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Chapter 14

THE EUROPEAN UNION'S 2014 NON-FINANCIAL REPORTING DIRECTIVE: MANDATORY EX POST DISCLOSURE – BUT DOES IT NEED IMPROVEMENT?

W. Gregory Voss

Introduction

In 2011 the European Union (“EU”) advanced a new definition of Corporate Social Responsibility (“CSR”): “the responsibility of enterprises for their impacts on society.”¹ This was deemed a “radical 2011 revision” of that which had preceded it. What was radical was the dropping of the reference to “voluntary” action² from the CSR definition and the European Commission’s (“Commission”) communication also referred to a then-future proposal for required non-financial reporting (“NFR”) on CSR,³ which would make the EU “an early mover in introducing mandatory” NFR.⁴ This eventually led to the adoption of Directive 2014/95/EU (NFR Directive),⁵ which amended Directive 2013/34/EU (Accounting Directive)⁶ insofar as NFR and diversity

¹ European Commission, *A renewed EU strategy 2011-14 for Corporate Social Responsibility* (Brussels: European Commission, 2011) at 6.

² A previous Commission definition of CSR was “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their shareholders *on a voluntary basis*” [emphasis added]. Commission of the European Communities, *Promoting a European framework for Corporate Social Responsibility* (Brussels: Commission of the European Communities, 2001) at 6.

³ Karin Buhmann, “Neglecting the Proactive Aspect of Human Rights Due Diligence? A Critical Appraisal of the EU’s Non-Financial Reporting Directive as a Pillar One Avenue for Promoting Pillar Two Action” (2018) 3 B.H.R.J. 35.

⁴ *Ibid.*, at 41.

⁵ EU, *European Parliament and Council Directive 2014/95/EU of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups*, [2014] OJ, L 330/1 (hereinafter, “NFR Directive”).

⁶ EU, *European Parliament and Council Directive 2013/34/EU 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*

information were concerned and constituted a “major step” in corporate report presentation within the EU.⁷ While not specifically directed to the extractive industries, these actions obviously impact them. To take the example of mining — one extractive industry — it creates “significant economic, environmental and social footprints” and faces “pressure to practice and communicate sustainability”.⁸ Companies involved in the extractive industries may be “caught in the middle” as they seek to avoid blame for what is described as the “resource curse” where development of the mineral sector leaves most resource-rich country citizens worse off — or at least no better off — despite the wealth created through the extraction of resources, due to State failures, and to lessen their impact. CSR is seen as encompassing a variety of means by which companies may try to respond to the various demands being placed upon them.⁹ Under the NFR Directive, the requirement for companies to which such legislation applies to engage in NFR, taking voluntary communication to the level of mandatory reporting, includes provisions on environmental and social matters. Thus, mining and other extractive companies that fall within the scope of the NFR Directive will be required to engage in CSR activities through the communication about such matters in their NFR.

The NFR Directive followed a development over time of non-financial auditing and reporting, with environmental audit practices (along with various other forms of audits in the United Kingdom) arising in the late 1980s and early 1990s.¹⁰ Environmental audits were incorporated into the due diligence process, initially in the context of transactions. Later the approach was adapted “to develop a management based style of self-assessment, emphasizing systems and self-informing”.¹¹ After the Exxon Valdez oil spill there was a call by pension funds and public bodies for self-evaluation, independent environmental auditing and public disclosure of results.¹² The International Chamber of Commerce defined environmental auditing as a “management tool” in

Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, [2013] OJ, L 182/19 (hereinafter, “*Accounting Directive*”).

⁷ Laura Sierra Garcia, Maria Antonia Garcia-Benau & Helena Maria Bolas-Araya, “Empirical Analysis of Non-Financial Reporting by Spanish Companies” (2018) 8:3 *Adm. Sci.* 2 - 17.

⁸ Anders Nilsson, Johan Sandström & Thomas Lind, *Sustainability communication in the mining industry* (Luleå: Luleå University of Technology, 2013) at 5.

⁹ Matthew Genasci & Sarah Pray, “Extracting Accountability: The Implications of the Resource Curse for CSR Theory and Practice” (2008) 11 *Yale Human Rts. & Dev. L.J.* 37-38.

