# De Gaulle Fleurance

## Observatory of Societal Transitions 2023

# Sustainability

## and new business models

HEC PARIS

SOCIETY & ORGANIZATIONS institute

DE GAULLE FLEURANCE

AVOCATS NOTAIRES

LEGAL STEP TO CHANGE

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# Editorial

by LOUIS DE GAULLE,

President of De Gaulle Fleurance

Reinforcement of the duty of vigilance; expanded non-financial reporting obligations; increased CSR pressure on governance bodies... Business has entered a new era. It is an era in which companies' contributions to a sustainable, human and planet-friendly world are a central factor in the equation of ecological and social transition.

Though pioneering companies have long taken them up on their own initiative, ESG (environmental, social and governance) commitments are today being made part of increasingly ambitious regulations. The Corporate Sustainability Reporting Directive (CSRD), which will enter into force progressively starting from 1 January 2024, harmonises sustainability indicators and requires reporting from around 55,000 companies, i.e., 5 times more than the earlier Non-Financial Reporting Directive (NFRD), which it modifies. As part of efforts to prevent social and environmental risks, the proposed Corporate Sustainability Due Diligence Directive (CSDDD/CS3D) is intended to establish a duty of vigilance affecting 20% of all European companies (vs. 5% under current regulations in France).

These regulatory developments have spurred changes to companies' business models. Those of us who monitor such developments on a daily basis have witnessed this directly. Executive officers are being specifically assigned to manage sustainability policies, and these issues - which have now become strategic - are being closely watched by executive and management committees. And for good reason. The consequences of a failure in this regard can be serious - it may cause reputational damage, leading customers, shareholders and financiers to turn away from sanctioned companies; financial penalties of up to 5% of overall turnover; increasing efforts to hold executive officers liable in human and environmental rights matters…

The impact extends beyond governance to affect all corporate departments: financial departments, integrating non-financial information into their relations with investors; legal departments, increasingly required to verify the compliance of that information or of the company's vigilance plans; CSR and HR departments, which are at the heart of this sustainable transformation process... And new tools are appearing, too, so as to help mitigate the risks associated with these issues, such as the “Dispute Boards” we offer to organise at large companies seeking to better manage the consequences of these developments.

And these developments are global, as can be seen in the work being done by the International Sustainability Standards Board (ISSB), which this summer published a set of international climate standards of its own that several countries have already committed to applying. These standards are harmonised with European standards, so that companies aren't required to conduct non-financial reporting twice, which would be time-consuming and costly. That was a commitment made by Emmanuel Faber, president of the ISSB, and Patrick de Cambourg, chairman of the Sustainability Reporting Board (SRB) of the European Financial Reporting Advisory Group (EFRAG) in charge of European sustainability standards, in our joint interview with them, held on the occasion of our previous Observatory.

Lastly, these trends are also helping to change our perspectives on the role of business. The CSRD directive treats companies as a living body, with stakeholders (employees, customers, service providers, local governments, local communities, etc.) that need to be involved in its transition. It remains to be seen whether this vision, which remains very European, will succeed in going beyond the borders of the EU. It's a critical issue for our companies, which would certainly come out stronger in global competition.

# Editorial

by BENEDICTE FAIVRE-TAVIGNOT, associate professor at HEC Paris, co-founder of the Society & Organizations (S&O) Institute

The reinforcement of regulations, such as the duty of vigilance and the entry into force of new non-financial reporting obligations, particularly with the CSRD in Europe, has come about as the inescapable response to the acceleration of the major environmental and social challenges that we face today: climate change, biodiversity loss, increasing inequality, and rising divisions within our societies.

The voluntary commitment of citizens and companies is of course a valuable initiative that should be highlighted. Europe, in particular, can be proud of the commitment of many of its companies to the environment and social responsibility. However, in times of economic instability, the limits of this voluntary approach become clear. For example, in the organic agriculture domain, the increasing cost of living may discourage consumers from purchasing organic products, thus endangering the entire sector.

Additionally, we have seen several examples of proactive and committed sustainability leaders leaving their positions, thus compromising the company's commitment as a whole.

Consequently, there is an urgent need for strengthened regulation, so as to guarantee the sustainability of the efforts being made, and to avoid a risky dependence on the voluntary commitment of specific company directors.

However, some underline the limits of this growing constraint: if corporate sustainability policies simply boil down to "compliance" and "checking the boxes," if investment in reporting distracts companies from making an in-depth transformation, then all these efforts will prove to be in vain and counter-productive.

Thus, an increased degree of transparency needs to be coupled with a real strategic approach. A commitment to CSRD must go beyond mere public relations or fundraising activities. Leaders and their collaborators must think deeply about the transformations necessary to carry out their economic activity while respecting both the limitations of the planet and fundamental social needs.

Reporting obligations can be appropriate and beneficial, provided they do not entirely monopolise stakeholders' energy and can become a driver of transformation.

Experimenting with new approaches to integrating environmental and social dimensions can help explore new possibilities and test out more effective ways of responding to the immense environmental and social challenges we face. All this has an essential role to play in the kind of comprehensive and systemic approach to transformation that can rise to today's challenges.

# EXECUTIVE SUMMARY

## Key figures

- In 2023, only 3 new proceedings were instituted addressing French duty of vigilance obligations, i.e. 4 times less than last year.
- The proposed European directive on the duty of vigilance, the CS3D, is expected to affect 20 % of companies (vs. 5% under French duty of vigilance requirements).
- Economic penalties for non-compliance with duty of vigilance obligations may be as great as 5% of a company's overall turnover.
- The CSRD directive will enter into force progressively starting from 1 January 2024.
- 12 is the number of ESRS (Environmental and Social Reporting Standards) that all large companies, whether listed or not, subject to the CSRD, will be required to use to prepare their sustainability report.
- 2026 is the year in which listed SMEs subject to the CSRD will be required to prepare their sustainability report according to separate standards, subject to possible simplification of their obligations.
- According to the Grantham Research Institute's Report, in 2022 more than 2,000 lawsuits were filed in over 40 different countries addressing matters related to global warming, 25% of which have been filed against Companies.
- Green bonds represent 7% of the global bond market, compared to 5% the previous year.

# Interview with

ARNAUD VAN WAEYENBERGE,
Associate Professor at HEC Paris

On June 1, the European Parliament adopted its position on the proposed European directive regarding the duty of vigilance. The Council of the European Union and the Commission have yet to make a decision, but their approval looks probable. What could this change for European, and particularly for French companies?

These European regulations have arisen within a broader and older context. Corporate social responsibility was born in the Anglo-Saxon world, driven by such works as H. Bowen's *Social Responsibilities of the Businessman* (1953), and has generally taken the form of “charitable” arrangements. Companies voluntarily wished to implement social and environmental policies. For this purpose, they adopted good practices, codes of good conduct, ethics charters, etc.

About twenty years ago, this voluntary phenomenon underwent a first transformation and began shifting towards judicialisation. Some consumers or citizens appealed to the courts, arguing that there was a significant difference between what a company had said and the reality. In this context, one case that left its mark on the corporate world was Kasky vs. Nike. In 1998, Mr. Kasky filed suit against the American company Nike, Inc. for false advertising, on grounds that it had put out a "code of good conduct" claiming that its subcontractors respected basic labour rights – which Mr. Kasky disputed. Mr. Kasky lost in the 1st and 2nd instances, but upon appeal the Supreme Court of California found that his request was well founded and referred the matter to the Appeals Court for further proceedings. A settlement was made between the parties, however, before the Court of Appeal could issue its ruling. It was a turning point: the case left its mark on Boards of Directors, leading companies to become more cautious in their CSR policy and their communications.

The courts have therefore been a leading driver of this transformation.

Today, we are experiencing a second transformation - one of judicialisation, with governments enacting laws to prohibit companies from engaging in certain activities contrary to the principles of CSR. This was the case particularly in the United Kingdom in 2015 (with the passage of the UK Modern Slavery Act) and in France in 2017 (Duty of Vigilance by parent companies and outsourcing firms). Europe decided to take action on the issue for a very pragmatic reason: to prevent the fragmentation of its internal market as a result of distinct duty of vigilance obligations emerging in different countries. Having divergent systems in multiple Member States would have created too many complications for businesses. Based on Article 114 of the Treaty on the Functioning of the European Union, the Commission therefore decided to propose legislation seeking to harmonise approaches to the issue.

The proposed directive establishing a European duty of vigilance would include four primary obligations for companies:

- To establish a duty of vigilance policy and identify potential or existing negative impacts on human rights and the planet.
- To prevent or mitigate potential impacts and put an end to existing impacts.
- To monitor the effectiveness of this policy and establish a complaints process.
- To undertake communications regarding this duty of vigilance.

With this directive the European Union will compel companies to take the environment and fundamental rights seriously, implementing a restrictive and meticulous legal framework, non-compliance with which can incur substantial fines. Not to mention the impact on the court of public opinion, since people may choose to stop buying products or shares from a company that has been sanctioned for non-compliance as well.

In France, a certain number of firms are already quite prepared to take these measures, because the French duty of vigilance law has already been in force for 5 years. They will not experience this as regulatory shock; the French and European duty of vigilance obligations are after all quite similar, since France's laws served as an inspiration for the European legislation to a certain extent. Nevertheless, the number of companies affected by the European directive would be much larger, covering all companies with more than 250 employees (vs. 5,000 employees for the French duty of vigilance).

## Can you see any sticking points that might arise in the implementation of this directive?

Let's turn back to the broader context: generally, when the Commission proposes a piece of legislation, it has already been well-negotiated with the Member States upstream; then Parliament takes hold of it, often being more ambitious on these types of issues and tending to take the Commission's legislation a step further; Member States indeed are generally more cautious, because they want to avoid the risk that their firms may choose to relocate.

Due to the action of these various different ways of seeing the issue, there are at least four sticking points that will need to be resolved over the course of the trilogue.

