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CONSULTATION DOCUMENT FOR AN INITIATIVE ON SUSTAINABLE CORPORATE GOVERNANCE:
COMPLETE A2 RESPONSES

Introduction

Atelier Aftab (A2) is a New York-based law firm specializing in business and human rights. Our clients include many of the world's most responsible Fortune 100 companies, including several European multinationals. We believe there are great virtues in law focused on sustainable corporate governance. But there are also serious dangers—for stakeholders and business alike—in overbroad, vague, and/or impractical legislation. Our comments to the European Commission Consultation on Sustainable Corporate Governance therefore sought to encourage meaningful, practical, and precise regulation. They are reproduced below in their entirety.

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?

Choices

- Yes, a more holistic approach should favour the maximisation of social, environmental, as well as economic/financial performance.
- Yes, as these issues are relevant to the financial performance of the company in the long term.
- No, companies and their directors should not take account of these sorts of interests.
- Do not know.

Reasons

There is little doubt that non-financial risks, particularly social and environmental risks, can have a material bearing on the long-term financial performance of companies across sectors. The risks include brand damage and loss of customers; litigation; criminal sanctions; regulatory penalties; operational challenges; and staff turnover. While the relative degree and import of each risk type depends on specific corporate context, the long-term relevance of this type of

risk—flowing from the business's impacts on society, including through its value chain—on business resilience and success is by now well documented.

That reality, however, does not warrant reconceiving the nature of the corporation as a public institution with inherently public responsibilities. While specific regulations—e.g., regarding environmental risk management, GHG emissions, fair treatment of workers and communities—are essential to ensure that business's private pursuits do not come at the expense of people or planet, it is far more radical to designate corporate leaders as fiduciaries for the world. Such a breadth of perpetual obligation and potential liability could, on one extreme, paralyze decision-making implicitly or through interminable litigation, or, on the other, accord directors unbridled discretion to run the corporation with minimal accountability. We would therefore strongly caution against an undue expansion of corporate duties as suggested by "a more holistic approach"—particularly when the ends pursued can be much better approached through more targeted measures.

***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?

Choices

- o Yes, an EU legal framework is needed.
- o No, it should be enough to focus on asking companies to follow existing guidelines and standards.
- o No action is necessary.
- o Do not know.

Reasons

Over the last decade, European companies across sectors have been at the vanguard of corporate sustainability. That welcome evolution has been largely driven by voluntary commitments and market drivers. But the number of companies who commit in practice to managing risks to human rights and the environment in a meaningful and rigorous way is vanishingly small relative to the universe of European business. And, even among those, there is tremendous variety in interpretation of expectations, because there is no clear method or accepted arbiter to resolve disagreements regarding scope of responsibility. The result is broad and deep uncertainty, which creates the risk of unfair competition and the perverse incentive

for media campaigns focused on the most ethical businesses by stakeholders who have little choice but to leverage voluntary commitments to obtain effective remedy.

A legal framework is essential to overcome the dangers of uncertainty and to democratize accountability. An overarching European framework is critical because of the integrated internal market. A patchwork of different national regulations of varying substantive and geographic scope, formal expectations, and potential remedies is likely to drive market fragmentation—e.g., under unfair competition laws—or extreme administrative costs if companies operating in multiple Member States are made to identify and comply with myriad distinct obligations.

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)?

Choices

- 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
- Other

Reasons

This is a pretty comprehensive list of the advantages of properly crafted legislation. It is unclear how such regulation would improve SMEs' position in supply chains—particularly since they are the ones likely to have the hardest time complying with due diligence legislation.

Question 3a: 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)?

Choices

- Increased administrative costs and procedural burden
- Penalisation of smaller companies with fewer resources
- Competitive disadvantage vis-à-vis third country companies not subject to a similar duty
- Responsibility for damages that the EU company cannot control
- Decreased attention to core corporate activities which might lead to increased turnover of employees and negative stock performance
- Difficulty for buyers to find suitable suppliers which may cause lock-in effects (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
- Other

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?