¹⁰ Michael Power, *The Audit Society: Rituals of Verification* (Oxford: Oxford University Press, 1997) at 3.

¹¹ *Ibid.*, at 60.

¹² *Ibid.*, at 61.

the early 1990s.¹³ Furthermore, audits reflect accountability to stakeholders, serving, for example, the goal of shareholder control.¹⁴ The concept of social auditing arose even earlier — in the 1950s—with France bringing the concept of social auditing into its law in the 1970s.¹⁵

Since the 1990s, with the developing recognition that businesses may have both positive and negative impacts on human rights, a push for greater corporate responsibility and/or accountability for negative impacts on human rights — such as badly treating workers with respect to working conditions and pay, polluting the environment, discriminating against certain groups or classes of people — occurred, primarily leading to the development of *soft law* measures.¹⁶ Such movement can be seen as making the link between corporate action (and inaction) and social justice, and is reflected in the development of a field that may now be described as “business and human rights”. However, with respect to firms, human rights responsibility relates to social expectations which are enforced in the “*courts of public opinion*” with due diligence being an important tool allowing for the discharge of such responsibility.¹⁷

The “triple bottom line” reporting so-named by John Elkington in 1994, “a sustainability framework that examines a company’s social, environment, and economic impact”,¹⁸ forced extractive industries to internalize social and environmental costs of their operations, to try to reduce them, and to take into account the importance of contributing to a just society.¹⁹ This and the socially responsible investment trend, led to “one hundred percent of mining companies and sixty-three percent of oil and gas companies among the *Fortune* global top 250 companies”²⁰ issuing social, environmental or sustainability reports by 2002. However, voluntary NFR would, in the years to follow, lead to mandatory NFR.

¹³ *Ibid.*, at 62.

¹⁴ *Ibid.*, at 127.

¹⁵ Martine Combemale & Jacques Igalens, *L’Audit social*, 2d ed. (Paris: Presses Universitaires de France, 2012) at 3.

¹⁶ Justine Nolan, “All Care, No Responsibility?: Why Corporations Have Limited Responsibility and No Direct Accountability for Human Rights Violations under International Law” in Lara Blecher, Nancy Kaymar Stafford & Gretchen C. Bellamy, eds., *Corporate Responsibility for Human Rights Impacts: New Expectations and Paradigms* (Chicago: American Bar Association, 2014) at 3-4.

¹⁷ *Ibid.*, at 13.

¹⁸ John Elkington, “25 Years Ago I Coined the Phrase ‘Triple Bottom Line.’ Here’s Why It’s Time to Rethink It.” (2018) Harv. Bus Rev. See online: <https://hbr.org/2018/06/25-years-ago-i-coined-the-phrase-triple-bottom-line-heres-why-im-giving-up-on-it>.

¹⁹ Lisa J. Laplante & Suzanne A. Spears, “Out of the Conflict Zone: The Case for Community Consent Processes in the Extractive Sector” (2008) 11 Yale Human Rts. & Dev. L.J. 69-85.

²⁰ *Ibid.*, at 85.

As a legal instrument, the NFR Directive drew its origins both from an earlier EU legal instrument and from international work on CSR, notably including the United Nations Guiding Principles, among other sources, and may be seen as a progression “from private, voluntary schemes to public and mandatory systems” with experiences from the former probably having influenced the drafters of the latter.²¹ While this trend is not unique to the European Union (the Asia Pacific region and Latin America have also been cited), the NFR Directive has been described as one of the most significant developments in this area.²² Indeed, the NFR Directive has been described as an example of the reflection in law and regulation of the United Nations Guiding Principles.²³ Furthermore, the new wording of the EU definition of CSR is seen to be “conceptually more in line with that presented in the Guiding Principles”.²⁴ These precursors are taken in order below.

First, Directive 2003/51/EC (Fourth Directive on Annual Accounts)²⁵ introduced the concept of non-financial disclosure requirements for annual reports into EU-level legislation on accounts. It provided that (in connection with the contents of the annual report): “To the extent necessary for an understanding of the company’s development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters.”²⁶ This language was carried virtually unchanged through to the Accounting Directive, which repealed Directive 78/660/EEC, the sole exception being the replacement of the word “company” by “undertaking”, and this in connection with the contents of the

²¹ Gerlinde Berger-Walliser & Paul Shrivastava, “Beyond Compliance: Sustainable Development, Business, and Proactive Law” (2015) 46 *Geo. J. Int’l L.* 467-468.

