SVENSKT NÄRINGSLIV
SWEDISH ENTERPRISE

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Consultation Proposal for an Initiative on Sustainable Corporate Governance

Comments by the Confederation of Swedish Enterprise

The Confederation of Swedish Enterprise ("Svenskt Näringsliv") is the main business organization in Sweden, representing 50 member organizations (industry and employer organizations) and over 60.000 member companies, among them most listed companies. It represents almost all sectors of business with the exception of the banking industry.

We consider that the two sections of the consultation - corporate governance and due diligence - ought to be divided and treated separately as the sections concerns dissimilar questions, each with far-reaching consequences. Thus, our comments here are divided upon the sections.

– Comments regarding corporate governance

The Confederation of Swedish Enterprise is very critical towards the need for, the aim of and the proposals regarding corporate governance. The initiative is unnecessary as well as harmful. We urge the Commission not to proceed with it.

We find it unacceptable that the Commission uses a defective report, the EY Study "On directors' duties and sustainable corporate governance" as the sole basis for a pervasive EU intervention in the corporate governance systems of the Member States which would have serious negative consequences for all types of European companies. Likewise that the Commission disregards the many consultation responses from business organizations, academics, institutional investors and self-regulation bodies that pointed out the defective empirical components and conclusions of the EY Study (e.g. https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/F583972).

Furthermore, we are very critical to the many biased questions in this consultation and share the statement made by the European Company Law Experts Group (ECLE): https://www.law.ox.ac.uk/business-law-blog/blog/2020/12/ec-corporate-governance-initiative-series-comment-european-company

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?*

0 Do not know

Since there currently are no general EU rules on directors' duties the question is biased and push the respondents to answer yes, an answer that most likely will be interpreted as support for the far-reaching EU legislation on corporate governance (new EU rules on directors' duties) which seems to be contemplated by the Commission at DG JUST.

We agree that stakeholders' interests should be taken into account by company directors. However, this is already the case, and it is sufficiently regulated by existing corporate governance codes and national laws in the Member States. Therefore, there is no need for this to be further regulated at EU level.

Taking account of all relevant stakeholders' interests, as determined by the company is directly linked to the performance and interest of the company. Since many years, companies have taken account of diverse stakeholders' interests alongside the financial interests of shareholders, not only because this is an expectation placed on them, but because they see the value also for the financial position of the company, in doing so.

It is a wrong assumption[1] that companies exclusively prioritise shareholder value or that shareholder value creation is necessarily contrary to companies having stakeholder-oriented approach in their daily business and in their strategies. Consideration for stakeholders' interests is often part of companies' CSR/sustainability practices, which by their voluntary nature go beyond what is required by law.

Corporate governance codes in many Member States have already introduced recommendations promoting that companies further integrate a stakeholder-oriented perspective. For example, the Swedish Corporate Governance Code states that tasks of the board of directors include i.a. (i) identifying how sustainability issues impact risks to and business opportunities for the company, (ii) defining appropriate guidelines to govern the company's conduct in society, with the aim of ensuring its long-term value creation capability and (iii) ensuring that there is an appropriate system for follow-up and control of the company's operations and the risks to the company that are associated with its operations..

However, changing the entire legal system of corporate governance in the Member States from a shareholder-oriented legal framework (i.e. the owners are the ultimate decision-makers) to a stakeholder-oriented legal framework (e.g. where stakeholders have legal rights related to the management of the business, to the implementation of business policies and strategies, to the enforcement of directors liability toward the company itself) will lead to unclear management responsibilities with internal conflicts of interests, paralysed boards and lawsuits given that not all stakeholders' interests are fully compatible with each other. This will weaken the owners' rights and incentives, which will have huge negative consequences for companies attracting risk capital, for the incentives to be entrepreneurial and innovative etc. It will create risk averse companies with deadlocks between stakeholders. It will negatively affect the very core of how companies operate (anchored in our market economy model).

Companies and their boards need to retain the flexibility to balance the individual stakeholders' interests as, depending on the situation, they can often not be put on the same level. Companies and its investors also need to maintain a clear, simple and effective corporate governance system ultimately dominated by its owners, if we are to have competitive companies in the EU also in the future.