Choices

	Relevant	Not Relevant
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**		
the interests of local and global **natural environment**, including climate		
the likely consequences of any **decision in the long term** (beyond 3-5 years)		
the interests of **society**, please specify		
other interests, please specify		

Reasons

This question touches on important concerns but risks being misunderstood. Stakeholder interests can obviously be relevant to business success. But they are not relevant simply because they exist. They are relevant to the extent (i) the stakeholders can affect the commercial endeavors of the business and its owners; and (ii) the specific interests at play are related to the commercial endeavors of the business and its owners. Absent such barometers of relevance, the fundamental nature of business itself would be reconfigured from private to public enterprise. That is: the wide variety of interests above *may* be relevant to the success of a company in many circumstances, but whether and how relevant they are to any business is context dependent.

Re **interests of society**: There are a wide swathe of "interests of society" that bear on the commercial environment and the long-term success of company. The most prominent of these interests pertain to stability—social and political—and the potential for economic growth. In particular, the rule of law (including prohibition of bribery), protection of equality, and assurance of the right to vote each play an outsize role in forming the commercial environment. In addition, fulfilment of welfare rights, including education, health, and social security can foster stability and economic growth.

Re **other interests**: Any company can also be meaningfully affected by the interests of creditors; persons and communities affected by a company's products and services; and the interests of regulators. (That is not to say that these interests should drive ultimate strategy; just that they may inform the interests of shareholders.)

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?

Choices

	Strongly agree	Agree to some extent	Disagree to some extent	Strongly disagree
Identification of the company’s stakeholders and their interests				
Management of the risks for the company in relation to stakeholders and their interests, including on the long run				
Identification of the opportunities arising from promoting stakeholders’ interests				

Reasons

We are cautious of constructing fiduciary duty to manage risks for the company “in relation to” stakeholders to the extent “in relation to” means to reshape the interests of the company. A legal expectation of directors to consider how interests of, and impacts on, stakeholders might shape the company’s fortunes is reasonable and desirable. A legal expectation to consider stakeholder interests in the company simply because stakeholders express them is not, for it could severely dilute the value of ownership and ripple through European commercial law in ways radical and unpredictable.

Identifying stakeholders is subsidiary, and implicit in, any expectation to manage risks in relation to them. We therefore do not believe it necessitates specific prescription—though such an expectation is unlikely to do harm.

We see no reason at all for the law to mandate identification or disclosure of opportunities from considering stakeholder interests, as the market is well enough able to guide such behavior—it is on risk identification that legal pressure is likely to address market failures.

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?

Choices

- 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

Reasons

We agree to the extent such law does not overwhelm directors' fiduciary duties in scope. That is, any expectation of directors in this regard should have clear and specific parameters in terms of (i) relevant adverse risks & impacts, (ii) relevant business involvement with such risks & impacts, and (iii) appropriate responses. The law must be cautious of transforming business into a quasi-public institution with broad social mandates. An effective legal requirement will depend on precise and practical definitions and indicators to ensure that directors, courts, and stakeholders can come to a shared understanding of when procedures are "adequate".

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?

Choices

- 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

Reasons

We are concerned that the question presents a false dichotomy. There are clear dangers in privileging short-term share value as the ultimate good of the corporation, particularly when such gains undermine long-term profitability or divert investment from innovation. But addressing those dangers does not require a radical expansion of directors' duties in a way that would reform the fundamental nature of business and practically undermine accountability. Directors can remain

focused on the success and resilience of the business by shifting relevant time horizons rather than expanding their array of masters. And, to the extent the concern is that directors exercise their discretion without harming stakeholders, that end can be accomplished through targeted regulation better than an amorphous and omnipresent duty—one which could, in practice, afford directors unlimited discretion, for an agent of all is accountable to none.

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?

Several significant risks—sometimes bipolar—would flow from the uncertainty and expansive accountability of broadening fiduciary duty to make directors always accountable to all stakeholders.