The first of these involves the directive's scope of application. Under current plans, it will have a very broad scope, targeting companies with over 250 employees and a turnover greater than €40 million. This scope is likely to be somewhat reduced under pressure from the Member States. Another aspect of this question is, will a covered company's value chain (all its various subcontractors) be subject to this duty of vigilance as well?  Parliament answered this question in the affirmative, but Member States are pushing to reduce the corresponding scope.

The second bone of contention will likely be whether or not the financial sector will be included. Though Parliament voted in favour of this inclusion, the issue will be determining precisely which actors in the financial sector and which types of financial activities will ultimately be concerned.

The third sticking point will have to do with executive liability. The Commission wanted to hold executive officers personally liable for violations of human and environmental rights. Parliament decided not to keep this provision. However, it does intend for there to be an impact on executive remuneration from these vigilance issues.

The last issue has to do with sanctions. The Commission wanted to let the Member States establish the amount. Parliament went further, setting fines at a minimum of 5% of overall turnover. This may thus prove to be a very heavy penalty. Plus, it wishes to ensure that non-European companies that are sanctioned will lose access to European public markets.

## What are the trends in climate litigation around the world?

This phenomenon of climate litigation has been growing in scale and is enjoying spectacular success. According to a Report from the Grantham Research Institute, in 2022 more than 2,000 lawsuits were filed in over 40 different countries addressing matters related to global warming.

75% of these lawsuits were filed in the United States. However, this very Anglo-Saxon type of litigation has tended to spread globally; it is now on the rise in the European Union and in the countries of the Global South. Over the course of 2023, many countries will be newly impacted by this kind of litigation, including Bulgaria, China, Finland, Romania, Russia, Thailand and Turkey.

Another trend is that this litigation is becoming international in nature, with increasing referrals to international courts, such as the ECHR or the CJEU.

Among these 2,000 lawsuits, half are strategic litigation, i.e., a way to force actors to take actions to combat global warming. NGOs and consumer associations are taking legal actions with the aim of changing public policies. 75% of this strategic litigation is instituted against governments. However, more and more of these petitions are aimed at companies, particularly major players in the oil and gas industry, but also against players in the food, plastics and financial sectors.

These actions are generally brought on one of the following legal bases: international commitments made by governments, such as the Paris Agreements; provisions protecting fundamental and human rights in a given country; the government's responsibility for culpable failure to act.

In half of this litigation, the environment and climate action come out the winners. The success rate is therefore quite high.

We can point to two cases to illustrate this trend. In the Urgenda case (2015), the Court of First Instance in The Hague ordered the Netherlands to take appropriate measures to achieve the European target of a 25% reduction in greenhouse gas (GHG) emissions. This decision was upheld on appeal. In the Neubauer case (2021), the German federal constitutional court overturned a German law that provided for the means to reduce GHG emissions on the grounds that the bill was not ambitious enough in regard to its objective and would place an excessive burden on future generations. This was a highly innovative argument.

## What concerns does this litigation raise for multinationals?

There are three key concerns here. One is reputational: being convicted can have an impact on consumers, investors and the stock price. Another is economic: the sanctions imposed may be substantial. And the last is personal: the liability of executive officers is now increasingly being pursued.

The NGO Client Earth, for example, sued the executive officers of the Shell group. The court of first instance dismissed the NGO's case. But the NGO will appeal. And if this trend continues, tomorrow, directors will need to justify their actions, proving that they voted appropriately and pursued a personal policy in line with the company's environmental commitments.

## What can be done today to help prevent this risk?

One solution would be for companies that have not yet done so to make changes to their governance model. For example, they would need to appoint independent directors to manage environmental and social issues, and have these issues monitored directly by the company's decision-making bodies, etc.

More generally, this proposed directive and the risk of climate litigation will encourage firms to create compliance mechanisms to prove that they take these issues seriously and have put all the necessary means in place.

Beyond that, however, these duty of vigilance regulations are only one part of the process. The European Commission has just proposed a Green Claims directive, intended to help facilitate legal action by civil society against companies. This is a global trend, with the United Kingdom having issued a code to this effect in 2021.

The time had come. After all, “our house is on fire and we're burying our heads in the sand,” as Jacques Chirac once quite appositely stated.

# Interview with

## GILLES VERMOT DESROCHES, Chief Citizenship Officer at Schneider Electric

What does this CSRD directive change for a group like Schneider Electric?

Nothing and everything at the same time!

Nothing, because Schneider Electric is a company historically known for its environmental, social and governance (ESG) commitments. It has always been counted among the Top 10 “most sustainable companies”. And for about twenty years now, we have worked to manage our ESG approaches as a whole using our “Schneider Sustainability Impact” dashboard. Updated every quarter, with indicators evolving every 5 years, it serves as a compass for Schneider Electric's commitment. It's an effective way to monitor the number of young persons trained, the number of women in management... The challenge for Schneider Electric is to stay one step ahead and position itself above the average.

The process we are going through today is something like a competition. It's a "Best in class," or best practices approach. Some exemplary companies have taken a head-on approach to the subject of CSR and have made it a performance issue, seeking to align their corporate strategy with the challenges faced by our world, take an active role in responding to them and participate in the solutions agenda.

The CSRD directive, for its part, defines a significant number of ESG indicators and asks all companies to report on them starting in 2024. That’s its strength. But with that we are moving from a logic of competition to a logic of examination. And there's a nagging question there: will companies thus be led to align with a common denominator, and wind up actually reducing their commitment? Or will they want to stick with the “Best in Class” approach, taking social and environmental progress as far as possible, as is the case today?

The CSRD is an achievement, in that it views the company as a living body made up of its stakeholders (customers, suppliers, employees, places in which it operates, civil society actors, etc.). After having been challenged a great deal on their Scope 1 and 2 carbon emissions, their HR and inclusion policies, etc., companies now understand that their engagement, impact, and responsibility do not exist in a vacuum, but in the context of their whole value chain. In order to make real progress, large firms need to mobilise all the stakeholders in their value chain as well.

Nevertheless, a great sea change is likely not around the corner, and the dashboards required by the CSRD will doubtless not solve everything. Especially if they lead to a comparison of indicators amongst companies that may at times be completely unrelated. Two companies, for instance, may market similar products, but have very different carbon footprints. Is it because one makes a greater effort than the other? Or because one is integrated and the other is not? Detailed knowledge and understanding of the business is needed before coming to any conclusion. Another example: in the context of a relocation, it is possible for companies to downgrade a particular indicator even though they are implementing a process of continual improvement.

### What impact might this directive have on European companies and in particular on their fundraising capacity?

One of the major aims of the CSRD is to monitor the efforts of actors in the European banking sector to green their portfolios and support their desire to increase their impact. By encouraging companies to communicate their ESG indicators, the directive makes it possible to organise dialogue with investors, beyond financial data. This is a good thing.

The CSRD regulation being the most ambitious directive on the international level, it will help European market actors to attract investors and capital from around the world. However, companies that are subject to reporting under the directive will need to report information that their competitors will not be required to report. This may sometimes work to their detriment. Not to mention the cost borne by European companies to integrate compliance with these regulations, which may increase their operating costs, reduce their profits and weaken their fundraising efforts.

Do you see international and European sustainability standards coming into alignment, as the ISSB and EU have committed to?

We are seeing two different tactics being pursued now. The ISSB intends to establish a rather low level of requirements that will be acceptable to all, so that it can be deployed at companies worldwide, with plans to then gradually raise that level. This was how Emmanuel Faber's wager, in hopes of bringing the Americans, the Chinese and the Indians around.

The tactic pursued by the CSRD on the other hand is to establish the most complete reporting standards possible, making a different wager: that beyond European companies, those that have the capacity to respond will do so, gradually leading others to do the same.

It will all play out over the next 5 to 10 years; will we see increased attention being given to ESG issues? If so, the European reporting standards will be up to the task. But if awareness has not been raised as much as desired, the ISSB reporting standards will be seen as sufficient.

I'm convinced that we need to move forward by seeking as much consistency as possible between the ISSB and European standards. Because our large companies, since they are global, will need (and need already) to maintain coherent dialogue with their contact persons and adopt the language and standards of their stakeholders.

Within a company, which department will now be the most legitimately qualified to manage these sustainability indicators? Won't the CSRD encourage financial departments to take charge of these issues?

By making all these ESG indicators more strategic and decisive, the CSRD directive will directly concern all sectors of the company: financial management because these indicators will contribute to investor relations; legal and compliance teams that will need to verify compliance; the company's audit teams because these indicators will be audited, etc.

But the challenge, in my opinion, lies elsewhere. Will this regulatory change tend to make these sustainability topics less of a secondary issue and instead make them more central? Or on the contrary, will this directive reduce active engagement and make ESG progress plans more of a legalistic and ordinary matter? As of today, nobody knows the answer.

# Interview with

MARIEKE HUYSENTRUYT,
*Associate Professor of Business Strategy and Policy at HEC Paris*

Since 2014 and the adoption of the NFRD Directive as modified by the adoption of the CSRD Directive, have you spotted any notable social developments among the 10,000 affected companies and their employees?

In theory, we would expect better and more reliable data to affect practices and discipline companies' behaviours. We have already seen similar changes in the financial market. Indeed, regulations and mandatory disclosures impacted the way businesses are run. It might be assumed that financial investors along with stakeholders, like you and I, would incentivise companies to improve their CSR scores.

However, in practice, the change has been weaker than expected for several reasons. First, the regulation was not very precise about the type of information companies are requested to disclose. Moreover, the information produced by different companies was not normalised, monitored, or verified by external agencies and therefore not comparable, nor reliable. In fact, financial market actors turned to ESG rating agencies thus creating a confusing amount of different rating frameworks, metrics, and pieces of information.  Finally, stakeholders were less initiative-taking and only a few put pressure on companies regarding their CSR scores.

To summarise, in theory we expected substantial change, in practice the response was quite weak.

