CRITICAL LEGISLATIVE DEVELOPMENT: THE ESCALATING IMPORTANCE OF EXTRA-FINANCIAL CRITERIA

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Investors' awareness of criteria that are not solely related to the profitability of a company goes back to the beginning of the century initiatives with ethical funds that combined financial needs and religious aspirations.

The term "non-financial criteria", that will be used in this article, embraces various concepts (Sustainable Development, Corporate Social Responsibility - CSR, Socially Responsible Investment - SRI, Environmental, Social and Governance Criteria - ESG) and makes reference to multiple issues: corporate governance and ethics, human resources performance, environmental impacts and, in general, societal issues such as gender equality.

The increase of non-financial criteria importance is illustrated by the rise of sustainable funds' offers: as of June 30, 2019, 531 funds totaled 185 billion euros in outstanding amounts, a rise of 27% over 6 months according to the Novethic indicator.

1. THE DEVELOPMENT OF A LEGISLATIVE FRAMEWORK

The increasing importance of extra-financial criteria developed at an international, European and national level.

a. At the international level

The first public initiatives to encourage companies to behave responsibly goes back to the late 1970s with the OECD Guidelines and Sectoral Guides for Multinational Enterprises (revised in 2011).

The concept of Sustainable Development first appeared in 1987 in the Brundtland Report issued by the World Com-

mission on Environment and Development, followed by the Second Earth Summit in 1992 in Rio, the International Kyoto Protocol in 1997, the United Nations Global Compact in 2000 and the Paris Climate Conference in 2015 (COP21).

The implementation of these regulations, for which it is difficult to provide a complete overview, is consistent with the purposes of TCFD (Task Force on Climate-related Financial Disclosures), a working group set up by the G20 in 2015, which aims to establish a common framework for financial transparency in climate matters.

b. At the European level

In July 2001, the European Commission published a Green Paper to promote a European framework for corporate social responsibility.

For more stringent regulation, it will be necessary to wait for the directive on non-financial reporting n°2014/95/EU as of 22 October 2014, applicable as from 6 December 2016, which requires companies with more than 500 employees to include in their management report a non-financial statement containing at least information relating to environmental, social and employees issues, respect for human rights and anti-corruption. However, companies may derogate from these obligations if they are able to justify it (this is the principle of comply or explain).

c. At the national level

The law on new economic regulations n°2001-420 as of 25 May 2001 was the first law on corporate transparency with respect to non-financial criteria. As a result, listed companies (without threshold conditions) were required to explain how they address the social and environmental consequences of their activity in their management reports.

The Grenelle 1 Act n° 2009-967 of 3 August 2009 and the Grenelle 2 Act n°2010-788 of 12 July 2010 extended this transparency obligation to certain unlisted companies exceeding thresholds of total balance sheet (100 million) or turnover (100 million) and employees (500) and provided for a new system for the control of non-financial information by an independent third party. Companies must also submit their commitments in favor of sustainable development.

In addition, companies with more than 500 employees are now under the obligation to draw up a balance sheet of their greenhouse gas emissions with the actions envisaged to reduce them.

Similarly, for institutional investors, the Energy Transition Act n°2015-992 of 17 August 2015 imposed an obligation to inform their subscribers about how they take into consideration non-financial issues.

Since the Ordinance of 19 July 2017, transposing the European directive on non-financial reporting, the non-financial performance declaration of Article L225-102-1 applies solely to large listed companies (the threshold being €20 million under the total balance sheet or €40 million turnover and with an average number of 500 employees), while the thresholds for unlisted companies have not changed.

Nowadays, the non-financial performance statement must contain information on climate change, sustainable development, circular economy, measures to be taken against food waste, food insecurity, respect for animal welfare and responsible, equitable and sustainable food and other social aspects.

2. RECENT DEVELOPMENTS

Finally, the Pacte law seems to solemnly recognize extra-financial criteria by incorporating them into the Civil Code. Article 1833 of the French Civil Code now stipulates that "the company shall be managed in its social interest by taking into consideration social and environmental stakes of its activity". It is regrettable that this new provision is only in line with the principle of "responsible but not accountable" insofar as failure to respect social and environmental issues does not constitute a cause of invalidity of the acts and deliberations of the company's bodies. Another amendment of the Pacte law concerns the possibility of the companies to have a moral purpose ("raison d'être"), consisting of "the principles with which the company is committed and for the respect of which it intends to allocate resources in order to carry out its activity". This could be an interesting aspect of corporate officers' liability in case of their non-compliance with a raison d'être included in the by-laws.

A significant step forward, the Pacte law strengthens the representation of women on management committees and sanctions its non-compliance by making null and void the deliberations of the board in which irregularly appointed persons participated.

3. AN EXTENDED DUTY OF VIGILANCE

Regarding anti-corruption, a legal revolution has occurred with the Sapin II law of 9 December 2016. In particular, it has opened up the possibility for companies to deal with certain criminal risks pursuant to "public interest judicial agreements" ("conventions judiciaries d'intérêt public")

which are akin to deferred prosecution agreements. It has also significantly increased the level of financial penalties applicable in France and provided for fines of up to 30% of the consolidated turnover of the group concerned. However, without any doubt, the most significant law in the sphere of compliance with the ESG criteria is the French Law n°. 2017-399 of 27 March 2017 on the Duty of Vigilance of multinationals and companies acting as principals ("Loi relative au devoir de vigilance des sociétés mères et entreprises doneuses d'ordre").

It was adopted in response to the scandal that followed the collapse of the "Rana Plaza" building in Bangladesh, when more than 1,100 women working in the textile industry were killed in 2013. This law requires large French companies to prevent social, environmental, safety and health risks as well as human rights violations related to their operations and to the operations of their subsidiaries, subcontractors and suppliers. As the law's application standards are broad, high application thresholds should be met (more than 5,000 employees in France, more than 10,000 employees worldwide at the end of two consecutive financial years).

The law on vigilance duty has been applied 4 times since its adoption in 2017: twice against Total and Teleperformance, which was accused of failing to respect the human rights of its employees, particularly in India, the Philippines, Mexico and Colombia. Quite recently, a formal notice for human rights violations was given to the EDF group in connection to a project by its subsidiary EDF Energies Nouvelles in Mexico.

These various claims aimed to require the companies at stake to adopt or to significantly improve, as a matter of urgency, an effective action plan to fight human rights violations or violations having an environmental impact. If the plan is not considered adequate by the Non-Governmental and Collective Organizations generally at the origin of the formal notices, they have the possibility to initiate the dispute before the French judge in order to demand a compliance injunction or that civil liability of the involved multinational corporation be engaged.

In the end, French law thus opens up the way for the victims to obtain compensation for the damage suffered. This could have significant financial consequences such as the cost of renovating a building or even abandoning an industrial project, which will have to be taken into consideration by the target companies and their investors.

4. CONCLUSION

The development of CSR and ESG policies reflects the growing desire of shareholders and consumers to be better informed. However, they now represent a real performance leverage and business opportunities, particularly at the international level. Moreover, from an investor perspective, the investing impact is eight times greater than it was in 2012, which clearly confirms the interest of this approach. To illustrate this idea, it is worth noting the explosion of the offer in terms of ESG Due Diligence.

At the national level, on 11 September 2019, the Parliament passed the draft law on energy and climate aimed at achieving carbon neutrality by 2050 and extending non-financial reporting of the investors on biodiversity risks.

It must therefore be noted that CSR and ESG regulations have proliferated around the world, as a requirement for sustainable growth or even a lever for performance, even if today the majority still limit themselves to an obligation to provide information and impose very few constraints or sanctions.