DeutscherAnwaltVerein

Position Paper

of the German Bar Association by the Committees on Corporate Social Responsibility and Compliance and Commercial Law

on the Public Consultation of the European Commission on sustainable corporate governance

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<u>Europe</u>

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- Directorate-General for Justice and Consumers (DG JUST)
  - Informal Expert Group on Company Law and Corporate Governance (E03036)
- Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW)
- Directorate-General for Trade (DG TRADE)

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- Committee on Legal Affairs (JURI)
- Committee on Civil Liberties, Justice and Home Affairs (LIBE)
- Committee on Foreign Affairs (AFET)

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BFB Brussels

BDI Brussels

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The German Bar Association (Deutscher Anwaltverein – DAV) is the professional body comprising more than 62.000 German lawyers and lawyer-notaries in 252 local bar associations in Germany and abroad. Being politically independent the DAV represents and promotes the professional and economic interests of the German legal profession on German, European and international level.

Summary

The DAV welcomes the intention of the Commission to regulate due diligence obligations in the supply chain. A harmonized legal framework is preferable to market fragmentation and ensuing problems due to various and possibly conflicting national laws. Nevertheless, any planned legislative framework must take into account the reality of the situation in a given country. In some countries, it is virtually impossible to exercise and prove the full control of the supply chains for political reasons. A differentiated and staggered approach is required; provided that to certain topics such as child labour and modern slavery very concrete requirements should apply. The sanctions regime must equally be based on such a differentiated approach. The DAV considers it also important that any planned legislative act of the European Commission recognises and takes account of the special role of lawyers and law firms. The personal scope of the planned legislative proposal should include an explicit exception for the legal profession on the basis of its professional secrecy obligations. As regards the directors' duty of care, a self-obligation of companies to include the consideration of relevant interests in their corporate management processes is deemed sufficient. The risk of unclear legal definitions is also one of the reasons why the DAV does not support the idea that the director's duty of care should encompass an obligation to balance the interests of all stakeholders. It is already a commonly accepted principle of good corporate governance to have directors define processes to include certain stakeholders, but also give them the freedom to balance and prioritize the different interests.

Mandatory human rights and environmental due diligence questions

The DAV fights for the rule of law, democracy and human rights in Europe. It defends the independence of the legal profession and campaigns for access to justice for all.

As independent agents in the administration of justice, lawyers are indispensable in order to comply with the right contained in Article 47(2) of the European Charter of Fundamental Rights that every person can be advised, defended and represented by a lawyer of their choice.

Furthermore, lawyers in Germany, as in other EU countries, are subject to stringent professional practice rules. In Germany, lawyers have an ongoing obligation to their clients (i) to advise them as comprehensively and exhaustively as possible and (ii) to keep confidential all knowledge about a client gained by the lawyer during the course of their professional activity. These obligations applicable to lawyers derive from the special role that lawyers execute as agents in the administration of justice according to § 1 of the German Federal Lawyers' Act

It is for these reasons that any planned legislative proposal to regulate supply chains must include an exception for lawyers when it comes to the scope of application. The DAV considers that the European Commission should recognise at least three forms of exemption for lawyers in the scope of the proposed supply chain rules:

1. Exemption for lawyers as 'suppliers'

Lawyers must not be treated as normal service providers in the supply chain. On the contrary, the obligation to divulge information under a planned supply chain regulation should not apply to lawyers whenever they are acting in their core area of legal advice and legal representation – similar to the reporting obligations applicable to lawyers for suspicious transactions in the field of money laundering.

The European Commission must bear in mind that it is contrary to the Rule of Law for lawyers to be held liable for the conduct of their clients. This principle is used in authoritarian states to prevent lawyers from advising people and defending cases that are contrary to the government's ideas. The independent legal profession and the independent exercise of their profession is an achievement of the Rule of Law. This must be recognised as a hallmark of the Rule of Law and simultaneously as part of the foundation of the very same principle – even when the legal profession is working on behalf of major human rights violators.

Furthermore, introducing requirements on law firms 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" in the provision of legal advice to their clients could conflict with the overriding obligations that lawyers have to advise their clients as comprehensively and exhaustively as possible. In various situations, the lawyer’s discharge of his/her duties will unavoidably be "linked with negative impacts" of his/her client, e.g. an environmental lawyer representing clients in permitting procedures will always be linked to the negative (but legal) impacts of the client’s activities on the environment.

