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## Due Diligence and Sustainable Corporate Governance

### Contribution to the European Commission's public consultation

Brussels, 2nd February 2021

The European Commission has launched preparatory work for an upcoming EU legislative initiative on the three issues of due diligence duty, directors' duty and directors' remuneration, which are grouped under the heading 'sustainable corporate governance'. The European Commission's plan comes after decades of heated debates on the need to revise the corporate governance model of companies in Europe in order to depart from a short-term financial outlook aimed at serving the sole interest of shareholders, to embrace a long-term sustainable strategic management of companies to the benefit of all stakeholders. The European Commission's plan also follows decades of both European and global debates on the need to adopt mandatory due diligence duty in order to compel multinational companies to respect fundamental human and workers' rights all along their supply chain, across borders. The European Commission revived its attention for the issue in light of its Green Deal strategy and commitments to deliver on the UN Sustainable Development Goals.

As part of the preparatory work, the European Commission is running an online public consultation open to all European citizens and organisations aimed at collecting a broad range of views. The results of the public consultation will then be compiled and guide the orientations the European Commission will take in its upcoming legislative proposal.

IndustriAll Europe regrets that workers and their representative organisations, the trade unions, do not get a chance at being formally consulted in the preparatory process despite being the ones suffering the direct consequences of flawed corporate governance on their job, their income and even their lives. Workers' views voiced by their trade union organisations must be reflected in any EU legislative proposal on due diligence and corporate governance. IndustriAll Europe demands are summarised below.

### Mandatory Due Diligence

Building upon existing international standards (UN Guiding Principles and OECD guidelines), industriAll Europe understands due diligence as: the process through which a company identify, prevent, mitigate and cease actual and potential adverse impacts on human beings and the environment, caused by its own activities or as a result of its business relationships (e.g. subsidiaries, downstream and upstream subcontractors, suppliers), and account for how these impacts are addressed.

An extensive body of research has been compiled over the years to account for the failure of existing framework to avoid blatant breach of fundamental rights and environmental obligations by multinational companies, at the expenses of workers and local communities all over the world. Voluntary approaches (e.g. companies' charter/code of conducts), international instruments (ILO, UN or OECD guidelines and principles) and non-binding European legal instruments (the 'comply or explain' principle-based Directive on non-financial reporting) have all proved their limits.

Against this background, some countries took the step of enacting national due diligence legislation (France, the Netherlands), while discussions for similar legal initiatives are going on in other countries (in Austria, Finland, Germany, Luxembourg, etc.). The current situation is thus one in which many different international non-binding instruments and some binding national laws coexist, leading to discrepancies and lack of legal clarity as to how corporate due diligence is regulated in Europe.

Harmonisation is urgently needed, building upon the lessons learnt from existing instruments and national legislation. Now is no more the time for evidence gathering. Now is the time for political action.

In line with the European Trade Union Confederation, industriAll Europe calls for a legally binding EU instrument in the form of a European Directive on mandatory human rights (including workers' and trade union rights) and environmental obligations due diligence, based on the following core components:

- **Scope:** all companies whose central management is established in Europe or which are active in the European union, regardless of headquarter country of origin, size, sector, operational context, ownership, legal forms, and structure, must be covered by the Directive. The Directive would thus also apply to SMEs, though a dedicated support scheme should be developed to assist them in designing and managing their due diligence plans. **Covered operations:** due diligence requirements should cover all companies' operations, independently of their size, including their own activities, the operations of their subsidiaries and controlled undertakings, and their business relationships, including their whole upstream and downstream supply and subcontracting chains, franchise and contract management, within and outside the EU. As a prerequisite supply chain transparency should be included through an obligation for public disclosure about details of supply chains.
- **Type of assessed risks:** due diligence plans must assess risks affecting local communities, workers and their trade unions, as well as the environment, in line with internationally recognised human rights, including ILO fundamental workers' and trade union rights. Compliance with environmental norms, social rights, workers' rights (incl. freedom of association, health and safety, rights to be informed, consulted and take part in corporate decision-making), trade union rights (incl. rights to collective bargaining on wage and working conditions, rights to take industrial actions), obligations regarding

anti-corruption, tax fraud and money laundering, must be checked as part of the due diligence mapping exercise. Mapping must rely on accurate, detailed and comparable data (using internationally recognised reporting standards), and be made available to the public.