- ***Unbridled director discretion*** as those responsible for everyone may, in practice, be accountable to no one.
- ***Corporate paralysis*** as directors and officers seek to avoid offending any stakeholder, particularly those with media savvy.
- ***Tenuous and tendentious litigation***, perversely targeting the most responsible enterprises because of their greater sensitivity to public pressure.
- ***Ever-expanding D&O liability proceedings*** to accommodate perspectives of diverse, likely conflicting, stakeholders interested in a wide array of decisions.
- ***Diminished allure of corporate investment*** if (i) directors are not bound to pursue shareholder interests, (ii) stakeholders and their perspectives on distinct projects and business lines are unforeseeable, and (iii) core business aims themselves may be subject to sudden reversal.

Question 9a: How could these possible risks be mitigated? Please explain.

The risks inherent in broadening fiduciary duty as proposed are significant, with long-term implications difficult to chart. We see three ways to limit the dangers.

- Develop a clear hierarchy of shareholders and stakeholders (and interest types) to inform directors' decisions and limit (i) potential paralysis and (ii) abuses of power.
- Structure the fiduciary duty as one of process, i.e., obliging directors to consider the potential impacts on a wide variety of stakeholders when making material decisions in the long-term interest of the company. Under this approach, directors would not be bound to make decisions in all stakeholders' interest—just the long-term interest of shareholders.
- Even if directors' have a duty to consider a broad array of interests, do not accord every stakeholder an enforceable right; leave that in the hands of shareholders. Stakeholders would retain rights to pursue directors and the company in case they suffer material harm because of directors' unreasonable exercise of authority.

Question 9b: Where directors widely integrate stakeholder interest into their decisions already today, did this gather support from shareholders as well? Please explain.

We do not know of any company that considers stakeholder interests at the same level as, and with equal weight to, shareholder interests. That said, we have worked with several companies that are sincerely committed to responsible business practices, including through rigorous and good faith understanding of stakeholder risks and grievances. Most shareholders have traditionally been indifferent, as long as the firm is performing well financially; the relatively few who pay attention are generally supportive, particularly because the care for stakeholders reflects generally strong habits regarding care for the company.

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? Please explain.

Choices

- 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

Detail

The danger in how corporate sustainability is currently pursued by most companies—in Europe and beyond—is that it is largely a public relations exercise. Many companies seek first to *appear* responsible to investors, customers, and civil society; and, because voluntary standards are subject to many diverging interpretations, such companies are able to grant *ad hoc* or shallow commitments the veneer of much greater legitimacy. Such approaches ultimately benefit neither stakeholders nor shareholders, because they frequently ignore salient risks, remain complacently static, and misrepresent the efficacy of corporate risk management.

The only way to avoid this danger is to ensure that sustainability moves beyond the communications department to inform all core business functions—legal, human resources, operations, procurement, product development, marketing, and more. In our experience, that integration in turn depends on a tone set from the very top of the company emphasizing that sustainability is a central business concern rather than a nice-to- have fodder for a sustainability report or marketing campaign.

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?

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:

We are aware of innumerable cases in the US and Canada filed by shareholders to enforce directors' fiduciary duties, including related to sustainability risks. We have previously written on those cases several times; our articles are available at atelieraftab.com.

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?

There is a clear role for stakeholders to play in ensuring that directors do not act negligently or criminally in a way that causes actionable injury. But that role needs to be properly constrained to ensure certainty and practicality. We would caution against creating a general interest enforcement power in stakeholders to ensure corporations pursue their interests at all time. But people injured by corporate acts or omissions—including workers, customers, communities, and civil society groups acting on their behalf—should be able to hold corporations and, in proper circumstances, their directors liable should they cause injury through negligence.

We stress that this in no way means that corporations should be free from regulation to protect the environment and respect human rights. To the contrary, targeted regulation—even with extraterritorial implications, as in bribery or modern slavery—is a better path to ensure accountability rather than reshaping fiduciary duty itself.