²² Constance Z. Wagner, “Evolving Norms of Corporate Social Responsibility: Lessons Learned from the European Union Directive on Non-Financial Reporting” (2018) 19 *Transactions: Tenn. J. Bus. L.* 619 at 640.

²³ John Gerard Ruggie & John F. Sherman, III, “Adding Human Rights Punch to the New *Lex Mercatoria*: The Impact of the UN Guiding Principles on Business and Human Rights on Commercial Legal Practice” (2015) 6:3 *J.I.D.S.* 457.

²⁴ Erika R. George, “Influencing the Impact of Business on Human Rights: Corporate Social Responsibility through Transparency and Reporting” in Lara Blecher, Nancy Kaymar-Stafford & Gretchen Bellamy, eds., *Corporate Responsibility for Human Rights Impacts: New Expectations and Paradigms* (Chicago: American Bar Association, 2014) at 284.

²⁵ EEC, *European Parliament and Council Directive 2003/51/EC of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings*, [2003] OJ, L 178/16.

²⁶ *Ibid.*, art. 1(14)(a), amending Directive 78/660/EEC to provide a new Paragraph 1(b).

management report.²⁷ However, one view is that because of the conditional nature of such language, “the 2003 EU Directive cannot be viewed as containing a mandate for non-financial reporting”.²⁸

In passing, it should be noted that extractive industry reporting is also covered by another EU directive, which is not the subject of this chapter. Directive 2013/50/EU amended Directive 2004/109/EC (Transparency Directive) to “require issuers active in the extractive or logging of primary forest industries” to report annually on payments to governments (Article 1(5), Directive 2013/50/EU).²⁹ In a provision that is of interest to extractive industries, the Accounting Directive calls for a Commission review and report on its payments to governments chapter by July 21, 2018, including an analysis on “the feasibility of the introduction of an obligation for all [European] Union issuers to carry out due diligence when sourcing minerals to ensure that supply chains have no connection to conflict parties and respect the EITI and OECD recommendations on responsible supply chain management”.³⁰ Such report has not yet been issued. Moreover, the NFR Directive adds that such report should take into account the following:

developments in the OECD and the results of related European initiatives, the possibility of introducing an obligation requiring large undertakings to produce on an annual basis a country-by-country report for each Member State and third country in which they operate, containing information on, as a minimum, profits made, taxes paid on profits and public subsidies received.³¹

These potential changes would extend significantly the scope of NFR.

Moreover, while not fully-covering the concerns expressed in the Accounting Directive, it should be pointed out that certain conflict minerals are subject to a relatively-new Regulation (EU) 2017/821, which establishes “a Union system for supply chain due diligence

²⁷ EU, *Accounting Directive*, art. 19(1), [2013] OJ, L 182/19, at 38.

²⁸ Constance Z. Wagner, “Evolving Norms of Corporate Social Responsibility: Lessons Learned from the European Union Directive on Non-Financial Reporting” (2018) 19 *Transactions: Tenn. J. Bus. L.* 619 at 660.

²⁹ EU, *European Parliament and Council Directive 2013/50/EU of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC*, [2013] OJ, L 294/13.

³⁰ EU, *Accounting Directive*, art. 48, [2013] OJ, L 182/19 at 54.

³¹ EU, *NFR Directive*, art. 1(6), [2014] OJ, L 330/1 at 8.

(‘Union system’) in order to curtail opportunities for armed groups and security forces to trade in tin, tantalum and tungsten, their ores, and gold”, and is designed “to provide transparency and certainty as regards the supply practices of Union importers, and of smelters and refiners sourcing from conflict-affected and high-risk areas”.³² One of the recitals to such Regulation set out a goal of the legislation and action of the EU:

This Regulation, by controlling trade in minerals from conflict areas, is one of the ways of eliminating the financing of armed groups. The Union’s foreign and development policy action also contributes to fighting local corruption, to the strengthening of borders and to providing training for local populations and their representatives in order to help them highlight abuses.³³

However, a full discussion of Regulation (EU) 2017/821 is beyond the scope of this chapter.