- **Trade unions' involvement:** workers and their representatives from the parent company and companies along its supply chain (subsidiaries, downstream/upstream subcontractors and suppliers) must be involved in all stages of the due diligence process, at both local, national, European and global levels. Cross-border social dialogue/industrial relations has a key role to play in ensuring the effective implementation of international instruments in this domain and along supply chains. Practically, this implies involving local, national, European and global trade union representatives and works councils in the design (risk mapping), the implementation (regular monitoring), and the reporting (alert mechanism) of due diligence plans. Involving specially refers to not just being informed, but being consulted on and co-designing due diligence plans, including the right for trade unions, at the relevant level, to negotiate the due diligence process with the company.
- **Sanctions and liability:** effective, proportionate and dissuasive sanctions must be foreseen from administrative enforcement in the event of a breach of the due diligence duty, on the one hand (i.e. lack of mapping, assessment and prevention of risks) to liability in the event of a breach of the remediation duty, on the other hand (i.e. lack of action to cease damages incurred, abroad included). Sanctions should be of a financial, administrative and procedural nature (incl. exclusion from public procurement and public funding). Both civil and criminal liabilities must be introduced. Monitoring will be essential, with trade union involvement, and a competent EU authority should be given this responsibility to ensure independence.
- **Enforcement mechanisms and grievance procedure:** Early alert mechanisms must be put in place in the company, in consultation with trade union representatives. The protection of whistle-blowers against retaliation must be secured. Enforcement must also be performed by public authorities which should be entrusted to investigate potential infringements and impose sanctions. Victims and organisations representing them (including trade unions) must have a direct access to justice in their own country and in the country where the parent/controlling/contracting company is based. Interim proceedings must be foreseen to halt the violation of rights until the court decides on the case. Burden of proof (of violation of rights) must rest on the company.

A European Directive should secure a common, cross-sectoral legal basis and, also, allow sector-specific issues to be addressed where necessary, in particular regarding the:

- **Textile sector:** Purchasing practices must take into account respect for human rights and environmental norms. Efforts must be collaborative and involve buyers, factories, workers and their unions with a view to making garment supply chain sustainable. This requires addressing root causes, including purchasing practices and systemic barriers. It must include longer-term commitments from buyers to suppliers in order to provide an incentive for them to comply, as well as sanctions if they do not. This requires building new models of initiatives such as the Bangladesh Accord on Fire and Building Safety, the ACT initiative on living wages and Global Framework Agreements targeting supply chains of global brands and retailers.
- **ICT sector:** In many supply chains we do not see 'the beginning', where the components of a finished product are produced. Just an example: For most mobile phones, rare earth metals needed, which come mostly from areas outside the EU, where child labour is a daily occurrence.
- **Extractive industries:** since 1 January, European legislation on conflict minerals has started to be applied to the 3 Ts and Gold, and as part of the EU raw materials strategy, action is foreseen on responsible and sustainable mining.
- **Energy sector:** the initiative on [monitoring CSR in electricity sector](#) launched in 2004 by the European social partners should serve as a blueprint for further elaboration of due diligence requirements in the sector.
- **Automotive sector:** as part of the EU raw materials strategy, the procurement of critical raw materials necessary for the electrification of transport necessitates particular attention.

In addition to a European directive on due diligence, industriAll Europe urges the EU to:

- play a major active and vocal role in the ongoing negotiations for a UN Binding Treaty on Business and Human Rights. The UN Treaty should provide for parent company-based extraterritorial regulation, i.e. a legally-binding cross-border duty to protect. The UN Treaty should also provide access to justice for victims of transnational corporate human rights violations (and the organisations representing them, including trade unions) in the home state of transnational corporations.
- support a special Convention at the ILO for regulating Responsible Business Conduct.
- Integrate Human Rights Due Diligence provisions into trade and investment agreements and its customs union.

## A stakeholder-oriented approach of corporate governance

IndustriAll Europe has long been advocating for a socially responsible and sustainable corporate governance of multinational companies which fosters the long-term development of companies to the benefit of workers, citizens and the environment. A substantial reform is required (and already long overdue) to depart from a purely financially driven model of management based on the short-sighted view of financial markets.

Here again, an extensive body of research has been compiled over the years to account for the damages created by the outdated shareholder-oriented model of corporate governance (excessive executive remuneration, narrow group thinking amongst board members, disproportionate dividend payment led to some infamous companies' collapse) and the failure of soft law instruments to reorient corporate management towards sustainable goals (including the failure of the 'comply or explain' based Commission Recommendation 2014/208/EU on the quality of corporate governance reporting). Simultaneously, econometric studies and social sciences research concurred to demonstrate that companies which have embraced a stakeholder-oriented model of management, including a high level of democracy at work, display better social and environmental performances, higher investment rates, better working conditions and more elaborated sustainable policies.

