

## ETUC REPLIES

### QUESTIONS FOR SOCIAL PARTNERS: DEDICATED HEARING ON THE "SUSTAINABLE CORPORATE GOVERNANCE INITIATIVE"<sup>1</sup>

22 February 2021

**1. Do you agree with the above analysis? If not, why? Do you agree with the need to foster more sustainable corporate governance through EU level legislation? Do you have any subsidiarity-related comments?**

“The core problem of unsustainable corporate governance practices is exhibited in directors not sufficiently identifying and integrating stakeholder interests, risks and opportunities linked to those stakeholder interests into their decisions as well as companies insufficiently addressing adverse impacts in their own operations and value chains.” p. 2

We agree that this is a core problem and that this problem can be partially addressed through EU level legislation.

First of all, we broadly agree with the EY 2020 study’s identification of **seven key problem drivers** of unsustainable corporate governance practices (page vi):

1. *Directors’ duties and company’s interest are interpreted narrowly and tend to favour the short-term maximisation of shareholder value;*
2. *Growing pressures from investors with a short-term horizon contribute to increasing the boards’ focus on short-term financial returns to shareholders at the expense of long-term value creation;*
3. *Companies lack a strategic perspective over sustainability and current practices fail to effectively identify and manage relevant sustainability risks and impacts;*
4. *Board remuneration structures incentivise the focus on short-term shareholder value rather than long-term value creation for the company;*
5. *The current board composition does not fully support a shift towards sustainability;*
6. *Current corporate governance frameworks and practices do not sufficiently voice the long-term interests of stakeholders;*
7. *Enforcement of the directors’ duty to act in the long-term interest of company is limited.*

We support the following measures to address these seven key problems (note: a number of these are identified by the EY study under “Option C” (‘hard’ legislative option)):

- 1) A **clear and broad definition of directors’ duties and the company’s interest** should be defined in EU law, for example by providing that the top management organ should assume full responsibility for managing the company in the best interests of the company, meaning that it considers the needs of the shareholders, the employees and other stakeholders, with the objective of sustainable value creation.
- 2) The **incentivization of longer shareholder periods** (differentiated voting rights, dividends and taxation based on length of holding) (i.e. encouragement of so-called ‘Loyalty’ shares) could in part be achieved by amending the Shareholder Rights Directive II to introduce binding rules requiring Member States to introduce mechanisms to incentivise longer shareholding periods.

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<sup>1</sup> Version 8 March 2021.

As short term periods for directors and supervisory board members are also a source of short-termism, an **EU requirement for a minimum number of years for such terms** could also be considered.

- 3) Requirements for corporate boards to **integrate sustainability aspects** (risks, opportunities, impacts) into the business strategy, to identify and set as part of the business strategy **sustainability targets aligned with international agreements and guidelines** (OECD Multinational Guidelines/UN Guiding Principles/ILO labor standards and Paris Agreement on climate change), and to **disclose appropriate information** (revised Non-financial Reporting Directive)
- 4) Better aligning executive remuneration policy with the long-term and sustainability goals through **amending the Shareholder Rights Directive II**, in particular by: 1. Regulating executives' ability to sell the shares they receive as pay 2. Making compulsory the inclusion of non-financial, ESG metrics (social, employment security, ecological and sustainability-oriented criteria) linked to a company's sustainability targets, in executive pay scheme. 3. Limiting the proportion of remuneration which is variable and in particular linked to short-term performance metrics.
- 5) Regarding board composition, we would like to note that ETUI research shows that the inclusion of board-level employee representatives (BLER) is positively and significantly associated with better performance on a wide variety of sustainability measures (environmental as well as social). Furthermore, a large body of research shows that companies can benefit from having diverse boards. The ETUC therefore calls for a **framework directive for worker information, consultation and participation** and objects to any restrictions on trade union and workers' representatives' information, consultation and participation rights. Furthermore, a **mandatory gender quota** would help increase diversity on EU company boards. Finally, an **EU requirement for boards to have a minimum level of expertise in social and environmental matters** is sensible.
- 6) A variety of mechanisms can strengthen stakeholders' ability to exercise voice and influence corporate governance. The ETUC's call for an **EU framework directive on information, Consultation and Participation of workers** mentioned above in 5). **Strengthening the rights of European and SE Works Councils** in sustainability reporting and strategy-setting is an additional mechanism. Requiring trade unions and worker representatives to be involved and consulted in the **design and monitoring of due diligence plans and the identification of human rights and environmental impacts and risks** is another key mechanism.
- 7) **Significant penalties and effective mechanisms for enforcement** are needed to ensure that directors promote sustainability and act in the long-term interests of the company. One effective mechanism would be the introduction of an EU-wide definition of 'disqualified director', including disrespect for human rights and the environment as grounds for disqualifying persons from duty as directors, since the threat of disqualification can serve as an effective deterrent to such negative behaviour.

