SVENSKT NÄRINGSLIV
SWEDISH ENTERPRISE

22 April 2022

In view of the subsidiarity control on the proposal for a Directive on Corporate Sustainability Due Diligence, COM(2022) 71

In the opinion of the Confederation of Swedish Enterprise, the parts of the proposed Directive COM(2022) 71 that relate to corporate governance – specifically Articles 15(3), 25 and 26 – do not comply with the principle of subsidiarity.[1]

First, it should be noted that a subsidiarity objection can be made to parts of an EU legislative proposal.[2] A parliamentary committee appointed by *Riksdagsstyrelsen* (the Board of the Swedish Parliament) stated the following in its report "EU-arbetet i riksdagen" (EU work in the Swedish Parliament) (pp. 166f; translated and highlighted by us in yellow below):

> "**Parts of proposals and of packages**
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> In the second, follow-up case, the Committee on the Constitution in the Swedish Parliament pointed out that the application of the two-step method is not restricted to a legislative proposal as a whole, but rather that it can be used to examine whether different components of a legislative proposal violate the principle of subsidiarity (bet. 2011/12:KU4 p. 23). The Committee on the Constitution clarified the meaning of this in a later context by stating that a committee may thus examine different parts of a proposal and conclude that some parts of the proposal are not compatible with the principle of subsidiarity while other parts are compatible with the principle of subsidiarity (KU prot. 2011/12:27).
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> In the follow-up case, the Committee on the Constitution also noted that it follows from the fact that the term 'package' is not used in the Treaty Protocol, that each draft legislative act is subject to a separate subsidiarity control, regardless of whether the European Commission has chosen to present it as part of a package with several linked drafts or not (bet. 2011/12:KU4 p. 35)"[3]

Link to the report can be found here.

The argument of the Confederation of Swedish Enterprise

The legal basis for the proposed Directive invoked by the European Commission is called into question for the corporate governance part, as Article 50(1) and (2)(g) of the Treaty on the Functioning of the European Union is aimed at implementing the freedom of establishment.

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[1] The principle of subsidiarity states that decisions should be taken as close to the citizens as possible. With the exception of cases where the EU has exclusive competence, the EU should not intervene if it is clear that it is more effective to act at national, regional or local level. The principle of subsidiarity is closely linked to the principles of proportionality and necessity, i.e. that EU action should not go beyond what is necessary to achieve the objectives of the Treaty.

[2] In Sweden the Swedish Parliament ("Riksdag") has decentralised the scrutiny of Commission proposals in terms of subsidiarity to all parliamentary committees.

[3] Free translation from Swedish to English made by the Confederation of Swedish Enterprise.

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> *Article 25 - directors' duty of care - states that Member States shall ensure that, when fulfilling their duty to act in the best interest of the company, directors of companies referred to in Article 2(1) take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term. Member States shall ensure that their laws, regulations and administrative provisions providing for a breach of directors' duties apply also to the provisions of this Article.*
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> *Member States shall ensure that the laws, regulations and administrative provisions governing situations of breach of duty by directors also apply in relation to the provisions of this Article.*

Article 25 is not necessary for fulfilling the purpose of the proposed Directive. The board of directors and management of a public, limited-liability company are already today required to take account of consequences for the company and the outside world in all areas relevant to the company in their decision-making. This includes the areas listed in Article 25(1).

The EU Regulatory Scrutiny Board (RSB) has issued two negative opinions on the European Commission's draft proposal for a Directive. As the opinions are largely concerned with the corporate governance component of the proposal, the RSB's objections should be taken into account. This will help maintain respect for better regulation principles – compliance with which is crucial to ensure that EU proposals are evidence-based and sufficiently substantiated in terms of the need for the proposed EU measure – its impact, its proportionality and, not least, its compliance with the principle of subsidiarity. In the second opinion[4] of 26 November 2021, the RSB has made the following statements on the corporate governance parts of the proposal (our emphasis):

- It "is not clear […] why it is necessary to regulate directors' duties on top of due diligence requirements."
- There is a need to "better explain and assess the value-added of regulating directors' duties, considering that the due diligence option already requires risk management and engagement with stakeholders' interests."
- Justification is needed "why stand-alone options covering directors' duties or due diligence requirements only were not identified and subsequently compared with the combination options."
- "The description of the directors' duties should clarify how directors need to incorporate conflicting interests of stakeholders and sustainability aspects. It should clarify whether or not there is a long-term interest of the company that could supersede particular interests of stakeholders or beneficiaries or particular sustainability considerations."
- Assessment is needed regarding "how the proposed EU corporate sustainability governance rules would fit with the different national corporate governance models existing in the EU, given the national focus of company law."