Question 5*: Which of the following interests do you see as relevant for the long-term success and resilience of the company?*

0 I do not know/I do not take position

Since many years, companies have taken account of diverse stakeholders' interests alongside the financial interests of shareholders, not only because this is an expectation placed on them, but because they see the value also for the financial position of the company, in doing so.

[1] See the earlier mentioned links to comments by legal experts.

All the interests listed in the table of question 5 are relevant for companies. Nevertheless, companies need to preserve the flexibility to determine not only the relevance of particular stakeholder groups to their business and how they interact with groups of different natures, but also the potential materiality of different stakeholder groups' interests to the company over the long-term. It cannot be demanded from companies to take all related stakeholder interests into account simultaneously and be legally responsible for the trade-off that necessarily has to be done between various, sometimes contradictory or incompatible, stakeholder interests.

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?*

0 I strongly disagree

There is a huge difference between which interests are relevant for companies to take into account and whether the EU should make mandatory requirement on directors' duties for all companies in the Member States. As pointed out in the answers to question 1 and 8 consideration for sustainability, long-termism and stakeholders' interests is already embedded in corporate governance codes and national company laws. There is no need for EU legislation on these matters.

As mentioned, companies need to preserve the flexibility to determine not only the relevance of specific stakeholder groups to their business and how they interact with groups of different natures, but also the potential materiality of different stakeholder groups' interests to the company over the short, medium and long-term.

It is not reasonable to believe that companies can carry out an exhaustive overview of all their stakeholders' interests. There is no definition behind "stakeholders" and no reasonable definition can be found due to the specificity of each company's environment. We strongly believe that any legal consequences attached to this notion would be unreasonable and counterproductive.

It should be recalled that many companies will have thousands of stakeholders who are impacted directly or indirectly by their activities. How material each of them may be to a company's long-term success and resilience may vary greatly from company to company in different circumstances. The board is ultimately better placed to identify the necessary trade-offs and balance the different interests and risks.

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?*

0 I strongly disagree

This is an example of the questions being biased, including an incorrectness ("instead of focusing on the short-term financial interests of shareholders"). Question 8 builds on the findings of the EY Study on directors' duties which has received substantial criticism by law and business professors across Europe and from the US[2].

[2] For example: https://www.law.ox.ac.uk/business-law-blog/blog/2020/12/ec-corporate-governance-initiative-series-comment-european-company, https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/F594640, https://hbr.org/2021/01/the-eus-unsustainable-approach-to-stakeholder-capitalism?utm_campaign=hbr&utm_medium=social&utm_source=twitter&fbclid=IwAR1qvQBamJaRX7I1CWbcb8bTHnlvf2J6NouH-a_TWWzlpO7S2RXK_tIqkGI and https://clsbluesky.law.columbia.edu/2020/11/09/the-european-commissions-sustainable-corporate-governance-report-a-critique/

The EY Study incorrectly assumes that European listed companies are driven by short-termism and at the same time do not take account of society's and stakeholders' interest. This basic assumption drives the whole study, including the methodology and the choice of sources, leading to a grossly misleading picture of European companies and too far-reaching recommendations.

The EY Study defines "short-termism" in a simplistic way as the ratio between, on one hand, a company's pay-outs in terms of dividends and share buy-backs and, on the other hand, the company's net income. Pay-out ratios cannot be used as a measure for short-termism. On the contrary, pay-outs are a crucial part of one of the cornerstones of economic policy in most EU countries, namely the mechanism requiring capital to be allocated from companies without profitable investment alternatives to companies with profitable projects, thereby supporting an efficient capital allocation in society. The Study wrongly uses Gross pay-out rate instead of Net pay-out rates. Moreover, as pointed out by Harvard professors, the Study's second "evidence" of short-termism is also misconstrued, namely that CAPEX and R&D intensity of listed companies decreased in the EU in the years 1992–2018. In fact, it increased. Their conclusion is[3]:

"We cannot rule out the possibility that short-termist pressures are causing some EU public firms to distribute too much cash to shareholders (or are generating other costs unrelated to capital flows). However, it is clear that the level of dividends and share repurchases in the EU is neither depriving firms of capitals needed to invest nor providing any other evidence of systematic and harmful short-termism."