Unfortunately, I have not seen a single large-scale scientific study evaluating the effect of this policy change. Most studies simply compare US firms to European firms that were subject to the NFRD regulations. These studies show that the CSR scores went up in Europe. However, one might ask if the rise in CSR scores was due to companies' improvement or to an upgrade in the quality of the data. The most interesting finding about these studies, is that companies which had the lowest CSR scores were the most responsive to regulations. Therefore, we could say that NFRD encouraged weaker companies to improve but did not have a concrete impact on companies which were already doing well CSR-wise.

Perhaps one more word of caution: We should not forget that the push for transparency led to a "box-ticking exercise". As an example, to illustrate this phenomenon, let us consider the promotion of gender parity in the workplace. In this case, what truly matters is not only equality in terms of representation, but also creating a workplace where women are treated fairly and feel respected and included. Here, inclusion is a completely different metric from equality. In fact, a recent study has shown that companies that perform well in terms of gender diversity are usually weaker on inclusion performance.

With the upcoming 2024 regulations, we will be entering a second generation of metrics which will take us beyond looking at statistics to measure inclusion and make sure that employees are being heard.

Over the last 10 years, $8 billion has been spent on these corporate sustainability regulations. Do you think it has been effective?

The honest answer is "we do not know". Again, there have been very few studies that sought to evaluate the effectiveness of these policies.

Furthermore, the recently published UN Global Sustainable Development Goal Report indicates that we are lagging on all sustainability goals, even though we might reach them by 2030. Therefore, to better allocate resources and meet these goals, we need to better understand what works and what doesn't. The good news is that by collaborating with academics, conducting field experiments for example, companies can become much smarter about how they spend their money on sustainability issues.

Did you make such a study?

In my own studies I use a lot of randomised controlled trials to evaluate the effectiveness of policies. It is a way of experimenting in the field and create realistic evidence of what works and what does not.

Diversity training is a great example of how little we know. We have not studied the effectiveness of this training and yet we are spending a lot of money on it. I think that this is where research and business should collaborate to make sure that we test ideas before implementing them to guide our investment choices.

Can you think of any virtuous practices that might inspire other companies? You were talking about the work you have done with companies. Are there any initiatives that impressed you?

I cannot attest that these changes were directly caused by the NFRD, but these are example of practices that I find inspiring.

My first example is L'OREAL. L'OREAL is producing information about their own products' environmental and social impacts and then communicating this information directly to consumers. They are using the push for transparency to build loyalty and strengthen their relationship with their customers. The challenge now is to make consumers act on the information. L'OREAL also verifies that its suppliers are abiding by Human Rights principles. Finally, they make sure that information about social or environmental impact is communicated in a visual, attractive, and simple way to their consumers.

My second example would be IKEA. IKEA has been trying to pressure their wood suppliers into adopting responsible practices. To do so, IKEA has maintained a balanced relationship with its suppliers, trying on the one hand to support them and on the other hand to police them. This methodology is very similar to the one which might figure in the due diligence law on Human Rights presently debated at EU level.

Finally, there are also companies like Crédit Coopératif, a cooperative bank, who have been going the extra mile to make sure that people with disabilities are integrated into their workforce.

In 2024, the CSRD will harmonise and generalise non-financial reporting obligations for 55,000 European companies. This means that five times as many companies will be affected by these obligations. What consequences can we expect from this, what will be the social impact of these obligations?

I was involved in the drafting of these obligations, more precisely the ones with regards to the workplace and employees. I think the standards will open companies' perspectives on what "social" really means. If you were to ask a company now, they would think of employees (scope 1), but they might not think about their suppliers and consumers (scope 3). The new standards aim at making companies consider their full supply chain as part of the social scope.

This consideration also relates to the way companies operate in communities. They will be forced to ask themselves new questions such as: how do my operations affect the community where I am operating? How do I affect my end users?

At first, the process will be frustrating and demoralising, because companies will not have the answers to many of the questions that the regulations ask for. However, the standards might also encourage companies to cooperate more, to share information and best practices on how to improve the life balance of their employees, their impact on communities and so on. Such information-sharing will allow companies to be more effective in positively changing their practices.

The standards implicate third party verification. We will witness the rapid growth of auditing companies interested in helping companies implement the CSRD. This will be a new open, dynamic, and vibrant 'market for support' leading to potentially new regulation policies.

Moreover, because the data will be externally validated, it will be more comparable and become a valuable resource for stakeholders going from academia to individuals. As the data will cover many grounds, experts such as academics, graphic designers or lawyers will contribute to stakeholders' ability to analyse it.

Finally, these new standards will encourage companies to take a forward-looking view when it comes to CSR.

## What impact do you think CSRD could have on companies' business models?

New business models will emerge. Companies will have to rethink their business model, just like Decathlon did when they started renting their products instead of selling them. They may also rethink their governance models, for instance given employees greater say, which may well spark new waves of innovation.

Most of the time, business models connect social and environmental aspects. Innovative business models will be driven to combine the environmental, social and governance. Companies will not think in terms of pillars anymore but understand that all these aspects are intertwined.

## One final word?

Traditionally, the social dimension of a firm has been underappreciated and we have not given it a lot of thought or attention.

Understandably so, we are overwhelmed by global warming and climate change issues. But what we do not fully understand today - and I do hope reporting will help companies see it- is that we cannot think of an ecological transition or the environmental dimension without including the social dimension and governance.

# BRUNO DEFFAINS

Attorney with De Gaulle Fleurance

## Companies and the duty of vigilance: overcoming the uncertainties of a changing legal landscape

Multiple large corporations have been criticised in recent years by non-governmental organisations and non-profit entities for their alleged failure to comply with their "duty of vigilance" obligations in regard to the human and environmental risks associated with their activities. Non-compliance with these obligations may result in legal action against them.

Lawsuits filed against French multinationals based on allegations of non-compliance with duty of vigilance obligations have been regularly listed in the reports published by the "Duty of Vigilance Radar," the latest of which was issued in December 2022.[1]For illustration purposes, we present below some key data from certain lawsuits against these multinationals and the grievances raised by the plaintiffs.

In 2019, TotalEnergies found itself in the legal spotlight, sued by Les Amis de la Terre, Survie, and a group of Ugandan non-profit organisations for allegedly violating human and environmental rights in connection with an oil project in Uganda and Tanzania. In that same year, Suez came under fire in the wake of an incident in Osorno, Chile involving the contamination of drinking water distribution systems. Nor was BNP Paribas spared; it too was served formal notice in 2020 for its financing of Marfrig, a large Brazilian company linked to deforestation, and its support for oil and gas projects. Casino was also sued in 2021 by environmental organisations accusing it of contributing to deforestation Sherpa via its South American branches. Since 2019, Téléperformance has been under

[1] https://plan-vigilance.org/radar-du-devoir-de-vigilance-quel-constat-pour-2022/

scrutiny by the non-profit due to concerns related to workers' rights in certain countries. In 2022, a lawsuit was filed against Yves Rocher over allegations related to workers' rights at a Turkish subsidiary. All these lawsuits were filed in consequence of the law of 27 March 2017 imposing a "duty of vigilance" on large companies. They now must ensure that they prevent risks such as child labour or environmental damage, whether in France or abroad, including among the subcontractors and suppliers with whom they maintain established commercial relationships.

The objective of this law is to ensure better transparency in production chains, and avoid catastrophes like the Rana Plaza disaster of 2013. However, although its intentions are laudable, the law has stirred debate. The breadth of its scope and its lack of clarity regarding the "duty of vigilance" pose challenges for international business. Companies are increasingly seen as auxiliaries of the State, helping to meet certain "public policy goals" such as protecting markets, protecting human rights, or maintaining international financial stability. They are therefore increasingly required to be concerned with ethical, social and environmental issues. Several international institutions, such as the United Nations, have sought to encourage companies to comply with this duty of vigilance. In 2018, the OECD even published a guide, entitled guidance on due diligence for responsible business conduct.[2] These changes in legislation have come about as part of a long-run perspective, giving greater consideration to the risks faced by society. The freedom to do business also implies a duty to be vigilant in regard to risks to fundamental and universal rights in the fields of human rights, health, safety and environment. This is not about unlimited responsibility, but about making efforts to find effective ways to address the most substantial infringements and risks.

In light of these issues, the definition and implementation of such a duty of vigilance imply multiple challenges, which the justice system must handle. In order to understand where we are today in the interpretation of this duty and the understanding of these issues in light of recent developments in the judicial field, various different points deserve special mention.

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[2] https://www.oecd.org/fr/daf/inv/mne/Guide-OCDE-sur-le-devoir-de-diligence-pour-une-conduite-responsable-des-entreprises.pdf

## Recent advances

The ruling issued by the interim relief judge at the ordinary court of Paris on 28 February 2023 concerning the aforementioned dispute between TotalEnergies and several NGOs, including "Friends of the Earth France" and "Survival" was an important turning point in the evolution of case law with regard to corporate social and environmental responsibility. However, the judge, by declaring himself "not equipped" to evaluate the vigilance plan and calling for more legal clarification, also underlined the limits of judicial intervention in these complex issues. The judgment also raised many questions about the effectiveness of the dialogue between companies and stakeholders - in this case NGOs - who appear to have divergent interpretations of their legal and ethical obligations.

This first case was both revealing and catalysing for debates on corporate governance in social and environmental matters. A few months later, on 6 July 2023, the ordinary court of Paris also dismissed legal actions brought against TotalEnergies by several non-profits and cities on the basis of the duty of vigilance. The coalition was seeking to force the company to take measures to limit global warming to 1.5°C and to suspend any plans to explore and exploit new hydrocarbon deposits. The judge emphasised that the question of whether the action was admissible was only a procedural issue and not a substantive one. The judge found that the formal notice served to TotalEnergies in 2019 was not sufficient as a basis for the negotiations required before a judicial summons. It should be noted that, according to the judge, the global scope of the grievances against TotalEnergies would make environmental disputes “impossible to control” if all local authorities could sue the company.

