

Background material for ECCJ LPWG meeting, Amsterdam, February, 7-8

Summary of observations from ECCJ's seminar on 'Mandatory environmental and social reporting' (November 2007, Paris)

The seminar's main goal was to discuss questions in regard of potential mandated corporate environmental and social reporting at the EU level. For the purposes of the seminar a background study has been drafted by GARDE programme. Following text is divided into two parts. Part I provides a summary of the background study. Part II wraps up the debate held in the seminar and includes the observations by Filip, Violaine and Ruth as the three leading parts of the seminar.

Part I. - Background Study

The background study was structured as follows:

1. The first part featured a table providing for comprehensive information about existing national schemes mandating environmental and social reporting. Table contained information about legislations' scope, content, form, consolidation requirements, and verification and sanction mechanisms. Following national schemes were analyzed: Denmark, Netherlands, Norway, Sweden, France, Australia, and Japan. Most different ness in those schemes is in respect of the requirements on the scope and content of the reported information.

A several general remarks were presented:

- ☞ most of surveyed legislations mandate reporting of only environmental information
- ☞ content of the reporting obligation is mostly not precisely specified, thus, particular indicators are generally not well developed
- ☞ concept of materiality to financial position of the company (a.k.a. "enlightened shareholder value") is not applied
- ☞ several legislations require disclosure of information about related internal policies and management approaches
- ☞ There is no unified pattern among surveyed legislation which companies are subject to reporting duties. Some mandate those companies that apply for environmental permits, while other put this obligation on companies admitted to stock exchange to please socially responsible investors. In Norway all companies paying taxes must report.
- ☞ Questions of consolidation of data with companies' subsidiaries or foreign operations are largely ignored. Only French legislation provides for provision requiring some information in this respect, however ambiguous formulation of that obligation undermines its effectiveness in practice.
- ☞ Verification and sanction mechanisms are missing

According to the evaluations done in the respective countries, problems with reporting in practice generally arise from a lack of detailed rules on content of the reports and on measurement and presentation of data. This, eventually, hampers the comparability of the reports and arguably prevents measures to be taken in terms of verification and sanctions.

2. Next part of the study provides information about existing EU legislation. The Modernisation Directive, that

amended 4th and 7th Company Directives, mandated companies to report on non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters. This is interpreted, however, in terms of “enlightened shareholder value” doctrine, that is, company is obliged to report on issues that are relevant to its future financial situation.

EU law, nevertheless, provides for a more extensive list of detailed environmental indicators. This list is, dating back to 2001, “recommended” to EU member states to be mandated on their companies in their legislation. However, this has never realized.

7th Directive, further, requires companies to prepare consolidated accounts covering their subsidiaries and companies under their direct control. The determining factor are shareholder rights, or stipulated right of the controlling company to appoint management board of the controlled company.

Final point raised by the study is the interconnection between EU accounting law and International Accounting Standards (IAS). According to the so-called IAS Regulation, IAS rules endorsed by the Commission take precedence over native EU rules. This will likely undermine mandating environmental and social reporting if taking place in the frame of this area of law, e.g., in respect of the definition of consolidation of data and segment reporting.

3. Further, study evaluates current EU policy documents as whether and to what extent these documents can develop into enforceable rules on companies reporting duties.

On one hand, European Parliament calls Commission to amend 4th and 7th Directive so that social and environmental reporting is included alongside financial reporting.

On the other hand, European Commissions plans goes nowhere that far. In 2008 EC will announce its plans to modernise industrial policies and introduce new measures to reach more sustainable production and consumption. The respective background materials are aimed at products and consumers. In this sense, labelling initiatives and voluntary commitment is emphasized.

