Japan Business Council in Europe

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JBCE Position Paper on Sustainable Corporate Governance

JBCE welcomes the opportunity to share our position on Sustainable Corporate Governance, ahead of the upcoming proposal from the European Commission and the subsequent future institutional discussions.

JBCE recommends the following considerations to be taken into account in the context of **corporate governance** (please consult details in the Annex):

- Sustainability priorities are business-specific as well as related to corporate culture, therefore a binding management style with a one-size-fits-all approach would risk undermining companies' long-term flexibility and the case-by-case approaches that are crucial for business growth.
- Legally enforceable duty of care obligations risk becoming a compliance tool rather than a stimulus for proactive and strategic management.
- Duty of care shall be applied to the company, not the director; as potential harms might go beyond the latter's mission.
- Soft law, such as corporate governance codes, are preferable in stimulating uptake, as opposed to narrow law which risks resulting in a compliance tool.

JBCE recommends the following considerations to be taken into account in the context of **due diligence duty** (please consult details in the Annex):

- With members operating in regions across the globe, JBCE prioritises the alignment of the EU legislation with international standards in order to avoid fragmentation region by region. A harmonised EU approach to due diligence legislation which is in line with the internationally recognised framework is absolutely necessary in order to avoid over-burdening companies and risking no significant improvements in supply chains.
- A distinction should be made between a company's liability and its responsibility to carry out due diligence. The responsibility should focus on the undertaking of due diligence across the value chain; with liability applying in severe cases where conducting such due diligence would have prevented the harm.
- Due diligence duty must remain a form of risk management, and should not result in a tick-box compliance tool.
- The EU should prioritise guiding companies as they carry out due diligence, placing a primary focus on incentivising companies to conduct this in a robust manner. Too much focus on a sanctions-based approach would have the undesired effect of companies severing ties with their suppliers rather than proactively engaging to effect change with a view to tangibly improving supply chains.
- The EU should elaborate on the legal clarity required for the integration of environmental due diligence, in view of ascertaining the impact of this.

ANNEX

1. **<u>Corporate governance (directors' duty of care, stakeholder engagement, remuneration of directors)</u>**

JBCE foresees sustainable corporate governance as guiding capacity-building for meaningful due diligence conduct. We appreciate the need to take into account the diversity of stakeholders' interests, as this engagement is vital to corporate governance. Therefore, corporate sustainability aspects, such as human rights, environmental, and climate change considerations, should be accounted for alongside financial aspects. However, **JBCE believes that requirements related to corporate governance should not be solely regulated by law, as companies' decision-making is significantly affected by investors' interests**. In this regard, JBCE believes the recent EU policy which introduces the process of accounting for environmental, social and governance (ESG) considerations in financial sector investment decisions contributes to companies' sustainable growth.

<u>Company diversity:</u>

- Every company constitutes a different corporate culture, management style and value creation mechanisms. Binding these together under a one-size-fits-all duty of care approach would undermine the flexibility that is necessary for a company to identify the best approach in the long-term.

<u>Management tool rather than a compliance tool:</u>

- In view of long-term growth and sustainable management, **JBCE believes that the director's duty of care should be defined by a company's own business characteristics**. Only companies themselves fully understand what can and should be prioritised to improve their sustainability.
- If duty of care requirements were legally enforceable, it would risk becoming a compliance tool, resulting in a box-ticking exercise where companies prioritise short-term actions to evade legal liability, rather than proactively and strategically transforming their management actions.

<u>Company duty:</u>

- **JBCE calls for the duty of care to apply to the company rather than the director or specific board members**, given that these actors may no longer be in charge when a harmful impact is observed.
- JBCE further points out that because the Sustainable Corporate Governance proposal will be introducing mandatory due diligence legislation, this will **negate the need for additional responsibilities** to be placed on companies under the same scope.

<u>Corporate codes:</u>

- To accelerate the inclusion of corporate sustainability aspects in corporate governance, we believe that corporate governance codes, based on their existing success (such as in Japan), are an effective way to incentivise companies to improve their sustainable corporate decision-making.
- In practice, many companies listed in Japan already include corporate sustainability elements as part of their corporate governance, based on voluntary corporate governance codes. Another successful example of voluntary guidelines is the Climate-related Financial Disclosures (TCFD) which requires companies to identify their own opportunities and risks arising from climate change, and then transpose these into corporate management processes. Today, there are more than 1068 companies (a third of which are Japanese) with a combined value of over $12 trillion, who voluntarily disclose and account for climate change in their management

practices. Uptake among companies continues to increase thanks to a soft law approach; one that is based on support and guidance instead of being compliance-oriented.