In addition, the following measures would help for support sustainable corporate governance:

- A **Financial Transactions Tax** would help discourage short-term speculative financial strategies
- **Limits on dividend payouts and share buybacks** when companies are receiving state subsidies and when their financial situation is fragile (i.e. when they do not have an investment-grade credit rating)
- Inclusion of **sustainability (i.e. environmental and social, including labour and trade union rights) requirements in national export promotion (guarantees, credits etc.) and public procurement, including:**
  - o Provisions on transparency, oversight, and anti-corruption. These are vital to prevent public support for nepotism, criminal organisations, tax dodgers, letter-box companies, or companies not complying with environmental, human rights (including trade union rights) and other social and labour standards throughout the whole sub-contracting and supply-chain.
  - o Rules to ensure that bids for contracts can only be considered from companies that:

- respect social and labour law and collective agreements,
  - comply with environmental standards,
  - publicly declare profit and tax payments,
  - are honest in their tax and social security dealings and do not have subsidiaries in countries that are on the EU tax haven blacklist (or elsewhere if it is for the sole purpose to reduce the parent company's tax bill),
  - have effective measures in place to prevent, mitigate and/or correct fraudulent practices throughout the whole sub-contracting and supply chain,
  - do not display predatory market behaviour i.e., compete on an unfair and unethical basis to gain market dominance.
- Limits and clear requirements regarding sub-contracting and supply-chains, i.e., not only full transparency of subcontractors but possible restrictions in levels of subcontracting, as well as clear due diligence and joint liability requirements.
- **Reduction in 'externalities'**, i.e. inclusion of costs of environmental and social impacts in the market price of goods and services, e.g. through **'anti-social and environmental dumping' tariffs** on non-EU goods and services
  - **Assessment of environmental and social impacts in EU competition/merger/takeover policy**

We believe that the initiatives developed in the sustainable corporate governance framework could be helpful to pursue the UN SDGs and to better protect human rights (including trade union and labour rights) and environment, only IF:

- They do NOT replace the key rule according to which companies shall, first of all, respect national, European and international law. Market and companies' behaviours have to be strongly regulated in order to fight inequalities and to pursue UN SDGs, human rights and environmental standards.
- Sustainable corporate governance initiatives shall NOT replace or negatively affect trade union and workers' representatives' rights. The right to collective bargain, as well as the right to information and consultation, and the right to strike are and shall be supported as enabling rights. Their protection is fundamental to effectively guarantee all of the other worker rights.

## **2. Do you agree that the initiative can contribute to curbing the agency problem, i.e.. the problem that directors act more in other interests than the long-term interest of the company? What conditions would need to be fulfilled to solve agency issues? What are the pitfalls perceived?**

The measures listed above could substantially contribute to a reorientation of directors' interests away from the short-term towards long-term sustainability interests. There are no perceived pitfalls of these measures.

The proposal on the directors' duties should be separate from the one on corporate due diligence. As stated by the Commission in its Impact Assessment, the former concerns modifying the codified company law Directive (2017/1132) and the consolidated Directive on Shareholder Rights (2007/36). Merging the two proposal risks to further complicate their legislative procedures.

Moreover, the problem that directors act more in other interests than the long-term interest of the company should be deeply analysed, in order to detect the real causes of short-termism.

According to a recent article of John Ruggie ([https://media.business-humanrights.org/media/documents/EU\\_mHRDD\\_paper\\_John\\_Ruggie.pdf](https://media.business-humanrights.org/media/documents/EU_mHRDD_paper_John_Ruggie.pdf)):

- Directors' duties are not the root cause of short-termism
- Directors themselves are responding to investor pressure, especially from hedge funds, other so-called activist investors and private equity firms, whose primary interest is in obtaining short-term returns and then moving on. Investors elect directors.
- There are numerous ways to penalize investor short-termism and encourage longer-term investments, including robust forms of variable taxation, unrelated to directors' duties.

Once the causes of short-termism have been detected, it is necessary to deeply consider the effectiveness of the actions promoted. According to Ruggie:

- Corporate law generally does not prevent directors from supporting making investments and developing policies for the longer term [...] explicitly adding words to corporate law to the effect that directors may take stakeholder concerns into account in the best long-term interest of the firm, such as exists in UK company law, has made little if any difference in practice

We strongly believe that companies cannot be let alone to decide how to promote human rights and environment.

In order to enforce and improve worker rights and, in general, the UN SDGs, trade union rights shall be strengthened. We need to support collective agreements at all level, including the transnational one.

We need to guarantee the effectiveness of the right of collective bargaining and the right to information and consultation that are strongly affected by the fragmentation of the supply and subcontracting chain.