The right of clients to legal confidentiality is another intrinsic element of the Rule of Law. If due diligence obligations were imposed in the supply chain and law firms were covered by them, the duty of confidentiality would no longer be guaranteed. Moreover, a control of the compliance with such obligations by the law firm would also not be compatible with the confidentiality obligations of lawyers.

Consequently, any planned legislation with regard to supply chains should not oblige companies to carry out a due diligence examination of the law firm when selecting their legal advisors and to apply those criteria which they must apply to other suppliers. Law firms, for their part, must be completely exempt from due diligence requirements with regard to their customers, i.e. their clients in this field.

The experiences with the French 'Loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre' show that companies bound by the law treat law firms as service providers in the supply chain like normal suppliers. If there are no regulatory exemptions, the clients do not take into account the lawyers' special function as legal advisors and guarantors of access to justice and their special obligations, in particular also confidentiality obligations towards other clients. In order to fulfil their duty of care and to avoid liability under French law, the companies require law firms, like any other supplier and service provider, to sign their codes of conduct, have their law firm audited and disclose documents relating to the management of the law firm or even to undergo a rating by external service providers, without distinguishing between the activity of lawyers as bodies in the administration of justice and that of the law firm maintaining an office.

2. Exemption for lawyers as 'consumers', where lawyers receive goods or services on the instruction and as agents of their clients

Lawyers operate in a 'knowledge economy'; the value that lawyers provide to clients is in the form of legal advice and legal representation. Similar to the obligation to report suspicions of money laundering, the obligations under a supply chain legislation should not apply to lawyers whenever they provide legal advice or legal representation.

In the provision of legal advice, lawyers may require additional expertise, in the form of third-party expert advice, for example, from people with expertise in certain sectors of the economy or from lawyers in other jurisdictions, or by purchasing resources, for example legal textbooks or academic journals. In a large number of cases, lawyers purchase such goods or services on the instructions and as agent of their clients. It would not, in this scenario, be appropriate to impose due diligence obligations on lawyers in the supply of goods or services. As above, it is contrary to the Rule of Law for lawyers to be held liable for the conduct of their clients.

In some circumstances, lawyers act as 'normal' purchasers of goods and services (IT, premises, office equipment, paper/stationary). The demarcation between 'normal' purchases is easy to make. The DAV has no objection to lawyers being subject to due diligence requirements in respect of these purchases in principle. However, in most cases when lawyers make 'normal' purchases, such as buying print paper, lawyers are end consumers and are not themselves part of the value chain of the product or service. It may therefore create an unnecessary and duplicative burden on lawyers to conduct due diligence in respect of these goods and services, given that such due diligence will already have been conducted by those entities that bring these products or services to market or distribute them within the internal market.

3. Special treatment for single lawyers, small and medium-sized law firms

Finally, the vast majority of law firms in Germany, as in other parts of Europe, are, in terms of headcount, revenue and balance sheet, micro-enterprises and SMEs. The principle of proportionality requires that this is taken into account and that less strict rules apply to such small and medium-sized firms. Hence, special rules or exemptions which are applied to micro-enterprises and SMEs should apply equally to law firms falling within these thresholds.

Questionnaire

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 an explanation for your answer: EU company law should clarify that consideration of the issues mentioned is part of the "best interest of the company", to the extent these issues are relevant for the long-term viability and sustainable growth of the company. While certain national company laws and soft laws (such as corporate governance codes) already require consideration of these issues, EU-wide

harmonization in this respect would be useful. More clarity on what interests companies and their directors must consider, would also facilitate dealing with shareholder and stakeholder demands on companies, including from activist investors.

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?

(x) 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: Various EU member states have already adopted provisions on due diligence requirements. Others are currently preparing such provisions. Moreover, there is a tendency to make soft law standards legally binding by using them to interpret legal provisions, e.g. of tort law. This situation is likely to result in a legal and market fragmentation, which runs counter to legal certainty and a strong uniform position of the EU at a global level. It therefore seems preferable that the EU adopts a harmonized legal framework. Moreover, the EU should advocate for this framework also at global level in order to achieve an international level playing field.

