canada	India	Norway	Turkey
Cape Verde	Indonesia	Oman	Turkmenistan
Cayman Islands	Iran	Pakistan	Turks and Caicos Islands
Central African Republic	Iraq	Palau	Tuvalu
Chad	Ireland	Palestine	Uganda
Chile	Isle of Man	Panama	Ukraine
China	Israel	Papua New Guinea	United Arab Emirates
Christmas Island	Italy	Paraguay	United Kingdom
Clipperton	Jamaica	Peru	United States
Cocos (Keeling) Islands	Japan	Philippines	United States Minor Outlying Islands
Colombia	Jersey	Pitcairn Islands	Uruguay
Comoros	Jordan	Poland	US Virgin Islands
Congo	Kazakhstan	Portugal	Uzbekistan
Cook Islands	Kenya	Puerto Rico	Vanuatu
Costa Rica	Kiribati	Qatar	Vatican City
Côte d'Ivoire	Kosovo	Réunion	Venezuela
Croatia	Kuwait	Romania	Vietnam
Cuba	Kyrgyzstan	Russia	Wallis and Futuna
Curaçao	Laos	Rwanda	Western Sahara
Cyprus	Latvia	Saint Barthélemy	Yemen
Czechia	Lebanon	Saint Helena Ascension and Tristan da Cunha	Zambia
	Lesotho		Zimbabwe

Democratic Republic of the Congo

Saint Kitts and Nevis

- Denmark
- Liberia
- Saint Lucia

* Publication privacy settings

The Commission will publish the responses to this public consultation. You can choose whether you would like your details to be made public or to remain anonymous.

- **Anonymous**
  Only your contribution, country of origin and the respondent type profile that you selected will be published. All other personal details (name, organisation name and size, transparency register number) will not be published.
- **Public** (selected)
  Your personal details (name, organisation name and size, transparency register number, country of origin) will be published with your contribution.

☑ I agree with the personal data protection provisions

If you replied that you answer on behalf of a business, please specify the type of business:

- institutional investor, asset manager
- other financial sector player (e.g. an analyst, rating agency, data and research provider)
- auditor
- other (selected)

If other, please specify:

voluntary forum of local authority pension funds in the United Kingdom

Consultation questions

If you are responding on behalf of a large company, please indicate how large is the company:

- Large company with 1000 or more people employed
- Large company with less than 1000 but at least 250 people employed

If you are responding on behalf of a company, is your company listed on the stock-exchange?

- Yes, in the EU
- Yes, outside the EU
- Yes, both in and outside the EU
- No

If you are responding on behalf of a company, does your company have experience in implementing due diligence systems?

- Yes, as legal obligation
- Yes, as voluntary measure
- No

If resident or established/registered in an EU Member State, do you carry out (part of) your activity in several EU Member States?

- Yes
- No

If resident or established/ registered in a third country (i.e. in a country that is not a member of the European Union), please specify your country:

United Kingdom

If resident or established registered in a third country, do you carry out (part of) your activity in the EU?

- [x] Yes
- No

If resident or established registered in a third country, are you part of the supply chain of an EU company?

- Yes
- [x] No

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 earlier in 2020. The

Commission is currently analysing those replies. In order to reach the broadest range of stakeholders possible, those questions are now again included 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.
- (x) 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.

Please provide reasons for your answer:

: In LAPFF's experience, more often than not, good social and environmental practices by companies and investors contribute to both improved financial sustainability and improved social and environmental sustainability. LAPFF has seen this link on the social side through its engagement over many years with company employees and communities affected by corporate activities. In our view, accounting for worker and community interests contributes to more efficient corporate operations; early identification of problems that could escalate into material financial risks, and a social license to operate. On the environmental side, LAPFF has long identified that stranded assets and lower shareholder returns would result if companies and investors did not transition to a net zero carbon economy. This trend has started to materialize in the last couple of years with the cost of power from new renewables dropping below the cost of power from fossil fuels in many jurisdictions and with Covid accelerating the move away from fossil fuels. Therefore, between market forces and social expectation, the transition is well under way and, in LAPFF's view, is irreversible.

However, LAPFF is also deeply committed to a just transition, or the need to account for the social dimension of a net zero energy transition. In order to balance environmental and social considerations and ensure that both environmental and social objectives are achieved in this transition, LAPFF's stance is that consistent and helpful legal and regulatory frameworks are an important part of an effective transition, for investors, companies, and society more broadly.