Against this background, while industriAll Europe welcomes the paradigm shift towards sustainable corporate governance proposed by the European Commission, we believe a holistic approach is necessary, which should not be limited to the sole question of board members' (i.e. directors) duty and remuneration, but should encompass a reform of:

- **Both board members' and top executives' duty** to manage the company in the interests of all stakeholders by securing the company generates long-term sustainable value, while preventing, mitigating and ceasing any adverse impact of its activities on workers, the environment and the society at large.
- **Both board members' and top executives' remuneration** which should move away from share-based components and, instead, be linked to long-term performance goals, assessed against indicators to be agreed with stakeholders (including respect of workers' and trade union rights, of decent wage, of health and safety standards, of CO2 reduction targets, etc.). Directors' and top executives' remuneration must be balanced and proportionate (e.g. based on a maximum CEO-to-worker pay ratio) and publicly disclosed (i.e. both the remuneration itself and how it is tied up with long-term KPIs).
- **Shareholders' remuneration:** The massive increase in the percentage of profits paid out to shareholders through share buybacks and dividends has increased company debt ratios (thereby increasing the probability of insolvency) and reduced the amount of financial resources available to companies for capital and R&D investments. Particularly disturbing is the continuance of pay-outs to shareholders when companies are receiving public subsidies and massively reducing the workforce. Measures should be implemented to limit dividend pay-outs and share buybacks if companies are getting public subsidies and if their credit rating is too low (e.g. a non-investment grade or 'junk bond' rating). 'Loyalty shares' (i.e. lower taxes or higher dividends for long-term shareholders) should be encouraged.

- **Both boards' and executive teams' composition:** diversity in terms of gender, age, social background, professional experience and field of expertise must be promoted on boards of directors, supervisory boards and top executive teams. In addition, representation of workers on corporate boards, with the same rights as other board members, must be fostered, so that strategic decision-making benefits from the specific social and industrial knowledge of companies, and insiders' understanding of work and production processes.
- **Dialogue between corporate governance bodies and employee representation bodies.** IndustriAll Europe stresses that workers are not just one stakeholder out of many, but hold a *primus inter pares* statute for bearing specific risks. Their health, income and employability are at stake and highly dependent on the way companies are managed. Their voice must be heard at the earliest stages of companies' strategic decision-making process. Any reform of corporate governance must thus include new ways and fora of dialogue between board members and top executives on the one hand, and worker representatives (that is works councils and trade union representatives on the shopfloor, in the entire company, at the group and the transnational levels) on the other hand.
- **Workers' voice in strategic decision making.** Dialogue must take place with strengthened bodies of worker representation in companies. IndustriAll Europe calls for workers' rights to information, consultation and participation to be complied by companies and enforceable before courts, including through effective, dissuasive and proportionate sanctions. Substantial and legally binding improvements of the European Works Council Recast Directive must be delivered with no further delay. A horizontal framework on workers' involvement in companies which make use of a European legal form or an instrument of EU company law enabling company mobility should be adopted.

## Mandatory corporate transparency

IndustriAll Europe invites the European Commission to avoid the pitfall of a scattered approach to corporate governance reform, and rather adopt a reform which tackles all the three dimensions of sustainable corporate governance as multinational companies, which should be managed in a:

1. stakeholder-oriented manner (see above-mentioned industriAll Europe demands)
2. accountable manner (hence our request for mandatory due diligence)
3. and transparent manner.

Although the third piece of the trypsic is missing from the current public consultation, industriAll Europe would like to reiterate its call for increased transparency from multinational companies. More specifically, industriAll Europe demands that:

- **Reporting be mandatory.** As the ‘comply or explain’ approach (as adopted for the non-financial reporting) failed to deliver more transparency from companies, reporting must become compulsory. Also, mandatory reporting must apply to all companies (regardless of their size, sector or legal form) located in or active in the EU, with specific support mechanisms to be provided to SMEs to fulfil their reporting duties. Failure to comply with reporting requirements must be met with proportionate, effective and dissuasive sanctions.
- **Reporting be integrated** instead of being dispersed amongst several financial reports on the one hand, and non-financial reports on the other hand. In accordance with industriAll Europe’s call for a revision of the 2014/95/EU non-financial reporting Directive, integrated reporting must include reporting about due diligence policies (respect of human, environment, social and trade union rights) and about industrial relations (compliance with information, consultation, participation rights and collective bargaining obligations). Reporting must disclose detailed and comparable data, including a minimum set of social and environmental indicators to report about, based on internationally recognised indicators.
- **Reporting to be broken down country-by-country**, including report about tax payment. Country-by-country reporting is a prerequisite to counteract tax avoidance and aggressive tax planning and ensure that multinational companies pay their taxes in countries where profits are generated.
- **Reporting be elaborated with all concerned stakeholders**, starting with worker representatives. A quality check must be performed not only by external auditors, but also by worker representatives.
- **Reporting be public:** integrated financial and non-financial reporting must be publicly disclosed, including in a European business register.