And we need to guarantee the right to collective action, including strike, at all levels, including the transnational level. Currently, the right to defend workers' interests collectively is not realized and sufficiently protected and enforced in all parts of the globe.

**3. Do you agree that the above planned director and due diligence duties will foster investment into sustainable operations, production processes and resilience? Are reduced shareholder payouts justified to enable this?**

Yes – numerous studies demonstrate the negative effects that a short-term orientation can have on firm investment, risk of bankruptcy, ESG performance, etc. (see attached list of recent studies on short-termism). A reorientation of director duties away from short-term share value maximization to the increase in stakeholder welfare and long-term value creation and the introduction of due diligence duties to align with stakeholder interests will foster these kinds of investments. High levels of shareholder payouts are one of the results of a short-term orientation, and though these may be reduced in the short run, shareholder value should increase more in the long run.

**4. Do you agree that employers' better-framed consideration of stakeholder interests in decision-making would drive better long-term performance and resilience as well as corporate investment into human capital development and better working conditions?**

Yes – academic research shows that investment levels (training, capital expenditures) are higher in 'stakeholder' oriented companies (e.g. Jäger et al (2019); Scholz (2017); Scholz & Vitols 2017), which include various mechanisms for 'worker voice' including European Works Councils, board level employee representation and the negotiation of transnational company agreements Attached is a list of recent studies on worker participation which demonstrate the positive contribution that board-level employee representation (BLER) has on a wide variety of outcomes.

**5. On the assumption that employers often do not have a strategic orientation on sustainability risks, impacts and opportunities, do you believe that integration of such considerations into the company's strategy, including setting of measurable (science -based) targets, would enable companies to take advantage of the sustainability transition and thereby improving their competitiveness and resilience?**

Recent research by the Alliance for Corporate Transparency shows that many of the largest EU listed companies lack detailed sustainability strategies (which should include targets and implementation mechanisms in addition to general commitments) (ACT 2020). Science-based targets may work well for

some indicators, e.g. CO2 emissions, but not for many ‘people’ issues. The development and implementation of ambitious and sophisticated sustainability strategies will be key to helping companies successfully manage the sustainability transition.

**6. Do you consider that employers’ better framed identification of opportunities arising from promoting employee’ interests would drive long-term productivity?**

Yes – worker involvement enables a better identification of such opportunities and the research cited above shows that worker involvement leads to more investment, which should boost long-term productivity. See the answer to 4) and the research cited there.

**7. Do you think that an EU legal framework for supply chain due diligence to address adverse impacts on human rights and environmental issues would strengthen the resilience of companies, increase employment and enhance job security? What are the main risks/challenges for EU employers and employees?**

We believe that an EU legal framework for supply chain due diligence to prevent adverse impacts on human rights and environmental issues will be useful to improve the protection of human rights, the environment and good governance. This framework will create a level playing field and increase the fair functioning of the internal market.

Such a framework would have a number of benefits for companies, workers and the environment. A ‘level playing field’ would enable fair competition between companies based on decent work (including job security), and high labor and environmental standards. It would also reduce ‘reputation risk’ for companies as they would have fewer negative impacts and risks in their supply chain.

**8. What are the essential features of the possible initiative you would like to see implemented, taking into account the company size and costs and benefits for employers and employees, for the objectives mentioned above? Do you have experience of measures that have/have not worked well?**

The essential features are listed in the answer to question 1) above. There are positive results from experience, as backed up by academic research, for all of these features.

Key Messages:

- The ETUC calls for a European directive on mandatory human rights due diligence and responsible business conduct.
- It should establish **mandatory and effective due diligence mechanisms** covering companies’ activities and their business relationships, including their supply and subcontracting chains.
- Businesses including multinationals, independently of their sizes, active in any sector should introduce a HRDD strategy/plan. Limitations in the scope of the EU directive could, if they were implemented, exclude from the application of the directive many companies whose operations have significant actual or potential impacts in the areas covered by due diligence obligations. For these reasons, the personal scope of the directive should cover **all companies, including SMEs, as well as public sector organisations, which are established (seat, headquarters or principal place of business) or active in the European Union, regardless of their legal forms.**
- The directive would constitute an important step forward to ensure the respect and enforcement of human rights. **Human rights should include trade unions’ and workers’ rights as main components. In addition, it should be taken into account that research shows that a disproportionately higher number of women are negatively and differently**

**effected from failed due diligence obligations. Therefore, a gender-sensitive and intersectional due diligence approach is key.<sup>2</sup>**