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.

If the role of such groups is properly targeted to negligence resulting in actionable harm—rather than merely failing to consider their interests at an overarching level—then there need not be an *a priori* limit on which stakeholders can bring actions.

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.

We do not agree with this definition for several reasons.

- *First*, "due diligence" in the context of voluntary corporate responsibility standards has an idiosyncratically broad and legally unwieldy meaning. We would recommend developing a definition consistent with general commercial usage to enhance understanding and practical adoption. In commercial and corporate governance law, "due diligence" refers specifically to the identification of risks and impacts through investigation. That is conceptually distinct from meeting the "duty of care" or "standard of conduct", which more accurately capture all aspects of reasonable business behavior.

- To enhance certainty and understanding while aligning with the broader legal framework, we would suggest capturing the relevant dimensions of the proposed duty in distinct obligations: (i) due diligence (i.e., assessment and investigation), (ii) risk management, (iii) remediation, and (iv) disclosure. Risk management would refer to reasonable measures expected to address risks based on level of involvement and severity of risk, including mitigation, leverage, and monitoring. Remediation would refer to processes and outcomes expected of companies that cause injury to the relevant interests. And disclosure would identify what type of information needs to be disclosed to whom and at what level of frequency. The elements would correspond to the concept in leading voluntary standards while aligning with law and commercial practice.

- *Second*, the proposed substantive scope is confusing. "Human rights" under international law, for instance, inherently capture a variety of "health" and "environment" impacts (though climate change is more challenging). Including both of these as distinct categories of impact suggests a narrow understanding of human rights or an extremely broad interpretation of health and environment entitlements. Since international human rights law focuses on the obligations of states and governments, any legislation would need clear definitions of what constitutes (i) an actionable impact and (ii) a sufficient link between a business and an impact.

- *Third*, the proposed scope of relevant business activities is too narrow. The consensus of leading voluntary standards, including the Guiding Principles and the OECD Guidelines, is that companies should consider impacts throughout their value chains—upstream and

downstream. Limiting the duty of care to a company's own operations and upstream business relationships is anachronistic and would miss some of the more significant (salient and material) impacts that companies can have on human rights and climate change through their products and services.

- *Fourth*, "foreseeability" should have no role in the definition unless it is inherently incorporated in the definition of causation. The inclusion of foreseeability as a distinct ground for creating corporate liability for an impact is at odds with civil and criminal law across EU jurisdictions (and beyond). Indeed, it diverges materially from how foreseeability is used in European human rights law, where the concept only matters as a *limit on liability* where factual causation is established. This novel use of the concept would also be counterproductive in encouraging due diligence in the first place: if foreseeability is material in determining responsibility for risk management, remediation, or disclosure, the legislation would create perverse incentives not to conduct more than "average" diligence—for that would create additional responsibility and potential liability. (*See* Y. Aftab & A. Mocle, *Business and Human Rights as Law: Towards Justiciability of Rights, Involvement, and Remedy* (LexisNexis 2019) at 105-111.)

- *Fifth*, to avoid interpretive misunderstandings, we would avoid being too specific regarding elements of due diligence—e.g., "reasonable efforts to identify suppliers"—unless the intention is to be comprehensively specific (reasonable efforts to identify affected stakeholders; reasonable efforts to engage with such stakeholders; reasonable reliance on internal or external experts to identify relevant risks, etc.). Otherwise, the presence of one specific element in the definition may be misused to justify not implementing others, which may be of equal import.

- *We would suggest the following definition based on the concerns above:*

  For the purposes of this consultation, "duty of care" refers to a legal requirement for companies to establish and implement reasonable policies and procedures to identify, address, and account for risks to human rights and climate change [defined in Annex] in the company's operations, products, services and value chain. "Company" includes subsidiaries, affiliates, and entities under the business's control. "Value chain" refers to a company's upstream and downstream "business relationships" and includes suppliers, subcontractors, distributors, and customers.