It should be noted that not all environmental and social objectives are directly linked to financial performance of companies and shareholder returns for investors. However, a number of jurisdictions have conducted legal analysis on how fiduciary duties accommodate environmental, social, and governance considerations (see, for example, PRI's 2019 Fiduciary Duty in the 21st Century report). For the most part, these studies have concluded that companies and investors are not precluded from pursuing environmental, social, and governance objectives unless these objectives pose material financial risks to companies and investors. As

a representative of long-term investors, LAPFF has found that overwhelmingly positive environmental, social, and governance objectives contribute positively to business performance and shareholder returns in the long-term.

A material problem is accounting standards allowing discounting of environmental liabilities (IAS 37). The standards framework is plainly anomalous. The justification for discounting insurance liabilities was that those companies held ring fenced risk free assets for meeting those liabilities, thus the expected future income of those assets offsets part of the liability. (See, for example, https://www.actuaries.org.uk/system/files/documents/pdf/discounting.pdf) Even that approach has an element of imprudence, given that future income is an unrealised gain.

However, the practice of discounting has got into international accounting standards (IAS 37) for other liabilities without that condition of ring fenced (let alone risk free) assets. Indeed the general pool of assets of fossil fuel companies will not merely not be risk free but may well comprise stranded assets. The discounting is unjustifiable.

Therefore, LAPFF is of the view that a more holistic approach by companies, law-makers, and regulators should favour the maximisation of social, environmental, as well as economic/financial performance, and that these issues are relevant to the financial performance of the company in the long term.

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:

Voluntary guidelines and standards on supply chain due diligence have existed in the form of corporate and industry codes of conduct for the better part of forty years now to little effect. Therefore, the voluntary approach has been given more than a fair opportunity to prove itself and has failed. This is because it is akin to putting the wolf in charge of the chicken coop. Self-regulation does not allow for adequate checks and

balances on self-interest. Consequently, a legal framework for supply chain due diligence is needed to address adverse impacts on human rights and environmental issues within the EU and globally.

Domestic legal frameworks on human rights and environmental due diligence have been emerging over the last ten years or so. The California Supply Chain Transparency Act and similar legislation globally were initial attempts at supply chain accountability through disclosure requirements. However, more recent domestic law requiring supply chain due diligence, such as the French loi de viligence, require more substantive requirements of both home companies and their supply chain partners, including those in third countries. Similar initiatives are being explored in a range of jurisdictions, notwithstanding the initiative in Switzerland which had a majority of popular support but failed just barely through the referendum voting process. Given that many of these mandatory supply chain due diligence laws are being proposed in European Union member states, it would be helpful for the EU to create a legal framework. This framework would be useful in two ways: (1) it could help to create model laws and standards for domestic legislation in this area; and (2) it could allow for the coordination of domestic initiatives in this area so that conflicting or incompatible standards do not develop and impede effective functioning of these laws and standards.

That said, any EU legal framework on supply chain due diligence will need to be flexible. Given the current political environment which seems to be leaning toward state sovereignty and anti-internationalism, the framework probably cannot be too prescriptive in respect of domestic law. Furthermore, if, as LAPFF would like to see, there is a third country component to the EU legal framework that extends beyond EU member states, the EU framework will need to accommodate the cultures and legal systems of those third countries. In light of these considerations, an EU legal framework on supply chain due diligence is probably best suited to an EU directive rather than an EU regulation with accompanying policy and guidance documents to assist with implementation. Such guidance could be rooted in existing international guidance, including the UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises and associated responsible business guidance, and the Taskforce for Climate-related Financial Disclosure.

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 freeride 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
- [ ] SMEs would have better chances to be part of EU supply chains
- [x] Other

Other, please specify:

Voluntary initiatives have not proven sufficient to compel the level of responsible business conduct necessary to ensure sustainable corporate governance and sustainable investment returns. Therefore, a good legislative and regulatory framework would be beneficial in creating appropriate incentives for businesses and markets to drive environmental and social standards up instead of allowing for a race to the bottom.

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)?

- [x] Increased administrative costs and procedural burden
- [x] Penalisation of smaller companies with fewer resources
- [x] 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 (e.g. 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
- [x] Other

Other, please specify:

It is dangerous to frame the cost-benefit questions this way. In relation to sustainability, the question regarding the above concerns is: what is the cost of not undertaking sustainable business practices? There is a false conception of short-term costs to business, such as through administrative costs and procedural burdens. The whole point of an EU legal framework is to avoid penalizing smaller companies and to create incentives for compliance vis a vis third country operators through a good legal and regulatory system.