Second, the United Nations Guiding Principles are divided into three “pillars”: (1) the State duty to protect human rights; (2) the corporate responsibility to respect human rights; and (3) access to remedy.³⁴ By adopting the NFR Directive, the EU was acting on the first of these: the State’s duty to protect. This was also done to force companies to act under the second pillar, in carrying out the required NFR, in the hopes that the necessary human rights due diligence (“HRDD”) would be carried out by the companies and that they would otherwise internalize its results, for the sake of learning and improvements.

Principle 3(d) calls upon States to “[e]ncourage, and where appropriate require, business enterprises to communicate how they address their human rights impacts.”³⁵ Principle 17 provides that “business enterprises should carry out” HRDD and should communicate how they address impacts.³⁶ Both of these principles may be seen as leading to the NFR Directive, although they may not be fully developed in it.

³² EU, *European Parliament and Council Regulation 2017/821/EU of 17 May 2017 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas*, [2017] OJ, L 131/1, art. 1(1) at 5.

³³ *Ibid.*, recital (7) at 2.

³⁴ United Nations Human Rights Council, *Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework* (New York and Geneva: United Nations, 2011).

³⁵ *Ibid.*, at 4.

³⁶ *Ibid.*, at 17.

1. THE NFR DIRECTIVE

In 2011, the Commission identified the need for sustainable, smart and inclusive growth for the EU. Reforms of its Action Plan were to contribute to sustainable development, social progress and employment, and environmental improvement, among other goals.³⁷ Later that same year, the Commission underscored the EU's treaty objectives of sustainable development and a "highly competitive social market economy"³⁸ and CSR was seen as a tool to help attain these goals. In this context, the then-future NFR Directive was meant, along with other measures, to "create an environment more conducive to enterprises voluntarily meeting their social responsibility".³⁹ The Commission specifically set out, as an element of its agenda for action in 2011-2014, improving disclosure of social and environmental information, including climate-related information, as a way to engage with stakeholders and to identify "material sustainability risks", while also being important for accountability and public-trust building for companies. Furthermore, an aim of creating a "level playing field" in the furnishing of social and environmental information was expressed, not just for extractive industries, but for all sectors.⁴⁰

1.1. The NFR Directive Proposal and Negotiations

When proposed by the Commission, the key objectives of what was to become the NFR Directive were:

- (1) To increase the transparency of certain companies, and to increase the relevance, consistency, and comparability of the non-financial information currently disclosed, by strengthening and clarifying the existing requirements.

³⁷ European Commission, *Single Market Act: Twelve levers to boost growth and strengthen confidence, 'Working together to create new growth'* (Brussels: European Commission, 2011) at 5.

³⁸ Article 3(3) of the Treaty on European Union (TEU) provides, in part: "The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment". EU, *Consolidated Version of the Treaty on European Union*, art. 3(3), [2012] OJ, C 326/13 at 17 (hereinafter, "TEU"). Furthermore, environmental protection and sustainable development goals are mentioned in the Preamble to the TEU, (*ibid.*, at 15), and in art. 11 of the Treaty on the Functioning of the European Union (TFEU). EU, *Consolidated Version of the Treaty on the Functioning of the European Union*, art. 11, [2012] OJ, C 326/47 at 53 (hereinafter, "TFEU").

³⁹ European Commission, *A renewed EU strategy 2011-14 for Corporate Social Responsibility* (Brussels: European Commission, 2011) at 3.

⁴⁰ *Ibid.*, at 11-12.

(2) To increase diversity in the boards of companies through enhanced transparency in order to facilitate an effective oversight of the management and robust governance of the company.