The EU legal framework should, however, be flexible enough to allow for a differentiated approach which reflects that in certain countries like China it is virtually impossible to exercise and prove the full control of the supply chains for political reasons. In addition, it has to be taken into consideration that e.g. China follows a different CSR approach (Harmonious business) and implementation (in particular through a Social Credit system) and that China insists that enterprises adhere to their rules on their territory. Enterprises should neither be forced to assure something they cannot deliver nor should they be held liable for it or be forced to leave a country because of the EU legislation. In such a case it should suffice that enterprises show their efforts to exercise due diligence in their supply chains.

Even the EU was not capable to negotiate in the Investment Treaty with China that China commits to abolish forced labour and slavery. The EU achieved only that China promised to undertake efforts in that regard. The EU Commission should take into consideration when they draft mandatory Due Diligence requirements that enterprises are usually not more powerful than the EU to force China to adhere to and accept their standards.

In addition, the EU legislation should not follow a strict compliance approach in all cases but should leave space and flexibility for an improvement over time (development approach). In a lot of countries in the Global South companies cannot change the situation overnight but should contribute to an improvement over time. It is often more efficient with regard to an improvement of the CSR situation of suppliers to work with them and use the leverage than to cancel the supply contract. It has been shown that a mere prohibition of e.g. child labour does not help to improve the situation of the children when the economic causes of child labour are not addressed; see *Bharadwaj/Lakdawala/Li*: Perverse Consequences of Well Intentioned Regulation: Evidence from India's Child Labor Ban, 2013; *de Hoop/Rosati*: Cash Transfers and Child Labor, 2013.

In such cases a differentiated approach should be allowed which combines development aid (e.g. education, good nutrition) with the possibility to generate income in a non-burdensome and non-dangerous way.

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)?

(x) 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

(x) Contribute effectively to a more sustainable development, including in non-EU countries

(x) Levelling the playing field, avoiding that some companies freeride on the efforts of others

(x) 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

(x) 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:

In order to achieve best effects for EU companies as well as the protection of human rights, environment and other CSR aspects it makes sense to give the companies room to negotiate to find tailor-made solutions instead of a one size fits all standards. Otherwise the EU company which might be in a position to improve standards but cannot achieve “everything” would only have the chance to withdraw from certain markets and leave those markets to participants which ignore such standards at all. This is in particular true for SMEs which have less transparency and less negotiating power in relation to their supply chain. Too rigid standards in this regard might have the opposite effect to harm their leverage in the value chain.

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

(x) 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

(x) 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

(x) Disengagement from risky markets, which might be detrimental for local economies

Other:

The effects very much depend on the content of the legislation. If hard sanctions (damage claims, fines etc.) are the consequences of a violation of due diligence standards there is definitely a risk that EU companies are responsible for damages they cannot control. Usually EU companies have no power to control the companies in their supply chain, they can only ask for and negotiate information rights and depend on the reliability of the information provided to them. If hard sanctions are considered the responsibility must be strictly on actions which the company and its management can control. Moreover, too rigid regulations which increase the administrative efforts and costs for EU companies significantly might have negative countereffects which might force the companies to withdraw from certain risky markets with detrimental effects for local economies. Even a decreased attention to core corporate activities cannot be excluded if the administrative efforts by the new regulation increase too much a

disproportionate amount of time and energy would have to be spent by key management of the company.

The DAV considers it important that any planned legislative act of the European Commission recognises and takes account of the special role of lawyers and law firms. As independent agents in the administration of justice, lawyers are indispensable in order to comply with the right contained in Article 47(2) of the European Charter of Fundamental Rights that every person can be advised, defended and represented by a lawyer of their choice.

Furthermore, lawyers in Germany, as in other EU member states, are subject to stringent professional practice rules. In Germany, lawyers have an ongoing obligation to their clients (i) to advise them as comprehensively and exhaustively as possible and (ii) to keep confidential all knowledge about a client gained by the lawyer during the course of their professional activity. These obligations applicable to lawyers derive from the special role that lawyers execute as agents in the administration of justice.

It is for these reasons that any planned legislative proposal to regulate supply chains must include an exception for lawyers when it comes to the scope of application. Please see the cover letter to this submission.