We would like to refer to a recent study at the Stockholm School of Economics[4], a highly ranked academic institution in the field of Corporate Finance. The study shows that (i) corporate short-termism is a much more complex and multi-faceted issue than what is asserted in the EY Study, (ii) that pay-outs to the shareholders is at any rate no reliable indicator of short-sightedness in business management, and (iii) that very weak signs of financial short-termism could be observed among Swedish companies.

UK based companies make up a big portion (one third) of the sample taken in the EY Study. Not only do these companies fall outside future EU measures, but they also fall under a different legal corporate system and generally have a different ownership structure (more dispersed ownership model compared to continental Europe).

National laws on directors' duties includes a duty to take into consideration all foreseeable risks, including those pertaining to sustainability. Corporate governance codes in many Member States have already introduced recommendations promoting that companies further integrate a stakeholder-oriented perspective. For example, the Swedish Corporate Governance Code states that tasks of the board of directors include i.a. (i) identifying how sustainability issues impact risks to and business opportunities for the company, (ii) defining appropriate guidelines to govern the company's conduct in society, with the aim of ensuring its long-term value creation capability, and (iii) ensuring that there is an appropriate system for follow-up and control of the company's operations and the risks to the company that are associated with its operations.

The Swedish Corporate Governance Code also states that the boards of certain companies (as set forth in the Swedish Annual Accounts Act) are to provide annually, in a sustainability report made available on the company's website, the information to shareholders and the capital market on sustainability issues that is necessary for an understanding of the company's development, position and results, as well as the environmental impact of its operations.

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[3] https://corpgov.law.harvard.edu/2020/10/27/short-termism-shareholder-payouts-and-investment-in-the-eu/

[4] Carlsson-Wall, M., Eugster, F, Hjelström, T. and Nilsson, H.: Corporate Governance and short-termism: An in-depth analysis of Swedish data. Stockholm School of Economics, 2021: https://www.hhs.se/en/about-us/news/department-of-accounting/20213/corporate-governance-and-short-termism-an-in-depth-analysis-of-swedish-data/

Sweden implemented the EU directive on disclosure of non-financial information by means of amendments to the Swedish Annual Accounts Act, entailing that the board is responsible for the company's non-financial reporting in the sustainability report to the same extent as for the company's financial reporting in the annual report.

Consequently, sustainability is already embedded in national company law and corporate governance codes, and hence common practice in companies. It should not be for EU law to determine which interests should be taken into account and how to grade them.

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? How could these possible risks be mitigated?*

Beyond undermining fundamental principles of our market economy model, an EU legislative intervention would violate the subsidiarity principle as the Consultation refers to the heavily criticized EY Study on directors' duties as its sole basis. Consequently, the need for EU mandatory rules has not been proven. The aim of sustainability, long-termism and taken account of stakeholders' interests that the Commission strives for is already embedded in existing national company laws and corporate governance systems. Thus, an EU legislative intervention would also violate the EU principle of proportionality since an EU action shall not exceed what is necessary to achieve its aims.

Furthermore, a legislative intervention would have a negative impact on several fundamental principles of our market economy model which is the freedom of enterprise and property (ownership) rights and disrupt a long-standing and fine-tuned balance in national corporate governance systems. Directors only owe fiduciary duties to the company itself and not to third parties.