(3) To increase the company's accountability and performance, and the efficiency of the Single Market.⁴¹

The battle to adopt the NFR Directive was a difficult one. The political situation was such that the member States took divergent positions on the Commission's proposal for the NFR Directive. Belgium, Denmark, France, The Netherlands and the United Kingdom were categorized as "supportive, at least in principle", while Germany was seen as "strongly opposed", and others showed indifference or were not sad to see the draft diluted during negotiations. France was seen as "the strongest supporter", while the United Kingdom offered amendments and "Germany was by far the most outspoken and hardline opponent."⁴²

Through the negotiations, SMEs and certain larger companies were removed from the scope of the NFR reporting requirements, effectively reducing the scope of the directive from 18,000 companies to 6,000.⁴³ This is reflected in the text of the NFR Directive: "Large undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year shall include in the management report a non-financial statement"⁴⁴ The term "public-interest entities", means (without going into the detail) publicly-traded companies governed by member State law, credit institutions, insurance undertakings, and those entities defined by member States as "public-interest entities".⁴⁵ Furthermore, companies were allowed to use existing national or international CSR frameworks for reporting to meet their obligations under the NFR Directive, under certain conditions, and allowed significant room for manoeuvre, containing extensive "comply or explain" provisions.⁴⁶

⁴¹ European Commission, *Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of non-financial and diversity information by certain large companies and groups* (Strasbourg: European Commission, 2013) at 3.

⁴² Daniel P. Kinderman, "The Struggle over the EU Non-Financial Disclosure Directive" (2015) SSRN (translation of Kinderman, Daniel P. "Corporate Social Responsibility – Der Kampf um die EU-Richtlinie" (2015) 2015 8 WSI-Mitteilungen 613) at 2.

⁴³ *Ibid.*

⁴⁴ EU, *NFR Directive*, art. 1(1), [2014] OJ, L 330/, at 4.

⁴⁵ EU, *Accounting Directive*, art. 2(1), [2013] OJ, L 182/19 at 26.

⁴⁶ Daniel P. Kinderman, "The Struggle over the EU Non-Financial Disclosure Directive" (2015) SSRN (translation of Kinderman, Daniel P. "Corporate Social Responsibility – Der Kampf um die EU-Richtlinie" (2015) 2015 8 WSI-Mitteilungen 613) at 4.

1.2. The NFR Directive as Adopted

The NFR Directive adds various reporting requirements to the Accounting Directive, that are taken up below: (1) environmental, social and employment reporting; and (2) diversity reporting.

1.2.1. *Environmental, Social and Employment Reporting*

Those companies that fit within the scope of the NFR Directive are required to make a non-financial statement in their annual management report. This report, which is covered by a new Article 19a of the Accounting Directive, is to contain non-financial information, insofar as it is necessary in order to understand the undertaking's "development, performance, position and impact of its activity", and containing at a minimum information relating to "environmental, social and employee matters".

This must include a description of the company's business model, company policies regarding these matters and their outcome, indicating the due diligence processes that the company has implemented, principal risks related to these matters (including, "where relevant and proportionate", business relationships, products or services likely to negatively affect those areas) and the way that they manage those risks, and non-financial key performance indicators related to their business. If the company has not adopted policies about these matters there is the requirement of a "clear and reasoned explanation".⁴⁷

The NFR Directive then allows room for manoeuvre; member States may allow certain information to be omitted from management reports:

Member States may allow information relating to impending developments or matters in the course of negotiation to be omitted in exceptional cases where, in the duly justified opinion of the members of the administrative, management and supervisory bodies, acting within the competences assigned to them by national law and having collective responsibility for that opinion, the disclosure of such information would be seriously prejudicial to the commercial position of the undertaking, provided that such omission does not prevent a fair and balanced understanding of the undertaking's development, performance, position and impact of its activity.⁴⁸

Furthermore, paragraph 4 of the new Article 19a of the Accounting Directive provides that where companies prepare a separate report for the same financial year covering the same information, whether or not based on "national, [European] Union-based or international frameworks", member States may exempt the relevant companies from the NFR statement obligation, provided that the separate report is published with

⁴⁷ EU, *NFR Directive*, art. 1(1), [2014] OJ, L 330/1 at 4-5.