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?

the interests of shareholders: Relevant

the interests of employees: Relevant

the interests of employees in the company's supply chain: I do not know/I do not take position

the interests of customers: Relevant

the interests of persons and communities affected by the operations of the company: I do not know/I do not take position

the interests of persons and communities affected by the company's supply chain: I do not know/I do not take position

the interests of local and global natural environment including climate: I do not know/I do not take position

the likely consequences of any decision in the long term (beyond 3-5 years): Relevant

the interests of society, please specify: Relevant

other interests, please specify: I do not know/I do not take position

for the interests of society, please specify:

For the long-term success and resilience of a company various interests need to be taken into consideration. This is especially the case as many companies aim to be 'good corporate citizens'. Consequently, in addition to all of the above-mentioned interests further issues may be of interest, such as social peace and welfare and keeping expertise in the EU as there would otherwise be a risk of a brain drain. However, the importance of all of these interests may vary from company to company and they impact on their success and resilience may differ significantly. Any binding provisions need to take this into account as there is no one size fits all-approach. Non-targeted, overly burdensome regulatory solutions could also risk pushing companies out of the European market.

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?

Identification of the company´s stakeholders and their interests: I strongly disagree

Management of the risks for the company in relation to stakeholders and their interests, including on the long run: I strongly disagree

Identification of the opportunities arising from promoting stakeholders' interests: I strongly disagree.

Please explain:

Even though it is clear and well accepted that all of the interests are relevant and need to be considered by directors in their diligent execution of corporate management, it also is clear that these points cannot easily be defined via legally binding obligations. This is also being made apparent in the course of the discussions where interests of stakeholders are balanced with the corporate interest. In addition, there is also the risk of unreasonable efforts being demanded, e.g. with regard to potential interests of 2nd and 3rd tier suppliers. The potential extension of the scope to all interests is virtually not controllable and therefore not possible to fulfil and achieve. Therefore, a self-obligation of companies to include the consideration of relevant interests in their corporate management processes is deemed sufficient. There is also a huge risk with regard to widening the circle of stakeholders whose interests need to be considered as foreseen in question 13 (see answer below).

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

(x) I strongly disagree

I do not know

I do not take position

Please explain:

Based on the explanation with regard to Question 6, it is only consequent to not have these obligations required by law. They are already adequately addressed in the legal requirements of corporate law to diligently execute corporate management. Even in some fields of law, liability regimes are already established which apply in cases of organizational failure, e.g. in environment law. Besides this, it would also be unclear how to adequately regulate the question of enforcement.

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?

I strongly agree

I agree to some extent

I disagree to some extent

(x) I strongly disagree

I do not know

I do not take position

Please provide an explanation or comment:

At first sight, a legal obligation to balance interests could help directors to get relief from pure short-term financial pressure. However, the risk of unclear definitions remains, especially with regard to defining clear criteria for corporate interests and stakeholder interests. Stakeholder interests which are defined unclearly could lead to extremely broad and vague understandings, which could lead to include socially aspired general goals like "fighting the climate change". This could lead to legal uncertainty which makes it nearly impossible for directors to lead a company with a clear focus on the corporate interest. It is already a commonly accepted principle of good corporate

governance to have directors define processes to include certain stakeholders, but also give them the freedom to balance and prioritize the different interests.

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?

We would expect directors to be faced with excessive liability risks should their duty of care explicitly extend to all stakeholders. There is also a significant risk that a disproportionate amount of time and energy would have to be spent on the various stakeholder groups and their interests, hindering directors from being fully focused on their companies' core business and strategy.

How could these possible risks be mitigated? Please explain.

Unless certain stakeholders are protected by specific mandatory legislation (e.g., environmental laws, consumer protection laws, etc.), the decision of directors what stakeholder interests to take into account and what weight, if any, to assign to such interests. should be a business decision subject to the discretion of the directors. When making such decision, directors should be protected by the business judgment rule.

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

Institutional and other large shareholders are very articulate about their expectations regarding the integration of certain stakeholder interests, in particular ESG, in companies' business models and strategies, and directors are generally responsive to these expectations. Otherwise, shareholders either exit their investment or vote against compensation policies, proposals for non-executive directors, specific corporate decisions or the discharge of directors. In addition, corporate governance codes and similar self-regulation frameworks also recommend the consideration of certain stakeholder interests. To the extent that these recommendations are subject to a comply or explain mechanism, which is generally the case, transparency regarding the integration of stakeholder interests is ensured. We further note that in the area of environmental sustainability, the taxonomy regulation already sets forth detailed requirements to be met by companies in different industry sectors to qualify as

sustainable. Any additional, potentially inconsistent regulation of the consideration of stakeholder interests should be avoided.

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?