The European Commission's follow-up to the RSB's second opinion[5] states that in the proposed Directive:

[4] https://ec.europa.eu/transparency/documents-register/detail?ref=SEC(2022)95&lang=en
[5] https://ec.europa.eu/transparency/documents-register/detail?ref=SWD(2022)39&lang=en

”Directors’ duties were changed. While most of the duties are closely linked with the due diligence obligations and necessary for the due diligence to be effective, they also include the clarification of how directors are expected to comply with the duty of care to act in the best interest of the company.”

This gives a misleading picture of the proposed Directive, as the European Commission does not address the main objection: the lack of sufficient justification, from the outset, to include directors' duties.

The European Commission also states that:

"Directors' duties [...] allows due diligence to become strategic and to infiltrate into relevant corporate functions. A due diligence obligation without a proper corporate governance backing and without directors’ responsibilities could become a mere compliance issue of secondary relevance. Regulating directors’ duty of care was retained.”

This means that the Commission has not taken into account the views expressed by the RSB and ignores the fact that existing company law rules at EU level – as well as national corporate governance codes (such as the Swedish Corporate Governance Code) - already provide sufficient incentives for directors to apply a duty of care.

> *Article 26 - setting up and overseeing due diligence - states that Member States shall ensure that directors of companies referred to in Article 2(1) are responsible for putting in place and overseeing the due diligence actions referred to in Article 4 and in particular the due diligence policy referred to in Article 5, with due consideration for relevant input from stakeholders and civil society organisations. The directors shall report to the board of directors in that respect. Member States shall ensure that directors take steps to adapt the corporate strategy to take into account the actual and potential adverse impacts identified pursuant to Article 6 and any measures taken pursuant to Articles 7 to 9.*

The requirement in Article 26, for the company's directors to ensure that the company complies with its due diligence obligations, is unnecessary. This is because if such obligations are imposed on the company, it automatically follows from national company law that the company's directors have such an obligation.

The requirements of Article 26 should be properly addressed to the association (company) and not to the directors. It should be left to the national organisational model, as in all other matters, to deal with how these duties are handled in terms of internal corporate governance.

Article 26 may also lead to inappropriate and unnecessary interference in the internal management of companies. It is important that the final authority over decisions on company strategy and other important decisions remains with the corporate bodies as designated by the public limited liability companies. Any watering down of this principle is a restriction of the company's right to self-determination, and of the shareholders' right of ownership.

It is also erroneous and inappropriate to give external stakeholders a legal right to influence directors’ decisions, when they bear no legal co-responsibility for the consequences. The provision is also unnecessary, as the participation of external

stakeholders in due diligence processes is already regulated in Articles 6-8, which require consultation in various contexts.

> *Article 15(3) - combating climate change - states that Member States shall ensure that companies duly take into account the fulfilment of the obligations referred to in paragraphs 1 and 2 (compliance with climate change strategy and emission reduction objectives) when setting variable remuneration, if variable remuneration is linked to the contribution of a director to the company's business strategy and long-term interests and sustainability.*

Article 15(3) is not required, as the EU Shareholder Rights Directive II [(EU) 2017/828] - and thus also national company law rules and corporate governance codes - already have provisions on remuneration in listed companies. These clearly state that the remuneration policy must contribute to the company's business strategy, its long-term interests and sustainability, and explain how it will do this.[6] This is a good balance, one which is further reinforced by national corporate governance codes. Determining in detail which of the environmental, social and governance (ESG) or ESG-related components should be included in variable remuneration - as is the case in the proposed Directive, is far-reaching and implies a restriction of shareholders' rights.[7]

The Commission's impact assessment does not seem to provide sufficient justification for the proposal, as pointed out by the RSB in its two negative opinions.

[6] Recital 29 of the Shareholder Rights Directive II states that: "The remuneration policy should contribute to the business strategy, long-term interests and sustainability of the company and should not be linked entirely or mainly to short-term objectives. Directors' performance should be assessed using both financial and non-financial performance criteria, including, where appropriate, environmental, social and governance factors."

[7] Recital 28 of the Shareholder Rights Directive II states that: "It is therefore important to respect the diversity of corporate governance systems within the Union, which reflect different Member States' views about the roles of companies and of bodies responsible for the determination of the remuneration policy and of the remuneration of individual directors."