EU legislative action would also have huge counterproductive effects on several other levels:

- Unlimited and diffuse director liability where directors by law are required to balance the interests of their stakeholders, will inevitably lead to stakeholder conflicts and deadlocks which in turn would weaken decision-making effectivity and lead to risk aversion and less entrepreneurial behaviour.
- The weakened decision-making effectivity and the watering down of ownership rights would also reduce investors' incentives to provide risk capital to companies, including first movers and others who need risk capital to invest in the sustainable transition.
- By having the law determining that directors must take on board all stakeholders expectations, there is also a risk of making directors (paradoxically) less accountable to anyone because these expectations would be vague, contradictory and difficult to measure against any KPIs.
- Evaluation of boards which is an important practice in listed companies would also become very difficult as well as holding board members accountable for poor results, financial or others.
- Considerable administrative burden would be added which would hamper and slow down decision-making processes in European companies making them more vulnerable to competitors (vis-à-vis those from outside the EU).
- Risk of frivolous litigation.
- Overly onerous and unprecise requirements on individuals, such as directors of European companies, would have the potentially damaging effect of discouraging progressive and highly qualified individuals from taking up directorships of companies. Insurers would have

difficult to offer board insurance products due to diffuse liability. Particularly, in this area of sustainable corporate governance, it is essential that companies can attract open-minded, progressive individuals to drive companies' strategies forward in this area.

***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?*

0 I strongly disagree

This question is clearly biased and based on incorrect grounds: Firstly, it is claimed that companies often do not have a strategic orientation on sustainability risks, impacts and opportunities. We do not find this postulate proven. According to the survey answers found in the EY Study on directors' duties 85,7% of companies declared to have a sustainability strategy already (p. 34, fn. 125).

Secondly, there is a huge difference between (1) the company deciding itself to include such considerations into its strategy, decisions and oversight, and (2) introducing legislation requiring such integration. And if legislation is introduced whether this should be (2a) national legislation or (2b) EU legislation. Giving the legislator (EU or national) a say on how strategies should be defined would go against our market economy model and the foundations of company law. Many concerns are raised in this regard: How to define in this case the company (foundation) contract and the responsibilities of shareholders? Is the core of the limited liability company and its purpose not being put into question? What would be the reasonable strategic orientation to follow by law? Where to draw the line between an orientation to serve a political ideology and sound economical and sustainable corporate decisions? Would it not be a risk that companies inadvertently become an extended arm of shifting political majorities? Where is the evidence for such a major intervention in national company law and corporate governance systems?

Thirdly, as mentioned above, many national corporate governance codes already require companies to implement a strategic orientation on sustainability risks, impacts and opportunities, in their own business strategy.

***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?*

Directors owe a legal duty of care (fiduciary duty) to the company. It is not appropriate to require directors to have a legal duty of care to stakeholders. Any such duty of care to stakeholders is and should be held by the company itself rather than its directors.

We object to the introductory statement to question 11 that there is a narrow understanding of the duty of care according to which directors are required to act predominantly in the short-term financial interests of shareholders. This statement is not supported by facts.

***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?*

0 I strongly disagree

Any EU legislative initiative on corporate governance should not lead to personal legal liability for directors with respect to company's impacts on stakeholders. Directors only owe fiduciary duties to the company itself and not to third parties, such as external stakeholders. It would violate companies' right to govern themselves through their internal organs to grant outsiders a statutory right to enforce directors' duty of care towards the company. As for directors' liability

towards stakeholders, the latter already have mechanisms of protection and can claim company's liability through traditional processes such as through tort law and contract law. There is no need to create more mechanisms. It should also be noted that the EU directive on whistle-blowers' protection will help companies in preventing and mitigating the risks they undergo.

The introduction of enforcement mechanisms would have a disruptive effect on the fine-tuned balance (built over decades) between boards, management and shareholders and could potentially create endless (frivolous) litigation (e.g. by anyone seeking to harm the company, including competitors).

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?*

Question 20b*: If you agree, which stakeholders should be represented?*

Question 20c*: What are best practices for such mechanisms today? Which mechanisms should in your view be promoted at EU level (Stakeholder general meeting? Complaint mechanism as part of due diligence? Advisory body? Other?)*

0 I strongly disagree

There is no need for further EU legal requirements.