The outcome of these first decisions clearly shows see the difficulty faced by the Justice system in tackling these sensitive subjects. Some progress has been made, including:

- The clarification provided by the court on the scope of the legislation, which "*assigns monumental goals for the protection of human rights and the environment to certain categories of companies, specifying the minimum means that must be implemented to achieve them.*"
- The inadmissibility of a summons without successive prior formal notices. The petitions submitted by the non-profit entities during the presentation of arguments before the interim relief judge were based on more than two hundred more new documents than had been attached to the 2019 formal notice and 2021 vigilance plan.
- Limited powers of interim relief judges: it is not within the powers of the interim relief judge to assess the reasonableness of the measures adopted by the vigilance plan.

Nevertheless, many difficulties remain, particularly regarding the consequences that companies can draw from these first decisions while awaiting those to be issued in coming months. To answer this question, the author of these lines draws inspiration from the subjects addressed in the framework of the Amicus Curiae to which he was invited in the context of the lawsuit opposing TotalEnergies and the NGOs. The following elements highlight in particular the imprecise and vague objectives of the law, which will require clarification in the future.

## Scope of the duty of vigilance

The European Union has picked up where French legislative initiatives left off, further extending the duty of vigilance. The draft European directive now targets all large EU companies with significant economic influence. It aims to cover all companies employing more than 500 people and generating an overall turnover of more than €150 million. EU companies employing between 250 and 500 people and generating an overall net turnover of more than €40 million at least 50% of which originates from a business sector classed as high-risk would also be covered. Non-European companies would be covered as well if they generate an overall turnover above 150 million euros within the EU. By way of comparison, while the French legislation of 2017 now in force only affects less than 5% of companies, the new European system would cover about 20% of companies.

As for the implementation of the French system, experience is limited, but the start of 2023 was the occasion for some progress on the judicial front, with contributions from the decisions mentioned above in the lawsuits brought against the company TotalEnergies. These decisions were the first judicial applications of the law of 27 March 2017 on the duty of vigilance of parent companies, but give little indication of how the courts may rule on the merits in the increasingly frequent claims being brought against French companies by non-profit entities on the basis of this law.

The law on the duty of vigilance requires large French companies to establish, publish and apply a vigilance plan to identify and prevent serious risks to human rights, human health and safety, and the environment. In case of allegations of non-compliance with these obligations, the company may be served with formal notice, and if it fails to take appropriate measures to remedy these breaches within three months, any person willing to take action may bring a case before the Ordinary Court of Paris to require the company to comply with its obligations.

In the case of TotalEnergies, the non-profit entities criticised the company's vigilance plan for the year 2018 and served formal notice upon it to comply with its obligations under the law on the duty of vigilance with regard to two of its oil development projects in Uganda. However, the court ruled that the non-profit entities' requests were inadmissible because they had not given TotalEnergies formal notice before going to court, thus failing to satisfy the provisions of the law.

However, these decisions involved no judgment on the merits of the case, and it remains to be seen how the judges will assess the companies' compliance with their obligations under this law in the decisions that will doubtlessly be issued in the future.

### Redefining the company's role

The duty of vigilance raises the question of a new type of corporate governance, seeking to align the interests of all stakeholders. This more sustainable approach aims to balance the company's for-profit and non-profit goals. By obliging companies to be more vigilant before making an investment decision or launching a development project, we seek to broaden the interests taken into account by the company.

Companies are a source of both solutions and problems for society: depletion of natural resources, climate change, social impacts, etc. To respond to these challenges, many companies have already adopted voluntary initiatives to manage waste, water, greenhouse gas emissions, or to collaborate with the non-profit world on philanthropic actions. The duty of vigilance is therefore not necessarily seen as a threat by all companies, but rather as an extension of existing practices that reflect social and environmental concerns.

However, “good practices” and “soft law” are no longer enough today. Revisions will need to be made to the core of the business model and to the entire chain of command and responsibility, from the shop floor or store front to the board of directors.

It is important to note that CSR is not a new paradigm or management fad, but a long-standing practice rooted in business practices that are more than a century old. Nevertheless, the fundamental problems faced by the modern economy will not disappear on their own, or through soft law alone. It is therefore necessary for lawmakers to address these questions comprehensively.

Thus, in many countries we can see that regulatory constraints are becoming more and more substantial. We have moved from voluntary CSR, which some have seen as too cosmetic, to a growing body of obligations that flesh out a broader societal responsibility.

In short, the duty of vigilance now constitutes a strategic pillar for companies, which now must report on their activity not only to their shareholders, but to all stakeholders as well. The introduction of the law has facilitated the acceptance of the duty of vigilance by companies' various different departments, and has helped encourage an end to "siloed" working.

### The duty of vigilance as a means of internalising externalities

An interpretation of the duty of vigilance through an economic lens offers an interesting perspective. Indeed, this duty may be rooted in a recognition of negative externalities. The risks of harm to human rights and the environment constitute a problem of negative externality, i.e., a "debt that is not readily compensated."

The concept of externality refers to a situation where the costs or benefits of an economic activity are not fully taken into account by the parties directly involved. For example, a company can pollute the environment without incurring the costs, which are then borne by society as a whole. This is called a negative externality.

To resolve this problem, it is necessary to internalise these externalities, i.e., to ensure that the costs are borne by those who generate them. This may be done through regulations, taxes or incentive policies. In the case of the duty of vigilance, this means that companies need to take into account the risks they pose to society and the environment, and put in place measures to prevent them.

However, the duty of vigilance should not be seen solely as a constraint. On the contrary, it can be a driver of positive change for businesses. Indeed, by taking social and environmental risks into account, companies can improve their reputation, meet the expectations of consumers and investors, and ultimately improve their economic performance.

However, this does require organisational and methodological changes to be made. Companies must be able to identify risks, map them, and implement measures to reduce them. They must also be able to report on their actions and progress. That said, the duty of vigilance should not be seen as an obligation of results, but rather as an obligation of means. Companies are required to do their best to identify and reduce risks, but they are not required to guarantee that no risks will ever materialise.

Lastly, it is important to note that the duty of vigilance does not affect companies alone. It also affects governments, which have a duty to put in place clear and effective regulations to govern business activities. It also concerns consumers, who have the power to choose products and services that are respectful of human rights and the environment.

Conceived in this way, the duty of vigilance seems to fit within an economic logic of the internalisation of externalities corresponding to social and environmental risks that traditionally have not been much or at all readily taken into account by companies and markets (reflecting the aforementioned "monumental goals"). However, efforts to minimise social costs are currently met with the imprecision of the legal mechanisms in place. How should a “reasonable degree of vigilance” be defined in common civil liability law? How far down the value chain should this reach? It is urgent that clear answers be provided promptly, particularly in regard to liability. Failing this, companies will face a significant risk of legal uncertainty, paradoxically preventing them from moving towards the “sustainable” solutions desired. And all this is not simply a matter of sustainable contract law, because what we are facing today is the whole issue of public policy for the environment. The issue is also made more complex due to the fact that it does not merely affect individual countries taken in isolation, since it goes hand in hand with questions of international economic competitiveness.

### "Dispute boards" set up to help prevent these new risks

In this era of increased corporate responsibility, various new legal tools have been emerging, and the duty of vigilance is only one of them. These tools constitute new standards, whose precise definition is still incomplete and constantly evolving. In this changing context, creating so many new uncertainties and questions, companies face unprecedented challenges, where the slightest mistake can lead to major conflicts with various stakeholders. These conflicts can result in considerable costs both for economic actors and for society as a whole, and it would appear essential to have resources at the ready to better anticipate and manage them. This is where “dispute board” mechanisms such as those organised by De Gaulle Fleurance come into play. These arrangements provide a space for dialogue and exchange, allowing companies to collaborate closely with all parties concerned. By anticipating grey areas and promoting communication, dispute boards play an essential preventive role. They guide companies through the twists and turns of the new obligations, helping to provide a smooth transition to an era of enhanced vigilance. In a world where dialogue is key, these mechanisms offer an essential tool for a confident navigation of the constantly evolving legal landscape.

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## 2023: the end of the French duty of vigilance?

### Repeated dismissals in duty of vigilance disputes

In the previous sections we have discussed some of the numerous formal notices and lawsuits launched against French multinationals in recent years based on the duty of vigilance law.

Four decisions have been issued to date by the Ordinary Court of Paris in cases on this subject that have gone to trial, all of which have resulted in a dismissal of the claims on procedural grounds, without a decision ever being made on the merits of the case concerned.

In this regard we may mention the two rulings of 28 February 2023 (n°22/53942, 22//53943), analysed in the sections above, in which the Ordinary Court of Paris declared the proceedings instituted against TotalEnergies inadmissible.

A series of similar dismissals continued to be issued throughout 2023.

By a ruling issued 1 June 2023, the Ordinary Court of Paris declared inadmissible the lawsuit brought by FIDH, Observatorio Ciudadano, the non-profit organisation Red Ambiental Ciudadana de Osorno, and the Ligue des Droits de l'Homme (LDH) against the Suez group in a case addressing the contamination of the drinking water network in Osorno, Chile. The judge held that the NGOs had not targeted the correct corporation in their summons. The court's decision to dismiss was also made on the grounds that their summons was not made on the basis of the same vigilance plan as that referenced in their formal notice.

In another decision, issued on 6 July 2023, the pre-trial judge declared inadmissible a lawsuit brought by various NGOs (Sherpa, Notre affaire à tous) and local communities against TotalEnergies, in which the plaintiffs had attacked the company for "climate inaction." The court ruled that the requirements of the negotiation phase called for by the law before taking legal action against a company that has failed to comply with its "duty of vigilance" were not met.

## New duty of vigilance litigation cases dwindle

While the period 2019 - 2022 proved relatively active in terms of new proceedings (service of formal notice and/or summons) instituted against multinationals based on the duty of vigilance law, 2023 showed a clear downward trend in such proceedings.