In relation to responsibility for damages that the EU company cannot control, the point is that often companies do have control but do not acknowledge this control or accept accountability for it. Failing to

enforce corporate responsibility and accountability through the legal and financial systems creates social and environmental externalities that eventually create greater costs not only to society, but to the businesses themselves.

In addition, not only has LAPFF's experience been that there is not a decrease in attention to core corporate activities which might lead to increased turnover of employees and negative stock performance, but attention to workforce issues, human rights, and climate and environmental impact actually increases operational efficiency, innovation, and staff retention because it creates a positive environment and mission for staff. Therefore, LAPFF would invert the analysis and ask: what is the cost of failing to attend adequately to environmental, human rights and workforce issues? In the long run, it is more costly than not doing so.

Supply chain experts will tell you that establishing positive long-term relationships with suppliers - who can include small and medium-sized enterprises - often creates cost and operational efficiencies, builds trust in the business relationship, and facilitates discussions around sustainability that lead to improved environmental and workplace outcomes. Therefore, a categorical assertion that there will be difficulty for buyers in finding suitable suppliers which may cause lock-in effects (e.g. exclusivity period/no shop clause) and also have negative impacts on business performance of suppliers misses the point that an EU legal framework should create incentives to create positive outcomes from long-term relationships rather than allowing for short-term incentives to create the negative outcomes listed here. This point relates to the concern about disengaging from risky third markets being detrimental for local economies. The UN Guiding Principles on Business and Human Rights and OECD guidance provide a framework for these tricky situations, but these situations should not be used as an excuse to shy away from enforcing appropriate social and environmental standards.

Section II: Directors' duty of care – stakeholders' interests

In all Member States the current legal framework provides that a company director is required to act in the interest of the company (duty of care). However, in most Member States the law does not clearly define what this means. Lack of clarity arguably contributes to short-termism and to a narrow interpretation of the duty of care as requiring a focus predominantly on shareholders' financial interests. It may also lead to a disregard of stakeholders' interests, despite the fact that those stakeholders may also contribute to the long-term success, resilience and viability of the company.

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/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	◉	○	○

the interests of persons and communities affected by the company's supply chain	X		
the interests of local and global natural environment, including climate	X		
the likely consequences of any decision in the long term (beyond 3-5 years)	X		
the interests of society, please specify	X		
other interests, please specify	X		

the interests of society, please specify:

In the US, we have seen businesses respond in defense of social rights to a number of social developments, such as North Carolina's refusal to acknowledge transgender bathroom preferences and the Black Lives Matter movement. These responses seemed to be due at least in part to a realization that failure to respond to basic human rights and accepted social values would compromise brand value and sales. We have also seen historically that businesses faced sanctions, for example in apartheid South Africa, where basic human rights for all people in the country were not implemented or enforced. In this case, while voluntary standards such as the Sullivan Principles were developed and supported by many companies, the voluntary, business-focused initiative was not deemed sufficient and became the basis of US sanctions legislation. Therefore, it is clear that sound and fair social conditions which are legally enforced are critical to ensure good business performance.

other interests, please specify:

The interests of persons and communities affected by a company's products and services are also important. LAPFF has seen the importance of this link both in respect of Scope 3 carbon emissions and the associated impact on climate, the environment, and society and in relation to weapons used to bomb citizens in other countries on the basis of clandestine deals between governments and companies.

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 (3) and 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	I do not take position
Identification of the company´s stakeholders and their interests	X					
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	◉	○	○	○	○	○

Please explain:

In LAPFF's experience, most companies fail to undertake adequate stakeholder mapping. Without this mapping, companies cannot properly know and understand the extent of their risks, impacts, and opportunities. LAPFF has noticed this problem in particular with extractive companies and with defense companies. Because these companies tend not to identify their full range of affected stakeholders, they end up with significant operational, reputational, legal, and financial risks and consequences, as well as causing or contributing to adverse environmental and social risks and impacts.

This failure to identify risks and impacts related to stakeholder interests means that companies cannot adequately manage these risks and impacts, either from an environmental and social perspective or from a business perspective. Short-term business incentives impede the identification and management of risks and impacts by creating a narrow focus for businesses on short-term profit, much of which can be illusory when placed in the context of long-term performance and impacts. This misalignment of incentives means that companies often pursue short-term objectives thus compromising opportunities to build more sustainable business paths both from a financial perspective and from an environmental, social, and governance perspective. A good legal framework would help to align business incentives with environmental and human rights incentives.