We recognise that consultation of relevant stakeholders is important in the normal functioning of companies. To generate significant benefits, the company, best knowing the impact stakeholders have on its activities and inversely (the impact it has on those stakeholders), should be given the flexibility to determine the relevant stakeholders depending on its specificities and the type of measures/mechanisms to inform, consult and engage with them. Companies already organise the dialogue with their stakeholders using different mechanisms that are suitable to the intended goals: internal, advisory committees, roadshows, direct dialogue, one to one meetings, partnerships, co-innovation, panels… etc.

Many Swedish companies publish sustainability reports which often include stakeholder engagement processes (cf. our answer to question 8).

New legal requirements risk destabilising or duplicating existing effective provisions. They could lead to either meaningless box-ticking exercises or to conflicting situations (between different stakeholders' interests) that would reduce efficiency of decision-making processes in companies and harm their competitiveness. Also, if there are requirements throughout the entire supply chain, at which levels should a company make sure to have a consultation mechanism? Only in their own direct operations or beyond that? It is not practically feasible to require a company to put in place and manage a consultation mechanism with each and every supplier.

We consider workers as important stakeholders, however of a different nature to other stakeholders, as they are part of the company. Whilst it is important that they too have the possibility to be involved in discussions on company strategy (including due diligence), this must be in full respect of national industrial relations systems. Furthermore, there is no need for further EU legal requirements to ensure this. The EU directive on information and consultation is already sufficient.

Question 21*: Current executive remuneration schemes, in particular share-based remuneration and variable performance criteria, promote focus on short-term financial value maximization. Please rank the following options in terms of their effectiveness to contribute to countering remuneration incentivising short-term focus in your view.*

0 None of these options should be pursued

Clear, understandable and comprehensive information on remuneration of board directors and its alignment with the listed company's long-term strategy helps boosting confidence in

companies and ultimately in the markets. A good balance was reached in the recent Shareholders Rights Directive II in terms of the level of prescription of the rules regarding remuneration policies to avoid triggering negative side effects.

The fully intended outcome of the negotiations on the Shareholders Rights Directive II was that disclosure requirements and shareholder say-on-pay were substantially increased, thus focusing on increased transparency but leaving the substance of the executive pay to the companies and their shareholders.

It seems ill-advised to reopen this discussion again so soon after, especially when this part of the Shareholders Rights Directive II has not yet come into effect in practice. It would be premature and in breach of EU better regulation principles.

Although the Shareholders Rights Directive II has no legal requirement to include non-financial KPIs in its remuneration criteria, a recital encourages listed companies to assess directors' performance using both financial and non-financial KPIs. Whatever KPIs a company chooses to use, there must be transparency in both the remuneration policy and report as robustness and reliability of those KPIs are key to investor confidence.

Moreover, the relevant rules of the Shareholders Rights Directive II clearly state that remuneration policy must contribute to the company's business strategy and long-term interests and sustainability and shall explain how it does so. This is a good balance which is even being strengthened by national corporate governance codes around the substance of executive remuneration. Defining percentages of variable remuneration, determining in detail which ESG components should go into variable remuneration or determining remuneration on the basis of the remuneration of the workforce is very far-reaching and intrusive on the fundamental rights of private companies and where applicable the autonomy of collective bargaining. This was specifically excluded from the directive and for very good reasons. It should remain for each individual company to decide how best to align executive remuneration with its business model, the strategy and goals (also long term).

Question 22*: 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. Please indicate which of these options are in your view effective to achieve this objective.*

0 None of these are effective options

This is a biased question. The assertion that current level of expertise in boards generally does not fully support a shift towards sustainability is not supported by facts. The skillset of board members is expanding also to meet the increasing needs of companies around digital and green transformation goals. The real debate about board competences is about how to drive values and change without recurring to a static box-ticking exercise which would derive from a legislative approach.

Not all relevant competencies can practically be represented in the board. That would require board sizes that are too big to function. This is not a problem in practice because boards, of course, also draw on competences/expertise outside the board.