By December 2022, 23 proceedings had been instituted based on the duty of vigilance law since its creation, i.e. twice as many compared to March 2021. However, according to our research, only three new lawsuits have been instituted on this basis so far in 2023.

The lawsuit against Danone, instituted on 9 January 2023 ("Deplasticise Yourself") is the first duty of vigilance summons introduced relating to the environmental issue of plastics. It was filed after formal notices served by NGOs to Danone and 8 other companies in the distribution and agri-food sectors in September 2022.

On February 26, 2023, climate litigation was launched by three NGOs (Oxfam France, les Amis de la Terre France, Notre Affaire à Tous) targeting BNP Paribas on allegations of contributing to global warming due to its financing and investments in the coal, oil and gas industry.

In May 2023, the French banks BNP Paribas, Crédit agricole and BPCE were served formal notice by Tierra Digna (a Colombian NGO) amid criticism of their financing of the Swiss company Glencore and its contribution to the fossil fuel industry.

Not only have there been only three new proceedings instituted, but we had to reach back to the beginning of 2023 to find them. We can therefore legitimately conclude that the number of such proceedings is dwindling. It seems that two main causes may be at the root of this trend.

One plausible explanation may have to do with the serial dismissals of petitions filed by NGOs in early decisions issued with regard to the duty of vigilance. It is likely that this would not tend to readily encourage NGOs to launch new proceedings.

Another explanation could be that NGOs are taking a wait-and-see position in regard to the European directive to be enacted on the duty of vigilance, which as is well known looks to be much more strict and restrictive than the French law.

## Governance bodies, a new target for CSR litigation

Media coverage of proceedings instituted against multinationals on the basis of the law on the duty of vigilance has tended to eclipse the drastic increase in CSR pressure on the governance bodies of companies.

It should be noted, for example, that the latest version of the Afep-Medef code of corporate governance for listed companies[3] published in December 2022, very significantly strengthens the CSR obligations to which directors are subject. For instance, the press release announcing this new version of the code states:[4]

*Afep and Medef have issued a new version of the corporate governance code for listed corporations (the Afep-Medef code). This version incorporates several modifications intended to make CSR strategy - particularly in regard to climate change issues - a central part of board duties.*

*It is recommended in particular that boards, on proposal from general management, determine multi-annual strategic orientations in these domains, particularly with regard to climate change issues, with regard to which this strategy must be accompanied by precise objectives aligned to different time horizons. This climate strategy and the primary actions to be undertaken for this purpose are to be presented at the general meeting of shareholders at least every 3 years or whenever a significant change is made. In support of a movement already widely underway to integrate CSR criteria into executive remuneration, the code now stipulates that the remuneration of corporate executive officers should include at least one criterion related to the company's climate objectives among their CSR criteria, and recommends giving preference to quantifiable criteria.*

CSR pressure has been brought to bear upon governance bodies not only through the regulatory

[3] https://afep.com/wp-content/uploads/2022/12/Code-AFEP-MEDEF-version-de-decembre-2022.pdf
[4] https://afep.com/publications/code-de-gouvernement-dentreprise-des-societes-cotees/

approach but also through litigation.

In this regard, the Shell/Client Earth case[5] very concretely illustrates the rise of this new litigation trend, targeting not the company itself but its governance bodies.

On 9 February 2023, the directors of the Shell Corporation were the subject of a complaint by the Client Earth collective, accusing them of poorly preparing the company for the energy transition. The plaintiff, a shareholder of the Shell Corporation, initiated this litigation process on the basis of a civil action for management misconduct (breach of the duty of care). The NGO considered that Shell's eleven corporate directors had *"breached their legal obligations under the Companies Act by failing to adopt and implement an energy transition strategy in alignment with the Paris Agreement."*

Client Earth argued in particular that insufficient climate action harmed not only the environment but also the interests of shareholders. It highlighted the fact that a board of directors is *"legally required to manage risks to the company that could harm its future success, and the climate crisis presents the biggest risk of them all."*

Interestingly, other Shell shareholders have joined ClientEarth's case as well, on the grounds that the future consequences of these allegedly flawed climate plans could include a collapse of the company's valuation, the elimination of jobs, and the risk of significant financial losses for shareholders and investors.

For its part, Shell's board of directors contested the lawsuit maintaining that its energy transition strategy, with its goal of carbon neutrality by 2050, was compatible with the Paris Agreement and was in fact one of the most cutting edge in the sector.

On 24 July 2023, the High Court of London issued a ruling in favour of Shell, finding ClientEarth's claims to be devoid of any legal basis and holding that court decisions are not an appropriate substitute for the decisions of a Board of Directors. In essence, the British court held that the appropriate battleground for challenging the decisions of a board of directors is the shareholders' meeting, not a court of law.

Even though the lawsuit filed by the ClientEarth collective was not successful, the growing regulatory pressure on governance bodies and the threat of legal action will certainly help push CSR subjects

[5] London High Court of Justice, 12 May 2023, no. bl-2023-000215

to the top of board priorities in years to come. It is thus to be expected that director profiles with solid CSR expertise will be in high demand in the context of board renewal processes.

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## Businesses and the financial services sector face new sustainability obligations

### A) Supporting businesses in implementing the CSRD

#### 1.1 Transparency requirements: proportionate or weakening?

In its communications on the European Green Deal,[6] the European Commission (hereinafter the "Commission") has committed to revising the provisions on the publication of non-financial information established under directive 2013/34/EU.[7] The Commission's objective was to redirect capital flows into sustainable investments by requiring certain categories of companies to publish relevant, comparable and reliable environmental, social and governance ("ESG") information.

Directive 2022/2464/EU,[8] known as the "CSRD" (Corporate Sustainability Reporting Directive), reflects the Commission's ambition to create new transparency requirements making it possible to measure, evaluate and manage sustainability risks, accompanied by auditing practices to help ensure the reliability of data and prevent greenwashing and double accounting.

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[6] COM (2019) 640 final

[7] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending directive 2006/43/EC of the European Parliament and of the Council and repealing directives 78/660/EEC and 83/349/EEC

[8] Directive (EU) 2022/2464 of 14 December 2022 amending Regulation (EU) No. 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting

The CSRD thus extended the scope of application of Directive 2014/95/EU,[9] known as the "NFRD," which applied only to large listed undertakings with more than 500 employees and to the parent companies of large groups meeting such criteria, to include:

- all large companies exceeding the stipulated numerical thresholds for at least two of the following three criteria: 250 employees, 40 million euros in turnover, and a total balance sheet of 20 million euros, as well as all parent companies of large groups meeting these criteria;
- listed small and medium-sized enterprises (SMEs), with the exception of listed microenterprises.

The CSRD also applies to third-country companies that have generated net turnover greater than €150 million within the EU for each of their last two consecutive financial years, and have a subsidiary or branch established within the EU.

Companies subject to the directive must now adopt a double materiality approach, publishing information not only on the impact of their activities on sustainability issues, but also the impact of sustainability issues on the development of their business and their financial results.

This information must be included in a specific section of their management reports, and, depending on the case, will need to include non-exhaustive descriptions of the company's business model and strategy, indicating risks and opportunities linked to sustainability issues, greenhouse gas reduction targets and corresponding deadlines, company governance with regard to these issues, the policies and due diligence procedures put in place, impacts linked to its value chain, and indicators in connection with the information to be published.

Several provisions nevertheless provide for exemptions for listed SMEs intended to limit the quantity of information they need to publish in regard to sustainability, and allowing them to refrain from such publication for the financial years prior to 1 January 2028 provided that they briefly indicate their reasons in their management report.

The Commission also planned for a gradual entry into force of the CSRD. Thus, it will apply to large listed companies with more than 500 employees starting from 1 January 2024, and to large unlisted companies meeting the aforementioned criteria from 1 January 2025.

Listed SMEs will be subject to CSRD reporting obligations starting from 1 January 2026, but their reporting will need to be prepared in accordance with other proportionate standards to be adopted

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[9] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups

by the Commission by 30 June 2024 at the latest.

The transposition of the CSRD into French law will be conducted by means of ordinance in compliance with article 12 of the law of 9 March 2023,[10] known as the "DDADUE law." The Government has nine months to enact this ordinance, expiring on 9 December 2023. It will also be responsible for defining the sanctions regime applicable to companies failing to comply with their public reporting obligations, since the CSRD has entrusted this task to member states.[11]

It should be noted that despite the concern for proportionality reflected in the text of the CSRD, aimed at responding to the growing concern of SMEs in the face of these new administrative constraints and progressive provisions for entry into force, the Commission may now be considering modifying the publication obligations initially planned for certain categories of companies subject to the CSRD.

In her State of the Union speech of 13 September 2023,[12] the President of the Commission, Ursula von der Leyen, on the subject of SMEs, announced the upcoming presentation that next month of *"legislative proposals intended to reduce reporting obligations at the European level by 25%."*

A change to the thresholds defined by the abovementioned accounting directive 2013/34/EU allowing the determination of which category EU companies and groups belong in may be under consideration.

While greater clarity and legal certainty for the companies of various sizes that have already undertaken internal procedures in preparation for the implementation of the CSRD is still forthcoming, the transparency obligations it contains have nevertheless already been coupled with compliance requirements for the information to be published.

### 1.2. The introduction of information assurance missions in respect of sustainability and open audit markets

Information assurance is provided via the performance of limited or reasonable assurance missions.

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[10] LAW no. 2023-171 of 9 March 2023 containing various provisions for adapting to European Union law in the fields of economy, health, work, transport and agriculture
[11] Article 51 of the abovementioned directive 2013/34/EU
[12] https://france.representation.ec.europa.eu/informations/discours-sur-letat-de-lunion-2023-de-la-presidente-von-der-leyen-2023-09-13_fr

The first of these generally concludes with the simple observation that no significant inaccuracies have been found in the audit subject. The second and more expensive of these requires longer-lasting examinations and tests to be performed in order for an opinion to be issued.