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.

Choices

- **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

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?

Reasons

We would propose combining option 2 with a variant of option 5, focusing a narrow range of critical human rights that are salient across industries and can be defined with reasonable precision. In our experience, the following themes are critical across all industries and underpin respect for an array of other rights:

- Child Labor
- Forced Labor
- Freedom of Association
- Right to Just and Favorable Working Conditions (which includes fair pay, occupational health & safety, rest & leisure, and non-discrimination)
- Security of the Person
- Right to Health (which includes adverse impacts on the environment as well as product marketing and defects)
- Right to Privacy
- Right to Self-Determination (including free, prior and informed consent)
- Climate Change (this would likely need to be a process-based definition to reasonably account for business context)

Focusing on a list of key human rights with specific definitions of adverse impact is a narrower commitment than many stakeholders seek. But it is also far more likely to lead to effective implementation and accountability than a comprehensive but amorphous list of wrongs that enable significant discretion regarding which impacts any company ultimately addresses. In addition, a narrow but clear list will enable companies to build the necessary infrastructure of procedures such that they (i) can be assessed effectively by regulators, (ii) can provide meaningful lessons across sectors, and (iii) will not immediately be overwhelmed by breadth.

Leading companies will immediately incorporate a broader array of rights to distinguish themselves from peers and meet voluntary commitments. Others will be able to build progressively with a keen awareness of oversight and understanding of what is expected. Indeed, legislation itself will then be able to evolve in scope in a more stable way as understanding is entrenched.

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.

Reasons

The necessary legal certainty will depend on precise definitions of core concepts, notably (i) what constitutes an adverse impact (particularly when the business is otherwise complying with national law); (ii) how a company can determine whether and how it is involved with an impact (or risk); and (iii) how a company should respond when it has a responsibility to remedy.

In this regard, it is critical that the legislation not simply parrot the OECD Guidelines or the Guiding Principles. While each of these standards provide a helpful framework for responsible business conduct, they are not conceived to be legally certain. As John Ruggie and John Sherman have written: "How human rights due diligence is translated into legislation and regulation is an iterative process that flows from the Guiding Principles but requires far more contextual and textual specificity." ("The Concept of 'Due Diligence' in the UN Guiding Principles on Business and Human Rights: A Reply to Jonathan Bonnitcha and Robert McCorquodale," 28 *European Journal of International Law* 3 (2017), 926). They are therefore effective as the beginning of legislation, but not its end.

For due diligence legislation to be effective in providing legal certainty, accountability, and a level playing field it needs to build on existing voluntary standards with clear definitions of "adverse impact", "involvement", and "rights-compatible" remedy so that companies can reasonably anticipate what they must do and stakeholders can fairly hold them accountable. The definitions will need to be in the legislation, coherent with existing corporate law, precise and practical enough to enable compliance, and flexible enough to apply to a diversity of corporate contexts. Supplemental guidance may help build understanding; but it cannot substitute for the certainty any legislation itself must offer to respect the rule of law.

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)

Choices

- Human rights, including fundamental labour rights and working conditions (such as occupational health and safety, decent wages and working hours)
- Interests of local communities, indigenous peoples 'rights, and rights of vulnerable groups
- Climate change mitigation
- 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

Reasons

We do not check "interests of local communities" and "natural capital" only to avoid redundancy, as both of these issues are captured within the concept of "human rights" and adding them as separate categories will only create interpretive confusion.

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?

The overarching principle should be to provide sufficient precision that a business or stakeholder, with the assistance of legal counsel if necessary, could reasonably predict what might create legal liability: "Owing to the general nature of statutes, their wording cannot be absolutely precise. … On the other hand, the use of overly vague concepts and criteria in interpreting a legislative provision can render the provision itself incompatible with the **requirements of clarity and foreseeability as to its effects**." (European Court of Human Rights, *Guide on Article 7 of the European Convention on* Human Rights (31 Aug. 2020) ¶ 29) At the same time, the definitions should be flexible enough to be applicable to a range of distinct contexts.