I strongly agree

(x) I agree to some extent

I disagree to some extent

I strongly disagree

I do not know

I do not take position

Please explain:

In order to establish a level playing field for all companies, the idea to avoid a separation of business strategy and sustainability strategy is supported. The clear requirement should be for all companies to have an integrated sustainable business strategy. However, it needs to be assured that companies are free to decide on the content of the subject of sustainability. It is in the core interest of all companies to include the sustainability risks in their business strategy according to their business model and scope. In addition, as it is already common practice by investors to look for the strategic integration of sustainability when deciding on their investment, it goes without saying that this focus will develop even without regulatory pressure.

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:

Stakeholder derivative suits do not exist under German law. Stakeholders who have been violated in any of their protected rights may be able to bring damage claims directly against the company based on tort or other grounds.

Similarly, shareholder derivative suits exist only in very narrow circumstances and are of little practical relevance.

Should the company have suffered damages, be it based on the company's liability for damages vis-à-vis a third party or otherwise, and should such liability have been caused by a violation of the directors' duty of care, the company would have to sue the directors for damages.

We do not think that the overall regime of company and director liability should be changed as part of the ongoing initiative on sustainable corporate governance, nor do we see any necessity for stakeholder or shareholder derivative suits in the context of enhancing sustainable corporate governance.

We also note that the annual general meeting provides a forum for shareholders (even if they hold as little as one share) to voice concerns regarding the adequate consideration of stakeholder interests. This an effective tool to put pressure on companies and their directors.

In their function as part of the legal system, lawyers have a special role and mandate to fulfil. The Rule of Law requires that each person has access to legal counsel. U.S. law firms such as Jones Day were exposed to strong criticism and pressure by civil rights groups to drop President Trump as a client and some of them gave in to this pressure. This kind of pursuit of stakeholder interests is not acceptable.

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

See response to Question 11 above.

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

I strongly agree

I agree to some extent

I disagree to some extent

(x) *I strongly disagree*

I do not know

I do not take position

Please explain your answer:

See response to Question 11 above.

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.

Not applicable.

Section III: Due diligence duty

For the purposes of this consultation, “due diligence duty” refers to a legal requirement for companies to establish and implement adequate processes with a view to prevent, mitigate and account for human rights (including labour rights and working conditions), health and environmental impacts, including relating to climate change, both in the company’s own operations and in the company’s supply chain. “Supply chain” is understood within the broad definition of a company’s “business relationships” and includes subsidiaries as well as suppliers and subcontractors. The company is expected to make reasonable efforts for example with respect to identifying suppliers and subcontractors. Furthermore, due diligence is inherently risk-based, proportionate and context specific. This implies that the extent of implementing 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 consider this to be a (mere) definition and therefore cannot agree. The suggested text is rather a brief description of the recommendations of the UNGP. Thus, instead of specifying terms, the text also refers to expectations ("The company is expected…"). Moreover, it uses numerous broad and undefined terms which runs counter the purpose of a definition, i.e. to achieve more clarity. For example, it remains unclear which human rights shall be relevant as only some examples are given. Likewise, the relevant environmental issues apart from climate change cannot be determined from this text. The same is true for the notion of business relationships. The terms "reasonable efforts" or "adverse impacts" are unspecific.

Consequently, this text is not justiciable and cannot be used to impose or at least support legally binding obligations on companies or individuals.

However, the challenges of a very broad and not sufficiently specified approach could be managed if definitions and obligations were established for certain sectors and/or topics, such as it already has been done by the Conflict Minerals Regulation. Further measures could aim at, e.g., avoiding child labor, human trafficking and modern slavery.

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.

(x)None of the above, please specify:

A combination of options 1, 2, 4 and 5 is preferable. For certain topics, such as child labor and modern slavery, and sectors very concrete requirements should apply. These may include requirements both with regard to processes and to certain outcomes.

For other topics a principles-based approach would be a better starting point to allow the affected companies, individuals, etc. as well as the competent authorities to "grow

into" these new requirements. The requirements can be developed and tightened over time. For this purpose, a smart mix of measures would be suitable, including soft law, recommendations and guidelines as well as legally binding obligations. In this process, first more granular and increasingly tightened process requirements and eventually concrete outcome expectations may be developed. Such an iterative approach would enable the development or broader implementation of best practices, sector specific solutions and ultimately new binding laws which are sufficiently clear, effective and proportionate.