⁴⁸ *Ibid.*, at 5.

the management report or is made publicly available no later than six months after the balance sheet date on the company website with mention of this in the management report.⁴⁹ Pursuant to Article 19a(5) of the Accounting Directive, the statutory auditor or audit firm merely checks whether the relevant NFR statement or separate report has been provided,⁵⁰ however, a member State may require that the information “be verified by an independent assurance services provider” in accordance with Article 19a(6) of the Accounting Directive.⁵¹

In a new Article 29a of the Accounting Directive, the same environmental, social and employment reporting requirements apply with respect to a consolidated non-financial statement in the consolidated management report, *mutatis mutandis*.⁵²

In addition to the documents for which they already had responsibility, the members of the administrative, management and supervisory bodies of an undertaking will also have collective responsibility, under amended paragraph 1 to Article 33 of the Accounting Directive, for any separate report used to satisfy the NFR reporting requirements for the management report, as well as for any separate report used to satisfy the NFR reporting requirements for the consolidated management reports.⁵³ Nonetheless, there is neither an audit of the NFR statement nor of the separate report by either statutory auditors or audit firms.⁵⁴

1.2.2. Diversity Reporting

The NFR Directive also amends the management report corporate governance statement provision of the Accounting Directive to add a new subparagraph (g) to Article 20. That addition requires a diversity policy description for publicly-traded companies governed by member State law. The requirement is couched in the following terms:

(g) a description of the diversity policy applied in relation to the undertaking’s administrative, management and supervisory bodies with regard to aspects such as, for instance, age, gender, or educational and professional backgrounds, the objectives of that diversity policy, how it has been implemented and the results in the reporting period. If no such policy is applied, the statement shall contain an explanation as to why this is the case.⁵⁵

⁴⁹ *Ibid.*

⁵⁰ *Ibid.*

⁵¹ *Ibid.*

⁵² *Ibid.*, art. 1(3), at 6-7.

⁵³ *Ibid.*, art. 1(4) at 7.

⁵⁴ *Ibid.*, art. 1(5) at 7.

⁵⁵ *Ibid.*, art. 1(2)(a) at 5.

The above description shall also be subject to the opinion of the statutory auditor or audit firm, who shall check that the information required has been provided.⁵⁶ Member States may issue exemptions to this requirement for companies that “have only issued securities other than shares admitted to trading on a regulated market ...”, unless they “have issued shares which are traded on a multilateral trading facility ...”,⁵⁷ and SMEs are expressly excluded from the disclosure requirement of Article 20(g) of the Accounting Directive.⁵⁸

1.3. Commission Guidelines

In 2017 the Commission issued non-binding guidelines on methodology for NFR. Key provisions include, first, the assessment of the materiality of information, with an emphasis on disclosing matters that have an impact on the company's activity.⁵⁹ Second, information provided should be “fair, balanced and understandable”.⁶⁰ Third, the NFR statement should be “comprehensive, but concise”,⁶¹ and fourth, within the scope of the disclosure requirements, “strategic and forward-looking” information should be included.⁶² Furthermore, the information provided should be shareholder-orientated, in the broad sense of the term.⁶³ Finally, the information should be “consistent and coherent”, both in the sense of consistency with the management report, consistency over time, and in the choice and methodology of key performance indicators (“KPIs”).⁶⁴ In addition, in June 2019, the Commission is expected to publish updated guidelines, meant to provide additional guidance on disclosure of climate-related information.⁶⁵

2. NFR AS PART OF A PROCESS THAT IS INTERNATIONAL

Consistent with CSR theory, the NFR Directive is meant to be part of a virtuous process to improve company CSR compliance and help in

⁵⁶ *Ibid.*, art. 1(2)(b) at 6.

⁵⁷ *Ibid.*, art. 1(2)(c) at 6.

⁵⁸ *Ibid.*, art. 1(2)(d) at 6.

⁵⁹ European Commission, *Guidelines on non-financial reporting (methodology for reporting non-financial information)* (Brussels: European Commission, 2017) at 5.

⁶⁰ *Ibid.*, at 7.

⁶¹ *Ibid.*, at 7-8.

⁶² *Ibid.*, at 8.

⁶³ *Ibid.*, at 9.

⁶⁴ *Ibid.*

⁶⁵ Technical Expert Group on Sustainable Finance, *Report on Climate-related Disclosures* (Brussels: European Union, 2019) at 3.

