

# SUSTAINABILITY AND CORPORATE GOVERNANCE: TOWARDS A STAKEHOLDER SOCIETY?

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**The impact of sustainable development on corporate governance has been the subject of debate for some years now, both at a national and European level.**

In 2018, the European Commission launched its Action Plan on Financing Sustainable Growth (the “Action Plan”). Among its core objectives was to examine whether there was a need to establish a requirement for boards of directors to develop and disclose a sustainability strategy, define measurable sustainability targets and specify possible rules under which directors would be required to act in pursuit of long-term corporate objectives.

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The Action Plan has achieved its first important objective with the adoption into law by the European Commission of a directive on corporate sustainability due diligence (the ‘Directive’).

As indicated by the European Commission, the aims of the Directive are to foster sustainable and responsible corporate conduct and to include human rights and environmental considerations in corporate activities and governance. The explanatory memorandum to the Directive provides that “given the significant number of suppliers both in the EU and in third countries, as well as the overall complexity of value chains, EU companies, including large ones, may encounter difficulties in identifying and mitigating risks in their value chains linked to respecting human rights and environmental impact. Identifying these adverse impacts in value chains will become easier if more companies exercise due diligence and thus more

data is available on human rights and adverse environmental impact.

Furthermore, the connection of the EU economy to millions of workers around the world through global value chains comes with a responsibility to address adverse impacts on the rights of these workers”.

The Directive covers EU companies, or third country companies operating in the EU, with a €40m+ turnover operating in high-impact sectors such as textiles, agriculture, manufacturing of food products, or the extraction of and trade in mineral resources.

SMEs (small and medium sized enterprises) remain outside the scope of the Directive, though they may be impacted by its requirements given their potential participation in the production chains of large companies.

As per the Directive, companies that fall within its remit must:

- (i) integrate due diligence into their corporate governance structures;
- (ii) identify actual or potential adverse human rights and environmental impact;
- (iii) prevent or mitigate said potential adverse effects;
- (iv) bring any actual adverse impact to an end and minimise its extent;
- (v) establish and maintain a complaints procedure;
- (vi) monitor the effectiveness of their due diligence policy and measures; and
- (vii) SHARE due diligence information publicly.

The Directive also provides specific obligations on directors to:

- (i) take into account the consequences of their decisions on sustainability matters including, where applicable, human rights, climate change and environmental consequences in the short, medium and long term; and
- (ii) put in place and oversee due diligence requirements including relevant input from stakeholders and civil society organisations.

Although there are weaknesses in its drafting and uncertainties in its interpretation, the Directive introduces an important change of perspective for companies and their directors. In particular, directors are now obliged to make long-term assessments of the strategies they have adopted, whilst taking into account stakeholders other than shareholders. It has been pointed out by some experts that the proposed rules may not actually alter the legal regime on directors' liability, who will continue to be liable only where their actions violate specific human rights and/or environmental protection provisions. This appears to be confirmed by the list of human rights and environmental violations contained in international conventions and listed in Annex 1 of the Directive.

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As things stand, it is not easy to predict how the Directive will be transposed into national law in EU Member States and how the debates there on this subject will evolve, but it is difficult to imagine it won't impact the role of company directors. The introduction of an obligation to balance interests is a novelty at present and must be assessed in relation to the provisions of Article 22 of the Directive, which provide that Member States must introduce forms of civil liability for companies that violate its requirements on the prevention and limitation of negative impacts on human rights and the environment. The possible conviction of a company on these grounds could also lead to its director being liable to said company for breach of their obligations as outlined in the Directive.

Although the approval and implementation process may be lengthy, companies and, in particular, their directors should start planning how to incorporate sustainability into their due diligence and corporate governance procedures. So should SMEs which are, or aspire to be, part of value chains connected to large companies. Sustainability will likely become central in the selection of business partners and quickly incorporating it into one's corporate culture could become an important element of advantage over potential competitors.

## KEY CONTACTS



### ARIANNA NERI

SENIOR ASSOCIATE • ROME

T: +39 06 684 0811

M: +39 340 2630 314

[aneri@wfw.com](mailto:aneri@wfw.com)

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