Such a differentiated and staggered approach would obviously also require a differentiated sanctions regime. For concrete process-related and substantive requirements there can be hard sanctions whereas for other topics no civil liability and no administrative fines should apply. Criminal sanctions seem to be disproportionate in (almost) any case.

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?

See response to Question 15 above and to Question 15b below.

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

It is difficult to answer questions 15a and 15b as we consider (i) that the distinction between options 1, 2 and 3 in question 15 is not clear and (ii) that it is unclear why a 'definitions approach' is only required in respect of options 2 and 3 but not option 1. The definition of 'due diligence duty' (above) refers to "human rights (including labour rights and working conditions), health and environmental impacts, including relating to climate change". The DAV considers that it would be very helpful and would provide legal certainty for these terms to be defined also for the purposes of Option 1.

The DAV would also suggest that the legislator clarifies the relationship between the EU requirements and national laws, e.g. on the environment. Moreover, it should be clearly

distinguished between environmental consequences of a global scale (such as climate change or a pollution of the seas) and those which are locally limited (e.g. soil pollution or product-related environmental requirements). Whereas measures may be more easily justified under the former category any legislative actions under the latter category need to be assessed particularly thoroughly against public international law (principle of sovereignty, limitations to extra-territoriality).

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)

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:

A staggered approach based on a smart mix of measures should be chosen with an increasing scope and intensity of mandatory due diligence requirements over time. For more details see the comment to question 15 above and 15d below.

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?

A staggered approach should be applied – based on a smart mix of measures, which evolve over time. For more details see the comments to question 15 above.

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?

See comments to question 15 above.

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

See comments to question 15 above. As a starting point particular high-risk sectors should be dealt with, e.g. certain natural resources and textiles.

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

As a starting point, child labour, human trafficking and modern slavery should be regulated.

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

(x) SMEs should be subject to lighter requirements ("principles-based" or "minimum process and definitions" approaches as indicated in Question 15)

(x) SMEs should have lighter reporting requirements

(x) Capacity building support, including funding

(x) 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

The vast majority of law firms in Europe are, in terms of headcount, revenue and balance sheet, micro-enterprises and SMEs. To the extent that special rules or exemptions are applied to micro-enterprises and SMEs, these should apply equally to law firms falling within these thresholds.

The legislator must take into account also the indirect impact on micro-enterprises and SMEs. It is to be expected that large customers will "delegate" their due diligence obligations to their suppliers independent of their size. Hence, even if micro-enterprises, SMEs and comparable law firms were not directly affected by a legal due diligence obligation they might nevertheless be contractually obligated to meet all requirements as their customers ask them to do so. This risk/burden needs to be reflected in the law and its application.

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.

Companies or law firms targeting the EU market or having a significant business within the EU should also be covered in order to ensure a level playing field.

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

Same obligations as companies or law firms registered/headquartered within the EU to ensure a level playing field. However, as with EU companies and law firms it should be possible to fulfil certain obligations at the headquarter level / in a consolidated way in order to avoid duplications and redundancies.

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: See the answer to question 17b. It should be possible to fulfil as many obligations as reasonable at a consolidated level (e.g. by the headquarter) in order to avoid redundancies as much as possible. Apart from that, we think that the legislative act should start with a basic harmonization to allow its addressees to get used to the new requirements. It should not be overly burdensome and complicated from the outset. Rather, certain focused amendments should be made later if and insofar as loopholes or significant deficiencies of the law become apparent.

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)?

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

(x) Other, please specify

Please provide explanation:

The enforcement must be aligned with the underlying substantive obligations. Hard consequences, i.e. civil liability and administrative fines, may only be applied to legally certain, clearly specified, binding requirements. By contrast, soft law recommendations and guidelines should not be enforced by sanctions. Hence, the smart mix of substantive measures must be complemented by a smart mix of enforcement and sanctions measures.

Further, any statutory enforcement and sanction measures should only be established where the market and/or regulation in other areas fails. If, e.g., investors are requiring the fulfilment of certain environmental or human rights-related obligations and therefore the market is self-regulating or where specific obligations and their enforcement are already stipulated in other legal acts no further measures are necessary. They could rather be conflicting or cause legal uncertainty.

Moreover, it must be clear and taken into account for the enforcement whether a requirement is only process-oriented or aims at certain outcomes.

Companies that fail to comply with legally certain, clearly specified, binding mandatory human rights and environmental due diligence (mHREDD) requirements should face penalties because otherwise the substantive requirements would be ineffective and useless.