2. Due Diligence Duty

JBCE's members' supply chains are global, and thus the impact of the EU legislation will be vast; covering everything from varied requests from business partners to risk management practices.

International standards & fragmentation:

- As an organization representing multinational companies, **JBCE strongly supports international standards that overcome national differences and regulatory hurdles**. A harmonised EU due diligence framework that is in line with international standards, including the UN Guiding Principles for Business and Human Rights (UNGPs) and OECD Guidelines for Multinational Enterprises, is of utmost importance to ensure that due diligence goes beyond a mere compliance tool, and is streamlined both across and within supply chains. Patchwork requirements among EU member states or regions would be burdensome for companies and would not improve human rights or environmental impacts.

- In accordance with our support for the EU's green transformation, JBCE would like to stress that **EU due diligence legislation should seek to ensure alignment with other relevant initiatives** including the proposal for a Corporate Sustainability Reporting Directive, which also constitutes disclosure obligations and the green taxonomy.

Scope of responsibility:

- The Commission's future due diligence proposal should differentiate between and clarify **company responsibility** to carry out human rights due diligence (HRDD) and **liability**, especially as regards scope and definitions. While the responsibility should – in alignment with the UNGPs – set out the expectation for HRDD across entire value chains, liability should be applied to a narrower scope of relationships, i.e. those whom are within their direct business relationships.

- The principal means of determining a company's liability for harm in its supply chains is to ascertain its 'control' over such an occurrence. Accordingly, **we ask the Commission to undertake a thorough consultation on the implications of this definition in order to appropriately define 'control'**. JBCE believes that the definition of 'control' should account for the supply chain market power between downstream and upstream companies; given that certain monopolistic upstream suppliers may hold more market power than the downstream company.

- Where a severe human rights impact could have been prevented or mitigated, through appropriate due diligence, there is a case for company civil liability. However, the upcoming new rules must recognise companies' efforts and practices related to their due diligence processes.

Avoiding the establishment of a compliance tool:

- Transforming due diligence into a 'narrow law' risks its treatment as **a compliance tool,** where meeting minimum process requirements are prioritised over risk management. **Due diligence duty must remain a risk management tool**. It is a standard of conduct and not an expectation of result. Developing a due diligence obligation that requires only the fulfilment of procedure would result in a compliance tool that burdens a company without tangibly improving supply chains.

Incentivising due diligence:

- **The Commission should incentivise and guide companies to proactively practice due diligence**, including by providing clear guidelines. JBCE believes that the process of drafting such guidelines should be inclusive of extra-EU industry which may nonetheless be subject to such guidance. Additionally, sanctions for harms caused in supply chains where adequate due diligence has been conducted should be avoided. The EU should prioritise guiding companies as they carry out due diligence, placing a primary focus on incentivising companies to conduct this in a robust manner. Too much focus on a sanctions-based approach would have the undesired effect of companies severing ties with their suppliers rather than proactively engaging to effect change with a view to tangibly improving supply chains.
- JBCE recognises that the intention to create mandatory due diligence legislation requires enforcement mechanisms, and therefore points to the leveraging of **trade and sustainability chapters (TSDs)** within trade agreements struck between the EU and its commercial partners in order to **intertwine due diligence obligations** and ascertain that such partners ensure sustainability in their supply chains in return for preferential access to the internal market.

Ascertaining environmental due diligence:

JBCE members recognise the link between human rights and environmental issues, and support the European Green Deal's goals. However, practically speaking, **greater legal clarity is needed on the intent and impact of environmental due diligence duty**. We therefore **call upon the Commission to conduct an impact assessment on the integration of environmental due diligence into supply chains**, and to provide clarity on which environmental standards are relevant, and how due diligence obligations would relate to existing environmental risk management. Additionally, **JBCE urges the Commission to avoid a duplication of environmental legislation and management strategies already adhered to**, as well as related forthcoming legislation that may apply.

About JBCE
Founded in 1999, the Japan Business Council in Europe (JBCE) is a leading European organization representing the interests of about 90 multinational companies of Japanese parentage active in Europe. Our members operate across a wide range of sectors, including information and communication technology, electronics, chemicals, automotive, machinery, wholesale trade, precision instruments, pharmaceutical, textiles and glass products. For more information: https://www.jbce.org / E-mail: info@jbce.org
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