Regierungskommission Deutscher Corporate Governance Kodex
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Mr. Didier Reynders
Commissioner for Justice
European Commission
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Chair

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Subject: Proposal for an Initiative on Sustainable Corporate Governance

Dear Commissioner Reynders,

Reference is made to the present consultation of the EU Commission on sustainable corporate governance. It is based on the "Study on Directors‘ Duties and Sustainable Corporate Governance" which the EU Commission (DG JUST) has presented in July 2020 and which serves as preliminary impact assessment for scenarios of possible intervention. The options discussed in the study are inter alia,

- requiring directors of listed companies to adopt the stakeholder approach (option C 1 no. 1)
- making the identification and limitation of sustainability risks and external effects a directors‘ duty (option C 1 no. 2)
- treating sustainability aspects as a mandatory part of corporate strategy and planning as well as respective reporting (option C 3)
- making compulsory the inclusion of sustainability targets in executive variable pay schemes (option C 4 no. 2)
- making sustainability-related expertise and competence a criterion for board composition (option C 5)
- calling for a structured stakeholder engagement concerning sustainability issues (option C 6)
- promoting the enforcement of sustainability related directors’ duties by giving stakeholders who are not shareholders a right to instigate legal proceedings (option C 7).

The reason given by the EU Commission for these interventions into company law is that from the Commission’s perspective listed companies in the EU pursue rather short-term shareholder interests instead of the long-term interests of the company. DG JUST sees "evidence" for this thesis in increased pay-out ratios, as if pay-outs were directly spent on consumption. The fact that dividends can and should be reinvested in other companies, not least in the interest of structural change in the economy, apparently plays no role.

Corporate governance is generally understood as a structure that serves to define but not to predetermine company objectives and management approaches (see OECD/G20 2015). The approach now proposed by the EU Commission is a different one. It takes a material approach and addresses the interest groups to be considered by the companies, the corporate objectives and strategy, and sets the focus beyond singular socio-political requirements within the framework of company law (such as the gender quota or sustainability criteria for executive board remuneration).

While the aim of EU regulation has been exerting indirect influence on the definition of corporate objectives so far, e.g. by reporting obligations under the Non-financial Reporting Directive, the EU Commission is now apparently willing to commit listed companies to sustainability goals.

The requirement of corporate governance is historically based on the separation of ownership and control within the company. Corporate governance should ensure that management, as the holder of control, pursues the interests of the shareholders (principal agent model). The issue of sustainability forces us to define the regulatory framework of corporate governance in a pluralistic manner, thus making it stakeholder-oriented. However, this in no way implies that corporate social responsibility should be enshrined in company law and should even take precedence over the interests of shareholders.

Thus, while society's interests in sustainable development certainly is legitimate, it is necessary to exercise great restraint when intervening in the shareholders' administrative rights, for example by giving representatives of civil society a say in setting objectives and in entrepreneurial decisions, in order not to put the core of the market economy-system at stake. Those who want to give corporate social responsibility priority over the interests of shareholders by means of company law accept that companies will have less risk capital available, which is urgently needed for the ecological transformation of the economy.

Corporate social responsibility should be limited to incorporating sustainability goals and expectations, such as those defined by the UN, into the discussion of specific corporate objectives, but should not entail a liability of the management. Against this background, the path taken by the Non-financial Reporting Directive, which requires corporate management to take account of sustainability goals through transparency obligations, appears to be the more appropriate solution. Reputational risks, customer expectations and last but not least the attractiveness for employees play their part in giving ecological concerns the necessary priority.

Regulatory requirements regarding corporate objectives (stakeholder and long-term approach) and the application of business management methods and instruments (risk management, strategy) also carry the risk of ending up as red tape and creating more harm than good to the undisputed good cause. The reason for that is the unavoidably broad discretionary scope of management when considering divergent stakeholder interests, when identifying and assessing risks, opportunities and external effects and when formulating strategies. As Ira Millstein said in an interview: "I don't think you can regulate doing the right thing. […] the directors are the people who can make it happen."

Conflicts of interest can occur both within interest groups and between interest groups. It has long been known that even the group of shareholders can have heterogeneous interests, which is why, for example, governance rules have been developed to protect minority shareholders. Less obvious but equally serious are inner-ecological conflicts, e.g. between climate protection and environmental protection in the case of nuclear energy, and conflicts between social and ecological issues, e.g. the mining of cobalt under inhumane working conditions for the production of batteries for electric cars. The vagueness of social responsibility stands in contrast to regulatory requirements for determining the company's objectives.

Sustainable corporate governance in the sense of the proposals of DG JUST contradicts the idea of stakeholder-oriented corporate governance and bears the danger of giving social responsibility priority over the interests of all other stakeholders, including shareholders. Instead, sustainable corporate governance should consist in management taking account of sustainability objectives within the framework of a pluralistic internal corporate governance. "Yes" to sustainable corporate governance, "no" to instrumentalising external corporate governance for sustainability concerns.

I kindly ask you to take these thoughts into consideration and will be pleased to explain our position to you in more details personally upon your convenience.

Yours sincerily

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Chair