In particular, we would recommend (i) clear definitions of involvement based on existing legal concepts (e.g., causation, vicarious liability based on benefit) rather than the novel and (legally) vague concepts of "contribution" and "direct linkage"; (ii) definitions of "rights-compatible remedy" that provide objective parameters of when a business has met its responsibility; and (iii) definitions of each of the specific risks businesses must address, adapted from the public to the private context.

With respect to "adverse impact", as discussed above, we would recommend that the business duty of care be defined with reference a specific list of core rights. Under international law, however, those rights are defined with reference to states and governments. They frequently do not have a clear meaning when it comes to the obligations of private actors, including businesses. For EU regulation to create legal certainty and accountability, it will need to translate international human rights in a principled way into the private context—drawing on international law while recognizing the distinct institutional structure and powers of businesses, so as not to burden them with public responsibilities.

Each definition should (i) provide a principle for when the right is adversely impacted (e.g., abuse of power with reference to core interests the right protects), and (ii) legitimate exceptions to that principle. (If the legislation endeavors to capture the full panoply of human rights, we would suggest that it at least embrace a principle for translating those rights from the public to the private context.)

To illustrate what a principled and coherent approach might look like, we provide below an extract from *Business and Human Rights as Law* (LexisNexis 2019) regarding how to translate freedom of expression into the commercial context:

> "The right to freedom of expression is … set out in Article 19 of the *Universal Declaration of Human Rights* and Article 19 of the ICCPR:
>
> 1. Everyone shall have the right to hold opinions without interference.

2. Everyone shall have the right to freedom of expression; this right shall include freedom to seek, receive and impart information and ideas of all kinds, regardless of frontiers, either orally, in writing or in print, in the form of art, or through any other media of his choice.
3. The exercise of the rights provided for in paragraph 2 of this article carries with it special duties and responsibilities. It may therefore be subject to certain restrictions, but these shall only be such as are provided by law and are necessary:
   (a) For respect of the rights or reputations of others;
   (b) For the protection of national security or of public order (ordre public), or of public health or morals.

…

"Transposing state-centric concepts to the business context raises two related issues. First, what are the legitimate expectations of a private actor as duty-bearer for the right? Second, what are the legitimate bases for the private actor to interfere with the right without adversely impacting it? As duty-bearers, companies and the state are fundamentally different in how they impact individual freedom of expression.

…

"Freedom of expression is subject to some restrictions in the state context; there are presumably ways in which businesses can limit the ability to express oneself without adversely impacting the right to freedom of expression. … The question … is: At what point do business limits on individuals' ability to express themselves become adverse impacts on individuals' right to freedom of expression?

…

"Applying these principles, we might translate freedom of expression into a business-focused right as follows:

(1) Businesses may not abuse their power to limit individuals' freedom to hold opinions or to seek, receive, and impart information and ideas of all kinds through any medium.
(2) Nothing in this right precludes a business from reasonably limiting individuals' ability to express themselves or receive information through agreements entered into freely and with informed consent or through fair, market-based limitations on access to goods or services. Any such agreements or market-based limitations must be in accordance with law.

"The definition is designed to capture the spirit of limitations on state action while recognizing the distinct function of business as a social institution." (Y. Aftab & A. Mocle, *Business and Human Rights as Law: Towards Justiciability of Rights, Involvement, and Remedy* (LexisNexis 2019) at 77-79 (citations omitted).)

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.

Choices

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

Reasons

While it is impossible to ignore the administrative burden that mandatory due diligence legislation could place on smaller businesses, we fear it could create perverse incentives in corporate formation and value chains were they to be entirely exempt from the regulation. We would encourage emphasizing that the expectations of any such legislation are sensitive to business size and industry. Effective due diligence can be conducted with careful thought that does not require a disproportionate investment of resources. The aim would be to ensure good corporate habits in a practical way while consistently making corporate ethics a component of product/service quality in Europe. We stress, though, that the legislation should pay close attention to the risks of overburdening small businesses in a way that is disproportionate to their risks and impacts. A regulatory impact assessment or pilot study would be strongly advisable to understand the possible consequences for relatively small enterprises.