Though a statutory audit of a company's accounts is performed on the basis of a reasonable assurance mission, the same does not apply for sustainability reporting. The NFDR, transposed into French law and codified as article L.225-102-1 of the Commercial Code, required the companies subject to its provisions to publish a non-financial performance statement. Under the CSRD, certification practices are being established for the information published in order to audit it.

The Commission nevertheless wished to gradually strengthen the level of assurance required for the certification of sustainability reports so that it would be similar to that applicable to financial information.

Initially, then, it introduced the obligation for a statutory auditor or an audit firm to issue an opinion on the compliance of the sustainability information with EU requirements on the basis of a limited assurance mission.

Article 34 of accounting directive 2013/34/EU as amended by the CSRD thus specifies that the opinion must address the compliance of the sustainability information with:

- EU sustainability reporting standards
- the process used by the company to determine what information is published in accordance with these information standards
- compliance with the obligation to tag sustainability information
- compliance with the information publication requirements provided under Article 8 of Regulation (EU) 2020/8502,[13] known as the "Taxonomy" regulation.

In order to facilitate the harmonisation of practices and the quality of information assurance in regard to sustainability, the Commission will need to adopt limited assurance standards by means of a delegated act before 1 October 2026. Pending this adoption, Member States will be able to use their own standards and procedures, and should be able to be able to refer before this date to the non-binding European guidelines currently being prepared.

Secondly, the Commission should also adopt reasonable assurance standards by means of a

[13] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

delegated act no later than 1 October 2028, provided that it is able to assess its feasibility.[14]

Though this new assurance mission seems naturally to fall to the statutory auditors or audit firms already tasked with verifying the financial statements and management reports, the Commission has expressed its fear of a risk of concentration in the audit market that may ultimately compromise their independence and increase their fees.

To ensure the reliability of sustainability information, it hopes to encourage the creation of a more open and diverse audit market that could include accredited independent assurance service providers,[15] and could also allow companies to enlist the services of statutory auditors other than those already certifying their financial statements.

Companies will therefore have to choose between accounting professionals that position themselves as legitimate players with expertise in the evaluation of financial performance and those that can offer support as part of an ESG performance approach requiring a deeper legal analysis of the development of the regulatory architecture and an understanding of sustainability issues beyond the simple implementation of the CSRD.

## A new role for attorneys?

The general assembly of the National Bar Council ("CNB") adopted a resolution on 11 May 2023 on the certification of sustainability information, deciding that lawyers would take their rightful place in this market.

The CNB thus called:[16]

*"- for lawyers to be designated as independent insurance service providers in the context of the transposition of the directive;*

*- for the legal profession to be represented within the independent administrative supervisory body common to all professionals authorised to certify sustainability information;*

[14] New article 26 bis of directive 2006/43/EC as amended by the CSRD

[15] Point b) 20), added to Article 2 of Directive 2013/34/EU as amended by the CSRD

[16] https://www.cnb.avocat.fr/fr/actualites/lassurance-dinformations-en-matiere-de-durabilite-une-nouvelle-mission-offerte-aux-avocats

*- for lawyers to be involved in the enactment of rules to which all independent providers of assurance services will need to be subject in order to bring forth the specific aspects of the legal profession."*

As information on sustainability - whether in terms of environmental, social or governance issues - is predominantly of a legal nature, the CNB finds two particular services that attorneys could offer to companies in this regard: i) CSRD-compliant sustainability reports, and ii) the sustainability audits, which would consist in certifying the information published in such reports.[17]

With the CSRD's new transparency requirements reinforcing the judicialisation of corporate social responsibility, it certainly appears legitimate that attorneys should have a specific role to play in this context. This is especially the case since issues of legal liability for the company and its managers may arise as a result of how this information interacts with the information to be required under the proposed directive on due diligence of 23 February 2022.[18] Because the information to be included in the sustainability report is related to the actual or potential negative impacts caused by the company's activities, the role of decision-making bodies or the due diligence procedures implemented will require the performance of an analysis of the risks incurred as part of preparing of the sustainability report.

However, attorneys seeking an entry into the sustainability audit market will not only need to obtain accreditation from COFRAC, but above all will need to guarantee compliance with the principles of independence and professional secrecy. The latter will need to evolve because it currently excludes matters related to consulting activities that are not linked to judicial proceedings.[19] Furthermore, since they are prohibited from simultaneously performing consulting duties and certification duties, lawyers must be careful to avoid any conflict of interest.

## 1.3. Adoption of sustainability reporting standards

To supplement the CSRD, the Commission was required to define a set of mandatory Sustainability Reporting Standards (ESRS)[20] specifying the information companies need to publish.[21] It entrusted

[17] https://www.cnb.avocat.fr/fr/actualites/audit-durabilite-avocats-devenez-organisme-tiers-independants-et-developpez-votre-activite
[18] Proposal for a directive on corporate sustainability due diligence and amending directive (EU) 2019/1937
[19] Decision no. 2022-1030 QPC of 19 January 2023
[20] European Sustainability Reporting Standards
[21] New article 29b(1), added to directive 2013/34/EU as amended by the CSRD

the development of these standards to EFRAG.[22]

These standards needed to specify the prospective, retrospective, qualitative and quantitative information to be published regarding environmental factors as well as factors related to labour rights, human rights, and governance. They also had to take into account possible difficulties in collecting information on actors in the value chain of companies not subject to these information requirements.

The Commission had until 30 June 2023 to issue a delegated act establishing a set of non-sectoral ESRS applicable to all companies falling within the scope of the CSRD and covering at least the information that financial market participants need to comply with the publication obligations specified in regulation 2019/2088/EU, known as the "SFDR" (Sustainable Finance Disclosure Regulation). The Commission also needs to issue a delegated act establishing proportionate standards appropriate for listed SMEs[23] before 30 June 2024.

EFRAG provided the Commission with its technical opinion on a first series of information standards in November 2022. On this basis, the Commission submitted for consultation from 9 June to 7 July, 2023 a proposal for a delegated act on ESRS. It collected and retained for consideration the various difficulties linked to the information collection and processing requirements proposed by EFRAG that companies reported being faced with, in particular those that had not previously been subject to legal publication obligations.

The Commission therefore made modifications to the draft EFRAG standards in order to ensure proportionality, which were reflected in the delegated act on ESRS[24] that it adopted on 31 July 2023 (hereinafter the "Delegated Act"). The principal changes in particular concern:

- The extent of companies' assessment of the importance of standards, disclosure requirements and data points. Here, the Commission has retained only one exception to the assessment left to the discretion of companies regarding the general information to be published (ESRS 2), and no longer includes the standard specifically relating to climate as initially proposed by EFRAG. It should be noted that if a company does not consider climate change to be an important issue, it will need to publish a detailed explanation of its assessment in this regard.
- The strengthening of transitional provisions (listed in ESRS 1): companies with fewer than 750 employees will thus be able to omit data relating to scope 3 greenhouse gas emissions and the

[22] European Financial Reporting Advisory Group
[23] New article 29c, added to directive 2013/34/EU as amended by the CSRD
[24] Commission Delegated Regulation of 31.7.2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards

requirements of the "Company workforce" standard for the first year when the standards will apply to them.

- Expanding the optional nature of certain information: the Commission has made optional certain datapoints that under EFRAG's proposal were to be mandatory, such as biodiversity transition plans and certain indicators relating to external workers.
- Relaxing the stringency of certain publication requirements: for example concerning the financial implications of sustainability risks and interactions with stakeholders.

Apart from this relaxation, the ESRS continue to favour a double materiality approach, requiring companies to report both their impacts on the population and the environment (impact materiality) and the impact of sustainability issues on the company (financial materiality).

The mandatory application of these standards to EU companies ensures the publication of good quality, relevant, reliable and comparable sustainability information usable by investors, civil society, consumers and other stakeholders. This information will make it possible to promote the evaluation of companies' performance in terms of sustainability and to direct funding towards environment and population friendly activities.

There are 12 ESRS, covering the following sustainability issues:

| Theme | Thematic ESRS | Purpose |
|---|---|---|
| Cross-sectional | ESRS 1 | General requirements |
| Cross-sectional | ESRS 2 | General information for disclosure |
| Environment | ESRS E1 | Climate Change |
| Environment | ESRS E2 | Pollution |
| Environment | ESRS E3 | Aquatic and marine resources |
| Environment | ESRS E4 | Biodiversity and ecosystems |
| Environment | ESRS E5 | Resource use and circular economy |
| Social | ESRS S1 | Company workforce |
| Social | ESRS S2 | Workers in the value chain |
| Social | ESRS S3 | Communities affected |
| Social | ESRS S4 | Consumers and end users |
| Governance | ESRS G1 | Conduct of business |

ESRS 1 provides general principles to be applied at the time of publication, and ESRS 2 specifies the essential information to be published.

All the other standards are subject to an assessment of their importance by companies as mentioned above, which does not mean, however, that their publication is optional.

Appendix E to Annex 1 of the Delegated Act provides a diagram, for non-binding illustration purposes, to help determine the information to be included for purposes of the ESRS:

The Delegated Act was submitted to the European Parliament and the Council of the EU for review during the month of August 2023. They were given two months, extendable once for the same duration, to formulate any objections, without however being able to make changes to the text. If the two European institutions do not reject the Delegated Act by the deadline, it will enter into force.

The Delegated Act will thus apply, as of the start of the financial year beginning 1 January 2024, to companies that were already subject to the non-financial disclosure obligations introduced by the NFRD. Article 2 provides for its entry into force on the third day after its publication in the Official Journal of the European Union, and for its direct application in EU member states.

### 1.4. The question of the interoperability of the ESRS: EU standards versus international standards

The new provisions introduced by the CSRD provide that the ESRS must avoid imposing a disproportionate administrative burden on companies, in particular by taking into consideration the work of other global standardisation initiatives.[25]

EFRAG's work is thus part of efforts to achieve coherence and alignment with existing standards and frameworks so as to establish a shared foundation for European companies and prevent them from being obligated to prepare multiple sustainability reports.