- A directive should empower workers to fight against violations of human rights. It should ensure the **full involvement of trade unions and workers' representatives in the whole due diligence process.**
- It should also include obligations for public disclosure about supply chains so that the transparency's principle is guaranteed.
- This directive should secure whistle-blowers' protection against retaliation and be in line with already existing EU legislation on this matter. Indeed, they are continuously at risk when they report irregularities in companies' activities.
- Effective remedies and access to justice should be available for victims, including trade unions. - Companies should be accountable for the impacts of their operations. **Liability must be introduced for cases where companies fail to respect their due diligence obligations, without prejudice to joint and several liability frameworks.**
- With respect to **freedom of association and collective bargaining** as core human rights in due diligence:
  - 1) it is critical that the human rights of freedom of association and collective bargaining are particularly noted as core human rights to be addressed under the due diligence duty,
  - 2) Any reporting requirements should thus require reporting on the percentage of workers covered by collective bargaining agreements,
- With respect to the **involvement of trade unions**: it should be full involvement with three elements
  - 3) The right to negotiate with the company the due diligence process at the different levels such as at national, European, or global levels, to correspond to the scope of a company's operations and value chains,
  - 4) Involvement in the risk mapping process, in line with the guidance for meaningful engagement under the OECD guidelines,
  - 5) Involvement in steps to mitigate risks identified, in particular for risks identified to the rights to collective bargaining or freedom of association. For example, trade unions should be involved in monitoring risks to these rights, or training local management to prevent violations from occurring.
- With respect to **top decisionmakers' involvement** in due diligence:
  - 6) A specific board director should be responsible,
  - 7) It should be ensured that supervisory boards/full administrative boards have oversight of the application,
  - 8) Due diligence should be put on the agenda of AGMs.

**9. What enforcement mechanism do you see fit best to the planned duties? Should certain stakeholders or groups be allowed to enforce the new board duties on behalf of the company? Should due diligence be enforced through administrative authorities and through civil liability for harm caused? Are EU level rules needed for this?**

The directive should contain provisions that encourages high-level corporate responsibility, including directors' liability, for addressing the identified actual and potential violations and negative impacts through the due diligence plan.

- **Access to justice and liability.** In case of violations of human rights and social and environmental standards violations as well as of negative impacts of companies' operations, **effective remedies** should be available for victims, including trade unions and other

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<sup>2</sup> See [OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf](#) and Report: [Gender Booklet Final.pdf \(ohchr.org\)](#)

interested third parties. Considering the challenges and obstacles that victims often face in the access to justice in third countries where European companies' operations take place, the possibility of access to justice in the Member State where the company is established (or where it is conducts business activities) should be ensured. It should therefore be possible to submit claims against companies which are established or conduct activities or have otherwise a link with a Member State in that Member State' jurisdiction. This possibility is already foreseen by the French corporate duty of vigilance law of 27 March 2017.

- **The burden of proof** regarding the full respect of companies' obligations and the link with the damages occurred shall rest with the company and not with the victims. Measures to facilitate access to justice for victims should include appropriate support schemes. Interim proceedings should allow the halting of operations violating human rights, social and environmental standards.
- A **specific liability framework**, including – where appropriate depending on the legal system and the violation – criminal liability, must be introduced for cases where companies fail to respect their due diligence obligations to their fullest extent and human rights, social and environmental standards violations or adverse impacts of companies' operations occur, including in their supply and subcontracting chains.
- Relationship with other instruments regulating business liability. **In any case the directive shall not impact on other subcontracting and supply chain liability frameworks established at national, European and international level (e.g. joint and several liability in subcontracting chains)**. This is a redline. As recognised by the UNGP, “enterprises conducting [...] due diligence should not assume that, by itself, this will automatically and fully absolve them from liability for causing or contributing to human rights abuses” [and other impacts].

#### 10. What additional measures do you think would be necessary?

- As noted above in the answer to 1), in addition to corporate governance measures in the ‘narrow’ sense, we support: A **financial transaction tax** to discourage short-term speculative financial investors
- **Limits on dividend payouts and share buybacks** when companies are receiving state subsidies and when their financial situation is fragile (i.e. when they do not have an investment-grade credit rating)
- Inclusion of **sustainability (i.e. environmental and human rights (including trade union and labour rights)) requirements in public procurement**
- **Reduction in ‘externalities’**, i.e. inclusion of costs of environmental and social impacts in the market price of goods and services, e.g. through **‘anti-social and environmental dumping’ tariffs** on non-EU goods and services
- Consideration of **environmental and social impacts in EU competition/merger/takeover policy**

Subcontracting and supply chains have become the business model in certain sectors. This strongly affect worker and trade union rights. Therefore, several interventions would be need in order to:

- Strengthen the joint liability rules already present in EU law (Seasonal Workers Directive; Sanction Directive; Enforcement Posting of Workers Directive);
- Shorten the supply and subcontracting chain;
- Forbid the outsourcing of core activities;
- Support trade union rights in the supply and subcontracting chain. The absence of worker representatives and violation of trade union rights along the subcontracting and supply chain is a risk that the due diligence plan should take into consideration;
- Develop the cooperation among Member States.