It is the task of the specific company to assess the desirable balance of competences and skills in the board and its committees in that specific company at any specific time. The optimal mix of competencies will change over time for any given company. The Swedish Corporate Governance Code states that the diversity policy may consist of Code rule 4.1 which states i.a. that (i) the board is to have a size and composition that ensures its capacity to manage the company's affairs efficiently and with integrity, (ii) the board is to have a composition appropriate

to the company's operations, phase of development and other relevant circumstances, and (iii) the board members elected by the shareholders' meeting are collectively to exhibit diversity and breadth of qualifications, experience and background. Gradual engagement with stakeholders also allows to extend networks to source further diversity and expertise.

The composition and the profile of board members is not something to be mandated by legislation. Any of the legal requirements could have the unintended effect of placing certain skills at a superior level to others (not mandated by law) perhaps equally or more important for a company's long-term sustainability.

Question 23: *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. 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?*

0 I strongly disagree

The statement in this question - that company pay-outs to shareholders 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 - has been largely contested by experts in the last months who consider that the level of dividends and share repurchases in the EU is neither depriving firms of capitals needed to invest nor providing any other evidence of systematic and harmful short-termism (see our answer to question 8). The statement overestimates European companies' pay-outs since it ignores inward flows e.g. capital increases and debt financing.

Two other issues should be considered when analysing pay-outs in European companies. Firstly, when looking beyond large listed companies, namely the levels of R&D of smaller companies across the EU, the expenditure in R&D rate has increased over the time period considered in the EY Study on directors' duties. The EU is the global leader on high-value green patents[5], suggesting the strong commitment of EU companies in green transition (note that 87% of green inventions in the EU are produced by the private sector). Secondly, the correct concept to use is Net shareholders pay-out, instead of the Gross shareholder pay-out. The latter fails to take into account equity issuances that move capital from shareholders to companies. The Net shareholders pay-out takes into account the pay-ins from new financing, be it in debt or equity. And data demonstrates that EU listed companies issue much more equity than they repurchase.

There are already EU rules on share-buybacks and there are EU market practises which are dealt with by the Market Abuse Regulation. Further legislation is not necessary.

The private sector has a crucial role to play in the field of sustainability, not least as companies are the engines of innovation. A well-functioning market economy with free capital formation and efficient capital re-allocation is vital to generate risk capital to business innovation. However, **this initiative on Sustainable Corporate Governance, where the proposed solutions are sought within company law and corporate governance, is deeply worrying. If the proposals were to become a reality, there would be a substantial risk that European companies would get less access to risk capital, implying that business sector dynamism and innovation will be hampered, and that the incentives for undertaking forward-looking investments and innovations necessary to support sustainable economic growth will be undermined.**

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[5] https://ec.europa.eu/commission/presscorner/detail/en/IP_20_2458

It is our firm believe that any EU regulatory initiative to deal with potential short-termism trends that may pose a threat to long-term value creation in companies should and must be handled within the framework of other disciplines than company law and corporate governance (e.g. labour law, environmental law etc.).

***Question 24**: Do you consider that any other measure should be taken at EU level to foster more sustainable corporate governance?*

Preserving the comply-or-explain approach
The integrity of the comply-or-explain approach in the EU must be preserved. This approach is widely supported by companies, boards, investors, shareholders, national regulators and market authorities. It allows companies to tailor corporate governance mechanisms to their specific circumstances, ownership structure, size, sector and culture. It also allows to go beyond (and ahead of) legislation in the pursuit of objectives that are in the interest of the company, its stakeholders and the society at large (e.g. sustainability, board diversity policies etc.). The comply-or-explain approach has helped making Europe a world reference when it comes to corporate governance and culture. It is essential to continue to protect and promote this approach as a viable means to achieve sustainable corporate governance goals, including those related to sustainablity.

Delisting concerns due to highly regulated environment
We have witnessed a worrying decrease in listings in the past years, and since 2015 there have been 300% fewer initial public offerings (IPOs) in European stock markets. One of the main reasons explaining these figures are the cost and burdens of legal requirements. Since 2005, Europe's share of the global stock market value of non-financial companies has fallen by nearly 50 %, while the dominance of the US and China has grown. The total stock market value of all European listed companies today equals probably only one tenth of the global market value. There is an inefficient supply of (risk) capital in Europe which the European Capitals Market Union strategy is trying to address. It is of utmost importance that any future initiative stemming from DG JUST is reconcilable with these objectives.