During consultations on the Commission's draft Delegated Act, new information was incorporated in order to help align the ESRS with the Global Reporting Initiative and the climate-related requirements of the International Sustainability Standards Board ("ISSB"). This information in particular concerned carbon credits, emissions reduction goals, and the quality of the data sources used for scope 3 estimations.

The ISSB, which favours simple financial materiality, only measuring the environmental risks and opportunities faced by companies in order to facilitate economic decision-making, also published its

[25] New article 29b(2), added to directive 2013/34/EU as amended by the CSRD

own sustainability reporting standards on 26 June 2023. Taking a voluntary approach, these standards, entitled IFRS S1 and IFRS S2, aim to encourage the integration of sustainability into corporate accounting and the functioning of global capital markets.

IFRS S1 builds on international accounting standards and includes information disclosure requirements designed to enable companies to communicate to investors the sustainability risks and opportunities they face in the short, medium and long term. IFRS S2 provides for specific climate-related disclosures, and is designed for use together with IFRS S1. Both standards incorporate the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD"). They have since been endorsed by the International Organization of Securities Commissions (IOSCO), which called on its 130 members, including the capital markets authorities tasked with regulating more than 95% of global securities markets, to examine how they can integrate the ISSB standards into their respective regulatory frameworks in order to ensure the consistency and comparability of sustainability information worldwide.

Though interoperability between the ESRS and the ISSB standards on the climate issues was part of the goal, significant differences of magnitude remain concerning the principle of double materiality advocated by the EU. Thus there is a conflict underway between these two competing standards, which may lead to the European model being compromised if it is not upheld internationally, ultimately impacting the weight of EU companies in the global economy.

As part of this conflict, non-governmental organisations have criticised the ISSB's single materiality approach for not being relevant to the management of natural resources. Others have pointed out that the requirement to publish scope 3 emissions solely from the shareholder value perspective as advocated by the ISSB does not place sufficient emphasis on business model alignment with the Paris Agreement. To which Emmanuel Faber, President of the ISSB, responds that *"the Paris Agreement and its overall objective are not sufficient in and of themselves, because certain signatory jurisdictions to the Agreement have their own specific national decarbonisation plans. (...) The more restrictive public policy defining the country's path becomes in those jurisdictions, the more scope 3 will represent a major transition risk for companies, which will thus be reflected in their accounting."*[26]

[26] https://www.linkedin.com/pulse/le-pilotage-des-%C3%A9missions-de-ges-indirectes-p%C3%A9rim%C3%A8tre-emmanuel-faber

The ESRS, in turn, came under criticism when they were made more flexible by the Commission as part of the adoption of the Delegated Act. Several investor organisations such as the Principles for Responsible Investment (PRI) and Eurosif have expressed concern that their members lack the information necessary to fully exercise their own reporting obligations, particularly in the framework of the SFDR.

The United States, for its part, is concerned about the extraterritoriality measures introduced by the CSRD, and lawsuits are already expected by the U.S. Securities and Exchange Commission (SEC) seeking to block the publication of rules on the publication of information on climate risks.

If the EU does not win this battle for standards at the international level, it risks losing its influence as a leader in the transition to a sustainable economy. If no normative hegemony is established, companies with operations in multiple jurisdictions will need to navigate multiple methodologies. It appears likely in any case that it will prove necessary for them to be assisted by both private and public actors as a result of the proliferation of scientific debates, guidelines, and environmental and social issues.

# JORDAN LE GALLO

Attorney with De Gaulle Fleurance

## B) Sustainable finance tools to facilitate the implementation of the SFDR

### 2.1. Retrospective on the reclassifications of "article 9" funds

The transition to level 2 of the SFDR Regulation[27] led to a large wave of reclassification of "Article 9" funds to a lower rank known as "Article 8," in anticipation of its entry into force on 1 January 2023.

As a reminder, the SFDR Regulation divides investment service providers by stages into 3 categories: (i) funds known as "Article 6" funds, which have no sustainability focus, whether social or environmental, (ii) "Article 8" funds, which have a sustainability focus meeting transparency obligations regarding their approach to sustainable investment, and finally (iii) "Article 9" funds, focused on sustainability, which are subject to stricter sustainability standards and pursue clear sustainability goals.

Level 2 of the FDR Regulation reinforces the transparency requirements to which financial market participants and financial advisors are subject in their non-financial reporting, in particular by requiring that these reports be prepared in accordance with "level 2 regulatory" technical standards (known as RTS). One of the stated objectives of this standardisation of non-financial reports is to promote their comparability.

Indeed, it is in anticipation of these increased obligations that certain players, like Amundi, have preferred to initiate a reclassification of their funds "Article 9" starting from the third quarter of 2022, out of concern for prudence in light of what may sometimes be unclear rules.

[27] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector

Thus, in its report dated January 26, 2023 entitled *"SFDR Article 8 and Article 9 Funds: Q4 2022 in Review,"* Morningstar announced that 2022 was marked by a massive reclassification of so-called "Article 9" funds to the "Article 8" rank, involving a total of approximately 175 billion euros in assets or 40% of "Article 9" funds.[28]

This wave slowed in Q1 2023, however, with only a dozen reclassifications.[29] At the same time, the number of "Article 8" funds increased by 260 formerly "Article 6" funds reclassified over this same period.

Until 14 September, stakeholders had assumed that the trend was going to be reversed in light of the clarifications provided by the European Supervisory Authorities on 14 April, indicating that the SFDR Regulation was a regulation concerning transparency, and was not intended to define investment sustainability criteria.[30] In practice, it is incumbent upon each administrator to explain in their non-financial reports the methods used to assess the "sustainable" nature of their investments. In other words, sustainability characteristics are not standardised by the SFDR Regulation, which provides flexibility to financial players to determine what is meant by "sustainable" investments, but at the same time impedes the objective of promoting mutual comparability among reports. Indeed, this lack of uniformity leads to difficulties of interpretation that inevitably tend to encourage stakeholders to use the tools already available to them to facilitate the determination and identification of these sustainability criteria and monitor compliance with them.

However, on 14 September, Brussels launched a new consultation[31] addressing *"the implementation of the SFDR"* which came as a heavy blow to actors in charge of its implementation. The European Commission's intention in this consultation appears to be to decisively intervene in fund categorisation, with the stated objective of reducing the risks of greenwashing. Mention has been

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[28] Morningstar – SFDR Article 8 and Article 9 Funds: Q4 2022 in Review: "*About 420 products changed SFDR status since September last year, including 307 that downgraded to Article 8 from 9, representing EUR 175 billion in assets, or 40% of the Article 9 category. More reclassifications are expected as new prospectuses are processed*."

[29] Morningstar – SFDR Article 8 and Article 9 Funds: Q1 2023: "*Close to 300 products changed SFDR status since our January review, including more than 260 funds that upgraded to Article 8 from 6 and just about a dozen downgraded to Article 8 from 9*."

[30] See question 5 (FISMA / 2930) of the *"Answers to questions on the interpretation of Regulation (EU) 2019/2088, submitted by the European Supervisory Authorities on 9 September 2022."*

[31] European Commission, Directorate-general for financial stability, financial services and capital markets union – Targeted consultation document – Implementation of the sustainable finance disclosures regulation – Introduction: "*The main topics to be covered in this questionnaire are: 1. Current requirements of the SFDR, 2. Interaction with other sustainable finance legislation, 3. Potential changes to the disclosure requirements for financial market participants, 4. Potential establishment of a categorisation system for financial products."*

made both of providing specific qualification criteria for funds in Articles 8 and 9, and of eliminating these articles and replacing them with a different categorisation, based for example on the type of investment strategy in place. Thus creating confusion about the continued existence of Articles 8 and 9, this consultation could hinder the development of initiatives at least until the publication of its results; the consultation will come to an end this coming 15 December.

## 2.2. Green, sustainable or social bonds: soft law financial tools likely to facilitate the implementation of the SFDR

### A few figures

In the green finance landscape, three types of sustainable commitments stand out among the Corporate Social Responsibility (CSR) tools able to help simplify the work required by financial players to comply with their obligations under the SFDR: social bonds,[32] Sustainability-Linked Bonds, or SLBs,[33] and, lastly, green bonds.

Despite the 2022 bond market collapse, the likes of which it had not seen since 1994, bonds have always shown a variable but dependable resilience.

Indeed, according to the Banque de France, despite a minor episode of stagnation in early 2020 due to the COVID-19 crisis, growth in the green bond market has been constant ever since its first issue in Europe, made by the European Investment Bank in 2007. This growth has now intensified to such an extent that between 2020 and 2021 the total amount of green bonds doubled, coming to account for approximately 7% of the global bond market in 2022, as compared to 5% in the previous year.[34]

As for sustainability-linked bonds (SLB), they first appeared on the European market in 2019, immediately arousing strong interest among economic players, and accounted for a volume of 16.3

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[32] Their proceeds are only used to fund eligible social projects, such as the construction of infrastructure in developing countries, e.g., clean drinking water, sewerage, wastewater disposal, transportation, energy (source: *"Sustainable bonds"* - 13 Apr. 2021 - 08:21 | Volker Schmidt, Ethenea Independent Investors).

[33] Their proceeds can be used for general business purposes as well, but their issuer must undertake to achieve specific key performance indicators linked to environmental, social and governance criteria. (Source: Ibidem).

[34] Banque de France – Post no. 278, published 12 July 2022, entitled *"Obligations vertes: une croissance durable?"* [Green bonds: is their growth sustainable?]

billion euros on the bond market in the first quarter of 2022, compared to 4.8 billion[35] in 2021. It is reasonable to assume that this growth will likely continue, and that SLBs will come to represent an even greater volume in 2023.