Question 7. Do you believe that corporate directors should be required by law to set up adequate procedures and where relevant, measurable (science –based) targets to ensure that possible risks and adverse impacts on stakeholders, ie. human rights, social, health and environmental 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:

In LAPFF's experience over the last couple of years, many companies do not have appropriate due diligence procedures to require corporate directors to incorporate environmental, social, and governance considerations into their decision-making process related to financial performance. Companies tend to start with profit and then try to retrofit environmental, social, and governance factors onto their profit objectives. LAPFF's view is that effective processes work the other way round. Companies must implement good

policies, procedures, and practices on environmental, social, and governance considerations to create profit. Otherwise, the ESG concerns will not be identified, prevented, and addressed in a way that protects people and the environment and that consequently protects businesses in the long-term.

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

- (x) 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:

In LAPFF's experience, there has to date been a false dichotomy between environmental, social and governance performance and financial performance. This separation can be seen in the term 'non-financial factors' when referring to ESG. LAPFF has seen that ESG factors are, in fact, financial factors in the majority of cases. On climate, LAPFF has been saying for many years that a failure by companies to prevent contributions to and account for climate change would lead to stranded assets and poor financial returns for investors. With the cost of power from new renewables now lower than the cost of power from fossil fuels in many markets, it appears that companies that prioritized short-term profit over more balanced and longer-term business-related factors, including ESG considerations, will have a very short life span. This trend also means that shareholders who had not anticipated these changes will lose out on significant returns. On the social side, over the last couple of years, LAPFF has engaged extensively with communities affected by mining operations. Community representatives explained that they had seen cracks in a tailings dam in Mariana, Brazil that collapsed and caused communities, companies, and investors untold damage, the extent of which is still unfolding five years on. If companies had listened to community input on this issue, they might have prevented this damage and damage from subsequent dam failures. Therefore, it is clear that in these cases and many others environmental and social factors are also financial factors. This is why they must be included as part of director duties of care in EU legislation.

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?

The risk if directors' duty of care is spelled out in law is that if the provision is not carefully worded, some ESG risks and impacts might be missed or left out. Therefore, this risk of omission could be mitigated by (1) making clear that any duties set out are not exhaustive; (2) establishing the requirements for mandatory environmental and social due diligence to a standard that meets or exceeds international environmental and human rights legal standards; and (3) focusing on environmental and social risk and impact rather than business risk and impact.

How could these possible risks be mitigated? Please explain.

> The danger of clarifying that the duties set out at law are not exhaustive is that companies will state that the law is vague and they will not know what duties to fulfill in respect of ESG factors. However, by rooting these duties in an environmental and human rights due diligence process, director duties will be clarified by the due diligence processes they have in place. In this case, there will need to be effective enforcement of and penalties for inadequate due diligence processes and failure to carry them out properly so as not to create the incentive for due diligence processes to omit ESG risks and impacts from their findings.

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

> LAPFF has always supported the wide integration of stakeholder interests into decisions because LAPFF's view is that this approach is a form of effective risk and impact prevention and mitigation for investee companies and investors.

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

- (x) 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:

> As explained above, LAPFF views many ESG factors both as environmental and human rights prerogatives and as financially material considerations. Therefore, it is critical that businesses take these factors into account in determining company strategy. This is particularly the case as effective environmental and human rights due diligence can identify issues or problems early in a process. Early identification and strategic discussion of risks, impacts, and opportunities can contribute to the resilience, sustainability, and innovative capacity of a business as well as preventing social and environmental harm. All of these factors impact on shareholder return.

Enforcement of directors' duty of care

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.

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?

Please describe examples:

Companies House in the UK sets out the seven director duties on its website: uphold the company constitution, promote the success of the company, exercise independent judgment, exercise reasonable skill, care, and due diligence, and avoid conflicts of interest, avoid personal benefit, and provide a record of board decision-making. These duties fall roughly into the two categories of duty of loyalty and duty of care.

