

EUROPEAN COMMISSION SEEKS FEEDBACK ON SUSTAINABLE CORPORATE GOVERNANCE

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Legal Briefings - By **Tara Theiss, Elsa Savourey, Oliver Elgie and Antony Crockett**

Earlier this year, we reported on the European Commission's [proposal](#) to introduce a legislative initiative on mandatory human rights due diligence, and on an early draft directive prepared for the European Parliament's Committee on Legal Affairs (the "**EP draft directive**").

The European Commission has now [launched](#) a [public consultation](#) to gather stakeholder views on its approach to regulation in the area of sustainable corporate governance. The wide-ranging proposal includes a mandatory new due diligence duty obligation and signals the possibility of EU legislation to expand directors' duty of care in relation to stakeholder interests. It is expected to inform a forthcoming Commission initiative in the New Year.

OVERVIEW OF THE CONSULTATION

The consultation is set against the background of the Green Deal and the Commission's objective of promoting "long-term sustainable value creation rather than short-term financial value". The Commission also seeks to use "competitive sustainability" as a means to assist with the Covid-19 recovery, as well as enhancing companies' resilience.

In contrast to the EP draft directive, the Commission has not set out the proposed contents of any future EU regulations or directives in detail. Instead, respondents to the consultation have been asked to address a broader set of 26 questions, divided into the following parts:

- Part I: the need and objectives for EU intervention on sustainable corporate governance;
- Part II: the option to define directors' duty of care in relation to stakeholders' interests at EU level;

- Part III: the possible introduction of a new due diligence duty;
- Part IV: other elements of sustainable corporate governance; and
- Part V: the impacts of the possible measures.

Feedback to the consultation is requested by 8 February 2021. A Commission initiative is expected to follow in Q2 2021.

Amongst other issues, the consultation invites views on various different ways of extending existing directors' duties under national law, as well as the option of imposing a mandatory human rights and sustainability due diligence obligation. The consultation is intended to be complementary to the ongoing review of the Non-Financial Reporting Directive.

We set out below a summary of the consultation's key areas of focus.

NEED FOR THE INITIATIVE

Part I of the consultation seeks views on the need and objectives for EU action on sustainable corporate governance. This includes questions as to whether companies and their directors should take account of human rights violations, environmental pollution and climate change, alongside the financial interests of shareholders, beyond what is currently required by EU law. It also includes questions relating to the potential benefits/drawbacks of EU-level regulation on supply chain due diligence focused on such issues. Similar questions were included in the [EU consultation on the Renewed Sustainable Finance Strategy](#).

Given the focus on due diligence in the United Nations Guiding Principles on Business and Human Rights (the “**UNGPs**”), we would expect there to be broad consensus in relation to the expectation that companies take human rights and environmental issues into consideration as part of their decision-making. Indeed, the EU-commissioned [report](#) on supply chain due diligence published earlier this year confirmed that multinational companies increasingly support the introduction of human rights due diligence legislation.

EXPANDING AND CLARIFYING DIRECTORS' DUTY OF CARE

Part II considers the existing duty of care owed by company directors and what it means to act in the “interests of the company”. In particular, the consultation asks whether the “interests of the company” is sufficiently clear as a concept and whether any lack of clarity might lead to short-termism on behalf of a company's management and a potential disregard for adverse environmental and social impacts, including in relation to human rights.

In this regard, the reputational, operational and financial consequences for companies that cause adverse human rights and environmental impacts can be severe. There is already an expanding legal infrastructure requiring companies to respect human rights. In particular, there is a global trend towards holding management responsible for adverse human rights impacts. For example, the UK and Australian Modern Slavery Acts require modern slavery statements to be approved by the board and signed by a director (or equivalent). In the UK, directors also have to include information regarding environmental and social impacts, including human rights impacts, in the company's annual strategic report. In France, large companies must include a report on the effective implementation of its vigilance plan in their annual management report. Imposing new duties on directors in the wider European context would be consistent with this trend.

It is not clear how directors' duties, which are ordinarily owed to the company, could be enforced in a meaningful way by victims of adverse impacts. The consultation is clearly mindful of these issues and has sought feedback on potential stakeholder enforcement mechanisms.

MANDATORY DUE DILIGENCE

Part III of the consultation considers the possibility of a new due diligence obligation and raises questions on the definition and scope of the duty, its application to SMEs and third countries, and the mechanisms for supervising and enforcing compliance.

In relation to human rights due diligence, it is worth noting that the EU Taxonomy Regulation came into force on 12 July 2020 (save for its disclosure requirements and technical screening criteria), as part of the Commission's Action Plan on Financing Sustainable Growth. In order to qualify as "environmentally sustainable" under the EU Taxonomy Regulation, a business must comply with minimum social and governance safeguards which align with the OECD Guidelines on Multinational Enterprises and the UNGPs. Given the growing cross-sector pressure on companies to qualify as "environmentally sustainable", many businesses will already be starting to conduct human rights due diligence. The Commission's consultation foreshadows that such pressure may crystallise in an express duty for all EU companies - and non-EU companies that are performing certain activities in the EU - to carry out such due diligence.

Notably, question 15 poses five options for the new duty. These include:

- a 'principles-based approach' (setting out a general due diligence duty) (referred to as "Option 1");
- a 'minimum process and definitions approach' (as above, but with additional harmonised definitions and sector-specific guidance) ("Option 2"); or
- a 'minimum process and definitions approach' (with additional environmental

requirements) (“Option 3”).

The consultation also seeks views on whether the EU should focus on either a ‘sector-specific approach’, a ‘thematic approach’ (for example, on a particular issues, such as modern slavery) or neither of these approaches.

The approach suggested in the EP draft directive has most in common with Option 1 (see Article 4 of the EP draft directive). However, the approach taken in the Taxonomy Regulation has most in common with Option 3. Given that the Taxonomy Regulation is already in force, Option 3 may present the best option for harmonising the regulatory approach in this area.

OTHER ELEMENTS AND POSSIBLE IMPACTS

Finally, Parts IV and V of the consultation pose questions on other elements of sustainable corporate governance, including stakeholder engagement, director remuneration and expertise on sustainability issues, and the possible costs and benefits of any of the proposed measures.

As noted above, feedback to the consultation is requested by 8 February 2021 and a Commission initiative is expected in Q2 2021.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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