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?

Choices

- o Yes
- o No
- o I don't know

Reasons

Otherwise, it would significantly disadvantage European companies and create perverse incentives regarding legal corporate structure to avoid liability.

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.

To protect consumer rights and preserve a level playing field, we believe that the link should be tied to the provision of goods or services in the EU. In our view, the UK Modern Slavery Act 2015 provides in Section 54 (2) a good example of such link and should be adopted for EU purposes. In other words, the obligations should apply to third country companies if they (i) supply goods or services in the EU and, (ii) have a total turnover of a certain amount in the EU overall.

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

We would expect companies that met the minimum threshold requirements to be subject to essentially the same obligations as their EU-based counterparts, which would ideally include (i) due diligence (i.e., assessment and investigation), (ii) risk management, (iii) remediation, and (iv) disclosure.

The enforcement mechanisms would need to be adapted to overcome jurisdictional and practical challenges. Civil litigation and fines may prove academic. We would suggest treating compliance failures as integral product/service quality defects, such that companies that fail to exercise due care—demonstrated through good faith policies, procedures, and disclosure—would not be entitled to (i) import licensing, (ii) intellectual property protection, or (iii) participation in public procurement. (Demonstration of compliance may require a certification process based on public reports or an attestation of conformity.)

A less onerous alternative may simply be a public register listing companies who have not met the certification requirements, so that all potential EU business relations and customers can be alerted. That may prove incentive enough for most recalcitrant businesses seeking to sell their wares in the EU.

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?

Choices

- Yes
- No
- I don't know

Reasons

The EU collectively plays a leading role in driving international law and global policy commitments. We would recommend leveraging this power to drive improvement across jurisdictions, both through high-level policy commitments (e.g., the Paris Accord) and more immediate sanctions in international agreements, particularly (i) bilateral investment treaties and free trade agreements, particularly re reciprocal tariff and investment protection; (ii) World Trade Organization expectations; and (iii) the Agreement on Trade-Related Aspects of Intellectual Property Rights. Conditioning access to protection conferred by such agreements on responsible corporate behavior could serve as powerful driver to make the global playing field more even.

We would stress, however, that such legislation's benefits are likely to far outweigh its costs even absent immediate third-country embrace. That is both because they inherently enhance corporate processes, innovation, and resilience and because they will distinguish European brands in the global marketplace.

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)?

Choices

- 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

Reasons

We hesitate regarding "judicial enforcement" because of the formulation: determining when a failure to conduct due diligence caused an injury is exceptionally difficult in the human rights context, where so many risks are endemic. For example, all authorities accept that modern slavery and child labor are global, cross- industry plights that are fueled by myriad systemic forces, cultural practices, and criminal activities. It would be an extraordinarily high bar to demonstrate that the absence of one company's due diligence is the cause of a systemic scourge. The better approach for judicial enforcement--consistent with civil tort/delict liability more generally--would be to create a due diligence defence, so that the judicial enquiry has two stages: (i) did the company cause or benefit from the harm; and (ii) if so, did it meet its duty of care to address such harms (including through due diligence, risk management, and remediation)?

Other: We would also consider trade sanctions for imported goods where companies cannot, or are unwilling to, demonstrate due care.

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?

Choices

- 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

Detail

We agree to the extent the expectation is reasonably defined as one of oversight. Companies should establish mechanisms to understand and assess a wide variety of risks to a wide variety of stakeholders, but that does not mean--and likely should not mean--that directors themselves are bound to engage directly with those mechanisms or those stakeholders, which would be practically overwhelming. The responsibility of directors, as with other areas of corporate risk,

should be to apprise themselves of material risks to the company on a regular basis and to ensure that those risks are addressed effectively. The actual implementation of such mechanisms and engagement with stakeholders, however, can readily and most effectively be handled by corporate personnel who report on a regular basis to the board.