In the UK, there has been litigation around UK companies being held to account for human rights and environmental impacts in respect of workers and communities in third countries. For example, in Chandler v. Cape, a UK company was held to have a duty of care to the employees at its South African subsidiary. A more recent example is Lungowe v. Vedanta in which Vedanta was held to have a duty of care to the employees of Vedanta's subsidiary in Zambia. At a minimum, these cases enforce the director duties to promote the success of the company and exercise reasonable skill, care, and due diligence. There are also arguably elements of avoiding conflicts of interest and avoiding personal benefit based on the facts of the cases.

Therefore, although there are not many human rights cases that enforce UK director duties, there are at least two that have not only done so, but that have extraterritorial application. It is also important to note that these rulings relied substantially on EU law, specifically the Brussels II Regulation. Therefore, it is important for any EU legal framework on environmental and human rights due diligence to align with existing law, regulation, and case law in this area. In the UK, it is unclear what the legal trajectory of this case law will be in light of Brexit, however.

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:

In 2017, shareholders of the Commonwealth Bank of Australia brought a claim against its directors on the basis that the company's annual report did not adequately inform investors of climate change risks. The investors also sought an injunction to stop the bank making the same omissions in future annual reports. The claim was avoided when, a week later, a new report was published by the bank's directors in which it was stated that climate change posed a significant risk to the bank's operations.

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?

- (selected) 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:

When a company directly affects people or the environment through its activities or products, the affected parties should be able to enforce their rights legally against company directors in relation to their duty of care. The reason is two-fold. First, this approach is necessary to comply with basic human rights and environmental law and standards. Second, as mentioned above, these parties usually have interests that are financially material to companies and therefore the directors and companies should be held to account for them. There is a separate point about social and economic enforcement of rights against companies and company directors. This latter approach to enforcement reinforces sound operational and efficiency practices by businesses, thereby reducing social, environmental, and business risk. It would be facilitated through a good EU legal framework on broader enforcement powers in relation to directors' duty of care.

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.

All stakeholders affected by a business in any way should have a right to enforce a company's duty of care. The nature of the stakeholder relationship to the company should affect the nature of the rights to enforcement, for example whether they are extensive or limited. This is why adequate and accurate stakeholder mapping is such an important prerequisite for any EU legal due diligence framework. Effective stakeholder engagement should help to inform these enforcement parameters. Therefore, LAPFF would not like to guess or prescribe what they should be, as enforcement mechanisms should be locally and culturally determined in each jurisdiction through procedures such as those set out in the UN Guiding Principles on Business and Human Rights. However, LAPFF notes the difficulty of local or culturally determined enforcement mechanisms is that they can lead to a lack of harmonisation of the rules across the EU. This lack of harmonisation can make it difficult for companies to determine how to comply. A well-constructed EU legal framework can allow for both harmonization of standards and effective local or culturally determined enforcement mechanisms, for example through an EU directive.

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 the 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 actions should depend on the risks of adverse impacts the company is possibly causing, contributing to or should foresee.

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

LAPFF largely agrees with this definition but suggests four small changes:

1. The duty should be termed "human rights due diligence duty" to distinguish it from the ordinary business due diligence duty, which focusses on legal risks for a company whereas human rights and environmental due diligence focusses on human rights risks to third parties external to the company and to the environment. Thus, it requires a different approach which is not a strictly legal approach.
2. It should be clarified that the "risk" is primarily that to the human rights of the rights holder and that the risks to the company are as a consequence of the risk and impacts to the rights-holder.
3. It should be added that due diligence is "inherently risk-based, proportionate, context-specific" and also aimed at providing a solution to the impacts on those affected as well as continuous learning and improvement.
4. Finally, it would be helpful to clarify that human rights due diligence is an ongoing and not one-off duty.

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 Option 1, 2 and 3 are horizontal i. e. cross-sectorial and cross thematic, covering human rights, social and environmental matters. They are mutually exclusive. Option 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 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.
- ● None of the above, please specify

Please specify:

Options 4 and 5 are too narrow. Effectively addressing sector-specific or thematic issues is dependent on a more comprehensive framework. It is not immediately clear why some combination of Options 1, 2, and 3 is not possible. There definitely needs to be a principles-based element to any legal framework in line with international human rights and environmental law and accounting for international corporate governance frameworks, along with a minimum standard of compliance while encouraging best practice in line with international standards.

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?

As above.

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.