In case of "hard", legally binding process requirements the administrative fines do not necessarily be linked to harm caused. Given the often indirect nature of human rights and environmental harm, especially in the supply chain, it would significantly weaken the enforcement of the process-related mHREDD requirements to require a causal link

to be established. The consistency of enforcement of mHREDD will deter non-compliance. Moreover, it also ensures a level playing field between companies. However, administrative penalties do not assist victims in directly accessing justice.

Access to justice is an essential part of ensuring that human rights and the environment are protected over the long term. The DAV considers that the Commission should also take steps to improve victims' direct access to justice, e.g. by expanding opportunities to receive a (public) litigation funding.

In any case, the DAV considers criminal offences to be disproportionate and too far-reaching at least in the beginning. The addressees of a legal act should get the chance to get used to the new requirements and civil legislation as well as proportionate fine seem to be sufficient to achieve compliance.

The enforcement mechanisms should follow a differentiated approach which reflects that in certain countries like China it is virtually impossible to exercise and prove the full control of the supply chains for political reasons. In addition, it has to be taken into consideration that e.g. China follows a different CSR approach (Harmonious business) and implementation (in particular through a Social Credit system) and that China insists that enterprises adhere to their rules on their territory. Enterprises should neither be forced to assure something they cannot deliver nor should they be held liable for it or be forced to leave a country because of the EU legislation. In such a case it should suffice that enterprises show their efforts to exercise due diligence in their supply chains and report on it which exposes them to the quite powerful "courts of public opinion".

Hard sanctions follow a strict compliance approach. There are situations, however, where such compliance approach is not the best way forward but where a comprehensive development package would be much more efficient to improve the situation in a sustainable way over time. (See above answer to Question 2). Such an approach requires a more flexible accountability tool such as reporting, eventually combined with supervision. The above listed hard sanctions would cut off such reasonable endeavours.

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

(x) 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?

Victims can bring a (tort) case before an EU court. Subject to specific situations, the court would usually apply the (tort) law of the country where the damage occurred. Hence, the victims are not worse off than if they had brought the claim before the court of their home country. Rather, EU courts may be significantly less susceptible of being dependent or subject to bribery attempts etc. Hence, the only difficulty may be a cost issue which could however also be resolved by financial support to the claimants.

We do not think that further measures at EU level should be adopted at this time.

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

I strongly agree

I agree to some extent

I disagree to some extent

(x) I strongly disagree

I do not know

I do not take position

Please explain:

No specific legal obligations of that sort should be established. Beyond what is already part of the managerial duties of directors, it should be left to the managerial discretion of directors whether and to what extent they engage with stakeholders.

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

Question not answered.

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)

Advisory body: Is best practice / Should be promoted at EU level

Stakeholder general meeting: Is best practice / Should be promoted at EU level

Complaint mechanism as part of due diligence: Is best practice / Should be promoted at EU level

Other, please specify: Is best practice / Should be promoted at EU level

Other, please specify:

Question not answered.

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): ***3.***

Regulating the maximum percentage of share-based remuneration in the total remuneration of directors: ***1.***

Regulating or limiting possible types of variable remuneration of directors (e.g. only shares but not share options): ***2.***

Making compulsory the inclusion of sustainability metrics linked, for example, to the company's sustainability targets or performance in the variable remuneration: ***7.***

Mandatory proportion of variable remuneration linked to non-financial performance criteria: ***6.***

Requirement to include carbon emission reductions, where applicable, in the lists of sustainability factors affecting directors' variable remuneration: ***5.***

Taking into account workforce remuneration and related policies when setting director remuneration: ***3.***

Other option, please specify

None of these options should be pursued, please explain

Please explain:

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).

(x) 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

(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

Other option, please specify

None of these are effective options

Please explain:

*** 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?

I strongly agree

I agree to some extent

I disagree to some extent

(x) I strongly disagree

I do not know

I do not take position

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

Question not answered.

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 do not think that further measures at EU level should be adopted at this time.

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 understand and own assessment, to what extent will the impacts/effects increase on a scale from 0-10? In addition, please quantify/estimate in quantitative terms (ideally as

percentage of annual revenues) the increase of costs and benefits, if possible, in particular if your company already complies with such possible requirements.

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

Please explain:

Question not answered.

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).

Question not answered.