Social bonds seem less popular on the other hand, with issues dropping by around 41% from 2021 to 2022, and ultimately accounting for a total value of around 130.2 billion USD.[36] Despite their dynamism at the peak of the Covid-19 pandemic, with a tenfold increase in issues from 2019 to 2020, followed by an additional 18% increase from 2020 to 2021, social bonds have now lost their lustre.[37] The surge seen between 2020 and 2021 can be attributed to the desire of governments and supranational organisations to provide support for social projects, particularly those related to health and employment, as a result of the health crisis. Europe[38] with France at the forefront, now largely dominates this market, due primarily to the issues of the Social Debt Amortisation Fund (CADES), which was described by its president in 2022 as "the leading global issuer of social bonds."

The 2022 collapse of the bond market impacted social bonds, which have shown less resilience than other forms of bonds. This collapse may be attributable to two simultaneous factors: on the one hand, restrictions in budgetary policies in various countries in the wake of the health crisis that sought to limit new emissions, and on the other, private actors giving priority to the “E” component of the “ESG” criteria, and thus favouring green bonds and SLBs.

## A definition of bonds

Sustainable bonds are ordinary bonds, i.e., securities representing a loan issued by a company, a local government body or a central government. In other words, the underwriter of the bond acts as a lender, providing money to a private or public entity in exchange for that security. Each bond is accompanied by a coupon corresponding to interest, and the bond loan must be repaid on the scheduled due date(s).

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[35] Source: Banque de France (https://blocnotesdeleco.banque-france.fr/billet-de-blog/les-sustainability-linked-bonds-un-outil-efficace-de-decarbonation).
[36] According to the 2022 *Climate Bonds Initiative* report entitled *"Sustainable Debt Global State of the Market 2022."*
[37] According to the 2021 and 2022 reports from the Climate Bonds Initiative, respectively entitled *"Sustainable Debt Global State of the Market 2021"* and *"Sustainable Debt Global State of the Market 2022."*
[38] Europe accounts for approximately 56% of the volume of social bond issues, according to the Climate Bonds Initiative.

They are referred to as:

- *"green"* if *"the proceeds will be exclusively applied to finance or re-finance in part or in full new and/or existing eligible green projects,"*[39] namely *"environmentally-friendly projects that promote a carbon neutral economy and protect the environment";*
- *"social"* if *"the proceeds will be exclusively applied to finance or re-finance in part, or in full, new and/or existing Social Projects"*;[40]
- *"linked to sustainable development"* if their *"financial and/or structural characteristics can vary depending on whether the issuer achieves predefined Sustainability/ESG performance objectives."*[41]

It is therefore up to the issuer of the bonds to determine sustainability criteria for the projects to be financed or the objectives to be pursued. But although these tools can help prepare financial actors for their reporting work by setting sustainability criteria in advance, it is up to the latter to verify that they are relevant, in order to avoid the risks of *greenwashing*[42] or *social washing.*[43]

## A reputational interest

When they were created, issues of green bonds were accompanied by a *"greenium"* [Green Premium] for the borrower. In other words, the interest rate associated with a green bond would be a few basis points lower than that of a non-green bond. The cost of financing for the borrower could therefore be slightly reduced, with investors accepting lower profitability in favour of a sustainable project. However, it appears that *"greeniums"* are now disappearing, reflecting trends in the primary bond market.

At the same time, the *Centro Studi Banca e Finanza* at UNIMORE University in Italy has observed that "social premiums" now do not exist for social bonds either. The return on a green or social bond would therefore be equivalent to that of a more traditional bond.

On the contrary, with regard to SLBs, the terms and conditions of the bonds, constituting a legally-

[39] Definition proposed by the *International Capital Market Association* (ICMA).
[40] "Sustainability-Linked Bond Principles: Voluntary Process Guidelines," June 2021 version, developed by the *International Capital Market Association* (ICMA).
[41] "Sustainability-Linked Bond Principles: Voluntary Process Guidelines," June 2020 version, developed by the *International Capital Market Association* (ICMA).
[42] Misleading or even deliberately deceptive use of environmental claims. The European Commission intends to create regulations to address greenwashing. So, on 30 March 2022, it presented a proposal for a directive of the European Parliament and of the Council amending Directives 2005/29/EC and 2011/83/EU to empower consumers to facilitate the green transition by providing better protection against unfair practices and access to better information.
[43] Also known as social laundering.

binding agreement between the issuer and the subscriber(s), may stipulate that the coupon linked to the subscribed bond (i.e. the interest rate):

- will increase (*step-up*) if the issuer fails to achieve one or more predefined ESG objective(s). This represents a punitive financial measure imposed on the issuer in case of any non-compliance with its commitments; and/or
- will decrease (*step-down*) if one or more predefined ESG objective(s) are reached or exceeded.

SLBs may alternatively or simultaneously include *step-up* and/or *step-down* mechanisms. It is specified that variation may occur in the rate periodically, at specified intervals, or at maturity, for example by requiring the issuer to pay an additional cost to investors if the initial objectives are not met.

In light of this, and aside from a few hypotheticals relating to SLBs, the interest in issuing and subscribing to sustainable bonds is above all a reputational one, particularly in a legal and regulatory context which requires increasing transparency from economic actors regarding the social, economic and ethical consequences of their operations, particularly as part of their non-financial reporting. There is no doubt that this ever more restrictive framework for non-financial relationships will increase the attractiveness among financial players of these green finance tools, which can help make their work easier, provided of course that issuers take matters transparency and determination of sustainability criteria seriously.

### A kind of soft law that requires special attention

To date, the regulation of sustainable bonds has been a matter of “soft law”, meaning that the regulations are not legally binding on stakeholders, but are recommended. In order to establish their credibility, issuers are strongly advised to comply with these regulations. Reciprocally, subscribers are strongly advised to exercise caution when considering investments linked to sustainable bonds, and to keep a close watch on compliance with this “soft law” framework, even if by itself it is insufficient.

For this purpose, the International Capital Market Association (ICMA), as a pioneer in the development of the “soft law” regarding sustainable bonds, has established a set of principles and criteria for the implementation of these issues in its "Bond Principles" publications.

The key word here is transparency, both in the use of funds and in the selection and evaluation of sustainability criteria.

It is incumbent upon investors to verify the criteria used by issuers. To do so, they need to draw parallels with criteria that are already subject to regulations. That's why the ICMA has proposed that the evaluation of "social projects" should be brought more into alignment with already existing legally-defined social standards and certification criteria.[44] For example, in January 2023, La Banque Postale, when undertaking an issue of social bonds, specified that its purpose was to *"help refinance affordable housing and more particularly government subsidised housing loans [PAS] respecting criteria such as those defined by the finance act of 2003."*[45]

Similarly, the European Union, having understood the growing importance of these instruments and the need to regulate sustainability criteria, now intends to address "green projects" and taxonomy together in a regulatory project.

## Towards a European green bonds regulation

In order to standardise the legal framework relating to green bonds while allowing comparability of bond issues with the aim of accelerating the energy transition, the European Council announced on February 28 that a provisional agreement had been reached in interinstitutional negotiations with the European Parliament on a draft regulation addressing green bond issuances, also known as the EUGB Regulation. This agreement will be submitted to the institutions for ratification[46] in fall 2023. According to a press release from the European Council,[47] this agreement is expected to enter into force 12 months after its approval. In order to ensure consistency between the texts, the EUGB Regulation provides for concordance between sustainable initiatives arising from green bond issues

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[44] "Sustainability-Linked Bond Principles: Voluntary Process Guidelines," June 2021 version, developed by the *International Capital Market Association* (ICMA).

[45] La Banque Postale - Press release of 25 January 2023, entitled *"La Banque Postale: Succès de l'émission inaugurale d'obligation sécurisée 'sociale'"* [La Banque Postale: Successful inaugural green covered bond issue]

[46] It should be noted that a draft regulation was submitted by the European Commission to the Parliament on 6 July 2021 seeking to enact "hard law" (as opposed to the "soft" law mentioned above) to regulate green bond issuances. This draft regulation was addressed in a report submitted by the European Parliament's Committee on Economic and Monetary Affairs on 20 May 2022. Interinstitutional negotiations between the Council and the European Parliament have been ongoing since then.

[47] https://www.consilium.europa.eu/fr/press/press-releases/2023/02/28/sustainable-finance-provisional-agreement-reached-on-european-green-bonds/

and European taxonomy.[48]

The draft EUGB Regulation in its version resulting from interinstitutional negotiations and published on May 10, 2023 provides for 2 distinct schemes: (i) the establishment of a *“European green bonds”* label, which would require actors wishing to use this designation to comply with the obligations established thereunder, first and foremost the requirement to use the funds resulting from the issuance of these bonds for activities respecting the criteria set forth in the European taxonomy, allowing a maximum margin of 15% that may be used for activities not perfectly compliant with the taxonomy, and (ii) a less restrictive, optional scheme to which market players can voluntarily submit, allowing them to issue what would be referred to as *"environmentally-sustainable"* bonds.[49]

The labelling scheme, which is stricter, would impose transparency obligations on issuers both before issuance, in particular through the prospectus, in compliance with the Prospectus Regulation[50] and subsequently through the publication of annual allocation reports until the funds raised are fully used, and at least 1 impact report after allocation of the entire yield. The first allocation report occurring after the funds raised have been fully used must be verified by an external examiner approved by the European Securities and Markets Authority (ESMA).

This framework would allow financial players, as part of their reporting under the SFDR, (i) to more easily evidence the sustainable nature of their investments by subscribing such transferable securities and (ii) to describe their sustainability criteria by reference to an established regulation, namely the taxonomy. To do so they would find the initially desired comparison objective in the context of the SFDR. Nevertheless, in order for financial players to be able to take advantage of this new tool to facilitate their duties, economic players, acting as issuers, must accept the corresponding constraints.

[48] Taxonomy refers to the *"classification of environmentally sustainable economic activities,"* per paragraph 16 of the preamble to Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.
[49] This optional scheme would therefore apply both for green bonds and SLBs.
[50] Subject to the control of national authorities, namely for example the Financial Markets Authority for France, which would therefore have sanction authority in the event of breaches.

# Presentation of partners

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