There need to be guiding principles to any legal framework so that businesses understand how to comply with the spirit of the law as well as the letter of the law. There also needs to be a minimum level of compliance set out so that no race to the bottom is allowed, in other words so that businesses are not able to use competitive advantage as an excuse to drive down standards. LAPFF is increasingly seeing that human rights, climate, and other environmental considerations overlap and that trying to compartmentalize them leads to lack of protection for all of these areas. Therefore, any legal framework must cover all areas of human rights, climate, and environment as set out in international law. Complementary guidance would absolutely be necessary.

Question 15c: If you ticked options 2) or 3) in Question 15 please indicate which areas should be covered in a possible due diligence requirement (tick the box, multiple choice)

- [x] Human rights, including fundamental labour rights and working conditions (such as occupational health and safety, decent wages and working hours)
- [x] Interests of local communities, indigenous peoples' rights, and rights of vulnerable groups
- [x] Climate change mitigation
- [x] Natural capital, including biodiversity loss; land degradation; ecosystems degradation, air, soil and water pollution (including through disposal of chemicals); efficient use of resources and raw materials; hazardous substances and waste
- [ ] Other, please specify

Question 15d: If you ticked option 2) in Question 15 and with a view to creating legal certainty, clarity and ensuring a level playing field, what definitions regarding adverse impacts should be set at EU level?

Definitions set at international human rights and environmental law, EU law, such as the Charter of Fundamental Rights, and the Council of Europe's European Convention on Human Rights, should be the starting point for these definitions. Meaningful engagement with affected stakeholders after a process of effective stakeholder mapping should help to inform these definitions.

Question 15e: If you ticked option 3) in Question 15, and with a view to creating legal certainty, clarity and ensuring a level playing field, what substantial requirements regarding human rights, social and environmental performance (e.g.

prohibited conducts, requirement of achieving a certain performance/target by a certain date for specific environmental issues, where relevant, etc.) should be set at EU level with respect to the issues mentioned in 15c?

> These standards should be set based on effective engagement with affected parties, including workers, communities, and member states.

Question 15f: If you ticked option 4) in question 15, which sectors do you think the EU should focus on?

Question 15g: If you ticked option 5) in question 15, which themes do you think the EU should focus on?

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[16] should be excluded
- [ ] SMEs should be excluded with some exceptions (e.g. most risky sectors or other)
- [ ] Micro and small sized enterprises (less than 50 people employed) should be excluded
- [ ] Micro-enterprises (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
- [x] Capacity building support, including funding
- [ ] Detailed non-binding guidelines catering for the needs of SMEs in particular
- [x] 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

> Often SMEs are parts of larger supply chains. Therefore, an EU legal framework should explore the possibility of implementing an enterprise theory of liability to ensure that SMEs providing goods and services to larger corporate entities are receiving the requisite resources and support in respect of compliance with environmental, social, and governance standards set out in an EU legal framework on due diligence.

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?

- (x) Yes
- ( ) No
- ( ) I do not know

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

> Any contractual link, activity or relationship that could be the basis for a finding at contract, tort law, or criminal law within the EU should be included in this requirement. Contracts should contain a clause that makes clear EU rules, including human rights due diligence, are directly applicable through them. New York State's long-arm statute might be a template for such a link.

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

> Procurement restrictions requiring environmental and human rights due diligence could be placed on third party entities seeking to contract or do business with either EU member states or business entities located in EU jurisdictions. This measure would ensure pre-emptive protection of environmental and social standards. If a violation were found or alleged, a breach of contract, tort suit, or criminal suit could be pursued depending on the violation and the provisions adopted in the EU legal framework.

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?

- (x) Yes
- ( ) No
- ( ) I do not know

Please explain:

> If no measures are taken to promote a level playing field, apart from actual or perceived barriers to trade that would discourage international trade and economic growth with the EU, there might be legal issues that arise

under World Trade Organisation rules. The idea of promoting environmental, social, and governance standards is not to foster an environment of protectionism within the EU, but to improve environmental, social, and governance standards while promoting trade and sustainable development.

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)?

- [x] Judicial enforcement with liability and compensation in case of harm caused by not fulfilling the due diligence obligations
- [ ] 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:

For the last forty years, we have had a regime of voluntary compliance. LAPFF's view is that while there has been progress in understanding how to uphold environmental and human rights standards on some fronts through this approach, effective protection of environmental and human rights standards in line with both international and domestic environmental and human rights law has not been realized. Consequently, there must be effective judicial enforcement and consequences for businesses failing to uphold this standard to ensure that a level playing field for all businesses encourages support of these standards, not a race to the bottom.