4. Finally, based on findings of previous chapters, the study presents proposal of mandating environmental and social reporting at the EU level. The basic outline of the proposal is as follows:

a) the duty to report is based on the notion of group, that includes both controlled and controlling entities. In this respect, global size of the group shall be determining factor, irrespectible of the value or size of its Europe-based parts.

b) companies shall be subject to the reporting duty based on their size. Small and medium enterprises shall be generally excluded, unless they meet other criteria, e.g., carry out activities falling under EC environmental regulations

c) the duty to report shall be established as a stand-alone legal tool (i.e. independent from EU accounting, and environmental law)

d) the content of the report shall be structured according to the precisely defined indicators. Data shall be presented on per-country and, where purposeful, on per-activity basis.

e) apart of the data about social and environmental impacts of the companies' activities, the reporting duty shall extend also to identification and description of concrete risks of harming the environment and abuses human rights in connection with corporate group's operations, incl. where such harm occurs within its supply chain. A description of steps taken to minimize reported risks should be included. In case the risks are not reported, or are reported but reasonable steps to prevent their materialisation are not undertaken, the controlling company, if to be found within European jurisdictions, shall be liable for negligence.

f) reporting duty shall cover disclosure of organisational, environmental, labour, societal (anti-corruption), and supply chain information. Study includes a complex list of indicators derived from existing mandatory and voluntary reporting standards.

- g) enforcement of the reporting duties could be enhanced either or both by „Right of competent authority to investigate“, and by „Right of NGOs having a legitimate interest to take a legal action“ - similarly to regime in EU consumer law - or, alternatively, Right of affected natural and legal persons with sufficient legal interest to take legal steps against competent authority in case of its inactiveness or wrong decision.
- h) study proposes to establish collective tort or criminal liability of management bodies and reporting companies for breaching the reporting duties, and turning the burden of proof in cases of human rights/environmental abuses that were not reported by the company.

Part II. - Observations from the Seminar

The seminar's discussion was focused on comments regarding the background study's outcomes. It should be noted here, that following are our observations based on the discussion within 1 of the 2 working groups. There were several noteworthy issues raised:

1. What is the level of transposition of modernization directive? Has it lead to any improvements in national legislations in respect of regulating environmental and social reporting? A potential opportunity for campaign at national level would be to push authorities to evaluate the transposition level of the clause or to do it ourselves.
2. Can, possibly, a „Right to know“ approach, once advocated by U.S. NGOs, be feasible?
3. Shall the corporate reports provide comprehensive information that would directly target consumers or should they be rather more complex and provide information for professional NGOs? Prevailing opinion was, that the reporting obligation should not be targeted only at consumer, but rather at all stakeholders.
4. 3 segments of reporting duty were distinguished. #1 – information about organisation. # 2 – information about the risks of human rights abuses the enterprise is facing. #3 – information about actual environmental and social impact of the enterprise. Those can be translated in questions:
#1 – How to define an enterprise, a.k.a. corporate group? There is a basic definition in the 7th Directive based on shareholder or management control. However, there might be other considerations, especially in regard of supply chain, sphere of influence, and conflict of interest.
#2 – We can't mandate corporations to report on all risks they face. Therefore, this duty will be limited to the risks that particular corporation can *reasonably* foresee if adhering to *due diligence* principle. The question stands, in this respect, can we define, or outline a due diligence principle?
#3 – What concrete information (translated to indicators) should the corporations be required to disclose?
5. In France, the position of Alliance pour la planete is that only a small number of indicators (3-4) should be developed for each sector - so effective comparison of environmental and social performance of corporations would be possible. Social criteria were not considered by the Alliance. This obviously is contradictory with the proposal we are discussing. To avoid such contradiction, we can look more to develop enforcement tools. But we need to remember that social criteria is not considered by the Alliance and also important to say that also a few criteria will be defined generally for all sectors and then sectoral criteria will be developed.

Further, Yann Queinnec emphasized potentials of cooperation with rating agencies. The question remains, what degree of simplification is possible, and what are the implications in respect of EU plans in the labelling field? This implies question, what are the details of future EU/national labelling initiatives?

6. Should a 'sectoral approach' be taken, that is, should for each distinctive industry be tailored a specific set of indicators? How to develop them?. There was agreement in the group that three different categories of criteria should be built into the reports:
 - i) General information about the company (what has been included in the Garde proposal under i, ii, vii) and that would be compulsory and equal for all sectors of activity. Information about supply chain in this part will go until 2nd tier supplier as it seems that legally we cannot ask a company to reveal the name of all their suppliers if they are not proven to be in the sphere of influence.
 - ii) 3 so-called CSR indicators: social-labour issues, environmental issues, and societal/communities issues which would be reported based on impact analysis. These „sectorals indicators“ would be developed differently for each sector and would be developed by state authorities in a multistakeholder process
 - iii) Risk analysis of the three indicators above

It is important to highlight that supply chain implications should be cross-cutting through the indicators. It was repeatedly mentioned that including risk assessment is a way to ease access to justice for victims, which is one of the objectives of the proposal and our work.