– Comments regarding due diligence

***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. 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?*

0 Do not know

Today's voluntary system based on UN and OECD guidelines has many advantages. It gives each company the flexibility to develop their sustainability work in the most effective manner for that particular line of business. It also contributes towards a level playing field globally. Practically all larger companies in Sweden pursue an active sustainability policy and work towards improving the human rights and environmental impact in their supply chains. Developments in markets and in society at large also leads to companies shouldering increasing responsibility not only for their own activities but also up and down their supply chain.

We are open to discuss additional requirements if this can be shown to be an effective way to promote sustainable development and is reasonable for companies to handle. However, binding legal rules carry with it many risks. They may impact negatively on international trade and make companies leave, or refrain from entering, complex markets. Detailed and inflexible rules may lead to

compliance costs soaring without tangible impact on sustainability. Companies may be held accountable for third party actions over which it has no control.

Consequently, the proper design of any legal framework for supply chain due diligence is crucial. It must minimize the many potential drawbacks of a binding instrument. In practice this means, in particular, that:

- the framework should be harmonized within the EU, i.e. specific national requirements or gold plating should be avoided. Any binding rules in this area should thus be in the form of a regulation.
- any social rights or collective rights, including co-determination, inferred through this legislation must not interfere with member states' labour market legislation or collective agreements or otherwise affect member states' national labour market systems. Consequently, proposals should not be included that are covered by TFEU Art 153.
- the legislation must be based on an obligation of means (process) and not outcome
- only first tier suppliers should be covered, i.e where there is a contractual relationship
- companies should be allowed to prioritize the risks (as outlined in the OECD guidelines)
- company obligations must be clear and proportionate
- it must be possible for a company to assess when they have done enough to avoid liability (safe harbor)
- it must not overlap with other existing EU-legislation or reporting requirements
- all reporting requirements should be aligned and done under the NFRD
- it should be aligned with and build upon the relevant UN and OECD guidelines

In addition, it is important to ensure that a legal framework does not deter companies from going further than their legal obligations. Companies' own initiative work is, and will remain, key to improve human rights and the environment.

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.*

0 Contribute effectively to a more sustainable development, including in non-EU countries
0 Harmonisation to avoid fragmentation in the EU, as emerging national laws are different
A framework should only be developed if it contributes to a more sustainable development. A main benefit is that it can provide the same rules throughout the EU. A patchwork of different national rules must be avoided. It might also have an effect on levelling the playing field within the EU. However, as the main risks would occur in competition on third country markets, the latter benefit should not be overemphasized.

Question 3a: *Please indicate which among the following possible risks/drawbacks linked to the introduction of an EU due diligence duty are more important for you?*

0 Increased administrative costs and procedural burden
0 Penalisation of smaller companies with fewer resources
0 Competitive disadvantage vis-à-vis third country companies not subject to a similar duty
0 Responsibility for damages that the EU company cannot control
0 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
0 Disengagement from risky markets, which might be detrimental for local economies
0 Other
In addition, if European companies, which are often at the forefront as regards human rights and the environment, become more risk averse and withdraw from problematic markets or cut out risky suppliers, this might very well be detrimental not only economically. By leaving the field open to less ambitious (or scrupulous) companies from other countries, the end-effect on human rights and the environment is likely to be negative.

And as pointed out under Question 2, depending on the design, binding legislation could be used to challenge members states' labour market legislation or collective agreements with far reaching consequences for the balance and proper functioning of the national labour markets.

More principled objections, i.e. letting companies take over the traditional role of the state in ensuring adherence to rules and introducing liability for other independent parties' action, are also potential important drawbacks.

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, i.e. human rights, social, health and environmental impacts are identified, prevented and addressed?*

0 Strongly disagree

This would be an unacceptable intrusion into the inner workings of a company with far reaching consequences for competitiveness and efficiency with questionable effect on HR and the environment.