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:

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

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?

- (x) 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 LAPFF's experience, as explained above in the responses to questions 6, 9, 13a, and 15, including workers and affected community members in company decision-making significantly increases the likelihood of reducing adverse environmental and human rights risks and impacts caused by companies. Additionally, it improves efficiency, innovation, and staff retention, as well as fostering a social (and sometimes legal) license to operate in challenging areas.

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

All stakeholders affected by a company's operations, services, or products should be represented.

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	○	◉

Other, please specify:

There could also be a mandatory stakeholder engagement mechanism requiring companies and stakeholders to set a framework for regular meetings, agendas, topics for discussion, and outcomes within given timeframes. These frameworks could serve as evidence of appropriate environmental and human rights due diligence processes. For example, LAPFF currently has a structured engagement process established with Brazilian community members affected by the Vale and BHP dam collapses at Mariana and Brumadinho. Investors and community members meet once a quarter to update one another on progress against objectives set at each meeting. A further topic of importance to improving company reparations and prevention of additional tailings dam collapses is agreed for each meeting. Then, additional objectives and action points are set and pursued by both groups. This type of engagement could act as a template for a stakeholder engagement component in an EU legal framework.

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 [17] (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.

This question is being asked in addition to questions 40 and 41 of the Consultation on the Renewed Sustainable Finance Strategy the answers to which the Commission is currently analysing. Ranking 1-7 (1: least efficient, 7: most efficient)

Restricting executive directors' ability to sell the shares they receive as pay for a certain period (e.g. 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 (e. g. 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:

In LAPFF’s view, environmental, social, and governance underpins to executive remuneration could prove helpful in fostering cultures of compliance with ESG standards. However, LAPFF continues to believe that effectively building these issues into corporate strategies and business models is the most effective way to undertake sustainable corporate governance.

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 [18] (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).

- [x] Requirement for companies to consider environmental, social and/or human rights expertise in the directors’ nomination and selection process
- [x] Requirement for companies to have a certain number/percentage of directors with relevant environmental, social and/or human rights expertise
- [x] Requirement for companies to have at least one director with relevant environmental, social and/or human rights expertise
- [x] 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
- [x] Other option, please specify
- [ ] None of these are effective options

Please explain:

Depending on the situation, any one of these criteria could be effective. However, in LAPFF’s experience it is helpful to have more than one board member in any one area with experience or expertise in a given area. This is because if there is only one worker representative, for example, or director with climate expertise, the board can more easily silo and dismiss a single director’s input. If more than one board member has experience or expertise in a given area, a more robust discussion of the company’s risks and impacts in that area is possible. The publication of an annual review of Board skill sets, indicating the above requirements would be useful.

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 % 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[19]. (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].
In your view, should the EU take further action in this area?

- (x) 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?

As well as the issues raised in the consultation there are other problems. Buybacks give the false impression of growth, by increasing earnings per share. The implications from this are:
1. As some fossil fuel companies are not investing in renewables, and some may have left it too late to compete with those that invested early, their natural path is of decline and not growth, but the decline is given the false impression of growth.
2. For some companies, managed decline may be the correct approach but buybacks give the false impression of growth.
3. For those companies that have left investments too late and are in inevitable decline, the shareholders left in the company end up owning a larger share of a wasting asset.

The simplest solution is to prohibit distribution by buybacks, which is the position that until relatively recently prevailed.

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:

Yes. Many boards lack diversity on several bases of diversity. Diversity at board level is a well-accepted risk mitigation mechanism and is therefore an important component of board structure. An additional problem is the lack of skills and knowledge to deal with climate change and human rights. As mentioned in the response to question 22, this problem is not necessarily solved by having a single director with expertise in relevant areas. However, some level of expertise in these areas is critical to effective risk management for companies. This is because companies are too often run from a management perspective (securing incumbency based on their skills) rather than that of the providers of capital.

Section V: Impacts of possible measures

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.

Table

	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			
Better environmental and social performance and more reliable reporting attracting investors			
Other impact, please specify			

Please explain:

Without seeing the specific EU legal framework measures proposed, it is impossible to speculate on the outcomes in respect of the above options.

Question 26: Estimation of impacts on stakeholders and the environment
A clarified duty of care and the 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).

LAPFF is not a company but does engage regularly with the world’s largest companies. Without seeing the specific EU legal framework measures proposed, it is impossible to speculate on the outcomes in respect of the above options.

Contact

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