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

A reasonably defined expectation, with directors overseeing the implementation of a complaint mechanism, does not require an *a priori* limitation of stakeholder representation. We would suggest that it be tailored to receive and address the concerns of stakeholders most likely to be affected by the company's products, services, and operations (including authorized representatives of such stakeholders where necessary). For practicality, any legislation would need to recognize the enormity of this enterprise and permit progressive realization, starting with workers and expanding to communities affected by operations before enabling reasonable access both upstream and downstream in the value chain.

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)

Choices

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

Reasons

Advisory bodies can prove helpful if (i) members are true experts in human rights risks related to the industry and in the Guiding Principles on Business and Human Rights; and (ii) are given a clear advisory mandate, which is respected by the senior business leadership. These characteristics are extremely rare; as a result, we have not seen an appreciable benefit of such bodies.

Stakeholder general meetings would likely serve very little practical purpose because of their breadth of participants and possible grievances. The scale would in effect constrain the

possibility for meaningful engagement with any stakeholder and set stakeholders with distinct interests at odds with one another. The only likely benefit would be an opportunity to embarrass the company without leading to on-the-ground changes.

Complaint mechanisms are critical to effective stakeholder engagement and ongoing due diligence. It is critical to recognize, however, that they cannot play the role of courts or public administrative bodies established to protect rights and issue remedies. They must have a narrower mandate—to provide avenues for stakeholders to express concerns—with flexibility to develop over time, so as not to create undue business risk.

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 (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)

Choices

Option	Ranking
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)	**5**
Regulating the maximum percentage of share-based remuneration in the total remuneration of directors	**5**
Regulating or limiting possible types of variable remuneration of directors (e. g. only shares but not share options)	**3**
Making compulsory the inclusion of sustainability metrics linked, for example, to the company's sustainability targets or performance in the variable remuneration	**1**
Mandatory proportion of variable remuneration linked to non-financial performance criteria	**1**
Requirement to include carbon emission reductions, where applicable, in the lists of sustainability factors affecting directors' variable remuneration	**3**
Taking into account workforce remuneration and related policies when setting director remuneration	**1**

Reasons

The key driver to focus on is the time horizon on which directors and officers and incentivized to make decisions. Companies focused on the long term are far more likely to consider and address sustainability issues in a strategic and coherent way because such issues are much more material in the long term.

We would, however, caution against focusing on sustainability drivers directly, because we are far from having authoritative metrics for good performance—particularly regarding human rights issues. An attempt to tie compensation to sustainability performance is very likely to make corporate leaders focus on arbitrary rankings and market perception rather than investing in the often-invisible and long-term ask of building a rigorous risk-management program that is integrated throughout corporate operations.

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 (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).

Choices

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

Reasons

While there is clear value in board understanding of sustainability risks, we do not believe it is necessary to be too prescriptive, particularly if other types of sustainability regulation are adopted (e.g., due diligence). Companies and boards react to legal and market pressures of their own accord, such as we have seen in recent years both with cybersecurity expertise and diversity endeavors. Targeted regulation regarding due care will inevitably drive concomitant adjustments by boards. The risk of becoming too prescriptive regarding board composition is that, instead of adapting dynamically, companies will treat composition as a mere compliance

exercise—with floor becoming ceiling, notwithstanding changing risks and evolving market pressures.

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:

We would encourage carrots as well as sticks. In particular, we would consider affording (i) favorable tax treatment (e.g., specified exemptions or deductions) or (ii) favorable government tender standing (i.e., bonus points) to companies that perform at a leading level in terms of corporate due diligence and disclosure. That might be accomplished, for instance, through a public-private partnership to develop benchmarks tied to the regulation.