SVENSKT NÄRINGSLIV
SWEDISH ENTERPRISE

Comments on suggested rules for sustainable corporate governance

The European Commission is set to propose a legislative framework for sustainable corporate governance in Q2 of 2021. This initiative is said to aim to "improve the EU regulatory framework on company law and corporate governance" and will include new rules on both corporate governance as well as on due diligence for supply chains. To this end, the Commission has conducted a public consultation, which closed on 8 February 2021.

The Confederation of Swedish Enterprise responded to the consultation on 5 February 2021. In our reply, we urged the European Commission to separate its proposal on due diligence from that on corporate governance. Indeed, we would prefer it did not move forward with the proposal on corporate governance at all.

Why the European Commission should separate the rules for due diligence from those for corporate governance

First, the proposals are seeking to address different issues. Due diligence is about minimizing the risk of adverse impacts on human rights and environment in supply chains. The concepts put forward on sustainable corporate governance, however, are aimed at resolving *alleged* short-sightedness in corporate governance.

Stakeholders also hold widely differing opinions on these two proposals. Many businesses support some level of due diligence requirements, but categorically reject those ideas advanced on sustainable corporate governance. Combing the two elements therefore could lead to a situation where many would reject any proposed legal framework in its entirety, despite supporting substantial parts of the proposal.

As corporate governance is a Member State competence, any proposal in this area would lead to discussions on subsidiarity and the EU principle of proportionality; legal challenges would also be expected. The outcome would be that any process seeking to introduce due diligence requirements is likely to be slowed down or stopped.

Why the European Commission should not proceed with its proposals on sustainable corporate governance

We consider the initiative on corporate governance to be unnecessary, potentially damaging to business and likely to be counterproductive to its planned purpose.

Changing the legal system for corporate governance in the Member States from a shareholder-oriented legal framework (where the owners are the ultimate decision makers) to a stakeholder-oriented legal framework (where the stakeholders have legal rights relating to the management of the business, to the implementation of business policies and strategies, to the enforcement of directors liability toward the company itself etc.) will lead to unclear management responsibilities. It will create internal conflicts of interest, paralyse board decision making and lead to legal actions, given that not all stakeholders' interests are mutually compatible.

This will dramatically weaken the owners' rights and incentives, with substantial negative consequences for businesses. It would potentially reduce the opportunities to attract risk capital, reduce incentives to be entrepreneurial and innovative and will undermine the incentives for making

the forward-looking investments and innovations required to support sustainable economic growth. It will effectively shift the power from the owners to the agents (management and boards), without any mechanisms for the owners to hold its agents accountable for their management. Also, the risk of enforcement by other stakeholders against management of different stakeholders' interests will risk companies becoming risk averse and prone to decision paralysis.

We find it unacceptable that the Commission would use a defective report - the EY "Study on directors' duties and sustainable corporate governance" - as the sole basis for such a pervasive EU intervention in the corporate governance systems of the Member States. The study has already been heavily criticised by law and business professors across Europe and from the US.[i]

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. No requirement for EU legislation on these issues has been proven, and consideration for sustainability, long-termism and stakeholders' interests is already embedded in corporate governance codes and national company laws. For example, the Swedish Corporate Governance Code, which applies to all Swedish regulated market listed companies, states that tasks of the board of directors should include the following. (i) Identifying how sustainability issues impact risks to, and business opportunities for, the company; (ii) defining appropriate guidelines for governing 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 in place for following up and controlling the company's operations and the risks associated with its operations. Thus, an EU legislative intervention would violate both the subsidiarity principle and the EU principle of proportionality, since an EU action should not exceed what is necessary to achieve its aims.

Companies and their boards need to be able to preserve the flexibility of determining both the relevance of specific stakeholder groups to their business and how they interact with different groups as well as the potential long term material nature of the interests of different stakeholder groups to the company. If we hope for competitive companies in the EU in the future, companies and their investors also need a clear, simple and effective corporate governance system. Such a system should be based on the 'comply or explain' mechanism and ultimately determined by the owners.

It is our firm belief that any EU regulatory initiative designed to deal with potential short-termism trends that may pose a threat to long-term value creation in companies should, indeed must, be handled within the framework of other disciplines - for example labour or environmental law - and not dealt with via company law and corporate governance.

Conclusion

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 reallocation is vital for generating risk capital to finance business innovation. However, this initiative on Sustainable Corporate

Governance, where the solutions proposed fall within company law and corporate governance, is deeply worrying. Were the proposals to become a reality, there would be a significant risk that European companies would have less access to risk capital. This would hamper business sector dynamism and innovation and undermine incentives for making the forward-looking investments and innovations necessary to support sustainable economic growth.

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[i] https://www.law.ox.ac.uk/business-law-blog/blog/2020/12/ec-corporate-governance-initiative-series-comment-european-company

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