7. A lot of room was given to the discussion on the supply chain and the level of reporting that can be imposed in this field. Suggestion was to look at initiatives already existing like Business Social Compliance Initiative. It breaks down to the above-mentioned 3 segments, that is, (1) information about suppliers, (2) information about risks of human rights abuses within supply chain, (3) information about actual social and environmental impacts. While 2nd issue can be made subject to considerations of reasonableness, 1st and 3rd question need to be resolved in rather less ambiguous way.
8. There was a final agreement that our political strategy should be developing two or even three strands of work in parallel: Plan A would be to push for a stand-alone legislation for mandatory social and environmental reporting based on the Garde's proposal plus the agreements reached in this seminar; Plan B would be to continue using political opportunities (i.e. modification of company law) to achieve some minor successes over time which would be aimed at improving the existing legal framework. In both cases, work at the national level and with Member States is very important, collecting support and developing best-practices guides. A third strategy (or Plan C) would be in the event that GRI is getting promoted as official EU reporting tool, and then what kind of complains or what kind of suggestions we would push for.
Violaine suggests to ask Sherpa to write down a paragraph on that topic as it was said that the conclusions on reporting would be discussed at the supply chain meeting and that reporting and supply chain were two topics to be linked.
9. It was also agreed that the official EU definition of SME (4th directive) which is the one defining what companies have to report and which don't, could be used as well in our ideal legislation

Several other issues were not discussed. Among those, the most important probably are:

10. Is it feasible, and to what degree, make directors liable for content of the reporting? What is the regime under Sarbanes-Oxley Act, or other similar legislation?
11. Is it feasible to advocate the private enforcement tools? This point was discussed but no concrete solutions were found. This is linked to the elaboration of the sectorial criteria. What persons could be actively legitimated? Are there any other examples of broad legal standing of public interest groups (e.g. Aarhus Convention, actio popularis against state authorities' decisions in France, etc.)? It was mentioned that in France enforcement is possible since 2005 when a new law reformed the code of commerce mentioning that a third part could go to court for lack of informations in the reporting of a

company. But so far, this option has never been tested by the civil society.

12. To what degree and how shall be the duty to report interconnected with improving the liability of corporations beyond limited liability principle as discussed in the seminar in London? The key question lies arguably in the notion of due diligence and duty to take reasonable steps to identify and prevent risks of human rights abuses in the company's sphere of influence (see point 4, #2 above). This goes on to the question of how to define the sphere of influence.
13. Is it feasible to mandate the form of the reports?
14. Is it feasible and effective to set up a verification system like, e.g., in EMAS or EU-ETS schemes? Or, in other words, is possible to repair those schemes so they would work?

The final remarks of the seminar concerned the policy how to resolve what concrete impacts of corporations shall be reported.

15. It was agreed that the main features of duty to reporting shall be mandated by EU rules. However, it was argued by some, that establishing sectorial criteria shall be left within competence of Member States. This point of view was not shared by everybody: some others thought that sectorial criteria must be approved at an international level to be relevant. The working process of establishing the criteria can have a national dimension but at the end it seems better to have an international common set of sectorial criteria.
16. Also, it was raised that it is needful to have the support of some business circles
17. It was suggested to use the upcoming 60th anniversary of the UN Declaration HR and France willingness to take action on that front in the coming year. It was also highlighted that Medef and some businesses may be interested to extend their reporting obligation to the other European businesses so they don't have a comparative disadvantage
18. The important role of trade unions was highlighted, especially in France where they are very powerful and taking into account that the "Alliance pour la planète" is only promoting environmental criteria for reporting. In that sense, it was deemed important to use Human Rights as a comprehensive and general principle that would encompass social, environmental and human rights aspects, in line with the UN HR declaration but no agreement was reached.