Question 14*: For the purpose of this consultation, "due diligence duty" refers to a legal requirement for companies to establish and implement adequate processes with a view to prevent, mitigate and account for human rights (including labour rights and working conditions), health and environmental impacts, including relating to climate change, both in the company's own operations and in the company's the supply chain. "Supply chain" is understood within the broad definition of a company's "business relationships" and includes subsidiaries as well as suppliers and subcontractors. The company is expected to make reasonable efforts for example with respect to identifying suppliers and subcontractors. Furthermore, due diligence is inherently risk-based, proportionate and context specific. This implies that the extent of implementing actions should depend on the risks of adverse impacts the company is possibly causing, contributing to or should foresee. Please explain whether you agree with this definition and provide reasons for your answer.*

0 Disagree to a certain extent

We believe that the definition is too vague to provide the basis for legislation. For example, the scope of "business relationships" within the supply chain must be clearly defined. We suggest that this only cover such parties that the company is directly connected to through contractual relationships.

Other suggested improvements of the definition include

- referencing the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals (2nd edition, 2013) as an effective international framework identifying the due diligence responsibilities for companies with suppliers with whom a direct relationship exists (p.39, 40) and highlighting the role of collaboration/associations to build capacity, due diligence and standards further upstream in the supply chain (p.42, 45).
- referencing or incorporation of the prioritization permission in UN Guiding Principle 17: "Where business enterprises have large numbers of entities in their value chains it may be unreasonably difficult to conduct due diligence for adverse human rights impacts across them all. If so, business enterprises should identify general areas where the risk of adverse human rights impacts is most significant, whether due to certain suppliers' or clients' operating context, the particular operations, products or services involved, or other relevant considerations, and prioritize these for human rights due diligence."
- Due diligence should be risk-based and take the materiality of risks in company operations into account. Important to consider that for all aspects the materiality of the issue depends on the nature of the operations, the linkage with the business in question and the degree to which the business may have caused/contributed to a potential impact. E.g. for some companies, climate emissions in the supply chain are relevant, for others it is not.

***Question 15**: Please indicate your preference as regards the content of such possible corporate due diligence duty.*

0 None of the above, please specify

Any rules should be horizontal, in line with the present UN and OECD guidelines, even if different sectors and types of companies face different challenges. Consequently, there must be a flexibility in the framework that takes these differences into account.

***Question 16:** How could companies'- in particular **smaller ones (SMEs')** - burden be reduced with respect to due diligence? Please indicate the most effective options.*

0 Other option, please specify

Given the risk for complexity and administrative burden, that it's the largest companies that have the resources for effective due diligence and that their impact on HR/environment is the biggest, a substantial turnover threshold could be considered. However, micro-enterprises and SMEs would indirectly be subject to any due diligence obligation through their role as suppliers to larger enterprises. Consequently, to apply it to all companies, with the possible exception of micro enterprises, might be a better option. However, this would necessitate keeping documentation and reporting requirements to a minimum and ensuring that the due diligence obligations are proportional to the size and resources of the company in question.

***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?*

0 I do not know

In principle, yes. However, it is to us unclear what situations are targeted, how the rules could be enforced, and what possible consequences this might have. E.g. if passive sales through a website by an American company is covered, might not action against this company be considered a trade restriction and invite retaliatory action against European companies? Consequently, its application needs to be specified and possible effects analyzed before this question can be answered.

***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?*

0 Yes

Multilateral agreements (WTO, UN) should be the preferred option to pursue sustainability in order to minimize the negative impact on European competitiveness and ensure a level playing field. Further development of the sustainability chapters in FTAs should also be pursued.

***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 of due diligence duty?*

0 Other, please specify

It is key that the rules are transparent and clear and causes as little administrative burden as possible. The aim must be to improve sustainability, not to sanction companies. Strict sanctions would be counterproductive since companies with a positive impact on sustainability would refrain from engaging with regions/countries/players that would benefit the most. Any sanctions must be proportional and transparent. If this is the case, it would be appropriate for companies to be liable for failing to maintain a reasonable due diligence process, or for providing inaccurate or deceptive statements about their process.

THE CONFEDERATION OF SWEDISH ENTERPRISE

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