“managing change towards a sustainable global economy by combining long-term profitability with social justice and environmental protection”, while aiding in the “measuring, monitoring and managing of undertakings’ performance and their impact on society”.⁶⁶ This process is intended to be international, both in the frameworks used and in the potential extent of reporting.

2.1. NFR as Part of a Process

In commentary to Principle 3, the Special Representative of the UN Secretary-General called for a “smart mix of measures — national and international, mandatory and voluntary — to foster business respect for human rights”.⁶⁷ These measures, which include enforcing laws, periodically assessing their adequacy and addressing any gaps in them, providing guidance to businesses on respecting human rights, and encourage business enterprises to communicate about the measures they take to address human rights impacts,⁶⁸ may be seen as part of a process. Companies are called upon to carry out HRDD, a process that includes “assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed”.⁶⁹ It also involves consultation with “potentially affected groups and other relevant stakeholders”,⁷⁰ and integrating the result of the assessment of human rights impacts into their internal functions and processes.⁷¹ As part of this process, businesses should communicate about the ways they address human rights impacts:

In order to account for how they address their human rights impacts, business enterprises should be prepared to communicate this externally, particularly when concerns are raised by or on behalf of affected stakeholders. Business enterprises whose operations or operating contexts pose risks of severe human rights impacts should report formally on how they address them.⁷²

The NFR Directive requires formal reporting, without the requirement that there be risks of severe human rights impacts, introducing “mandatory communication, including on [due diligence]

⁶⁶ EU, *NFR Directive*, recital 3 [2014] OJ, L 330/ at 1.

⁶⁷ United Nations Office of the High Commissioner for Human Rights, *Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework* (New York and Geneva: United Nations, 2011) at 5.

⁶⁸ *Ibid.*, Principles 3, 4.

⁶⁹ *Ibid.*, Principle 17.

⁷⁰ *Ibid.*, Principles 18, 19.

⁷¹ *Ibid.*, Principles 19-21.

⁷² *Ibid.*, Principles 21, 23.

processes by the company and its supply chain”.⁷³ In this light, it may be seen as part of the CSR process. Professor Buhmann sees the United Nations Guiding Principles’ second pillar, which she abbreviates as CR2R (Corporate Responsibility to Respect), as containing both a compliance element and a social expectation element, with the boundary line between the two being dynamic. The reflexive law view, cited by her, assumes that “the firm’s understanding of the implications of its societal impact in economic terms rather than as a legal compliance issue is a condition for organizational change.”⁷⁴ That organizational change would involve using the process to change the organization in order to avoid human rights impacts. HRDD, which is also a process, should be engaged in by firms subject to the EU NFR requirements, and may serve risk management purposes in that it helps reduce risk related to reputational harm or “economic sanctions by stakeholders”.⁷⁵ Reporting should not be “an end in itself” but should be used, together with other practices in order to reduce harmful human rights impacts and to establish accountability, in conformity with the United Nations Guiding Principles.⁷⁶ Learning about social expectations and adopting practices in coherence with them may be seen as a potential (and desired) positive result of the process enabled by reporting.⁷⁷

Professors Park and Berger-Walliser theorize what they call Corporate-Regulatory Feedback Loops (“CRFLs”) to describe processes that may be employed to achieve CSR goals. The CRFL principles involved several steps: Step 1 – Monitoring; Step 2 – Communication; Step 3 – Assessment; Step 4 – Feedback; and Step 5 – Learning.⁷⁸ According to them, CRFLs are started by monitoring environmental impacts;⁷⁹ when such an impact has been identified it should be communicated to regulators and stakeholders.⁸⁰ Based on what is communicated, there can be coordination between the company and government entities to assess benefits and costs to the impact.⁸¹ Then, there is feedback, which may involve “rulemaking, standard setting, and

⁷³ Karin Buhmann, “Neglecting the Proactive Aspect of Human Rights Due Diligence? A Critical Appraisal of the EU’s Non-Financial Reporting Directive as a Pillar One Avenue for Promoting Pillar Two Action” (2018) 3 B.H.R.J. 25.

⁷⁴ *Ibid.*, at 31 (citations omitted).

⁷⁵ *Ibid.*, at 32.

⁷⁶ *Ibid.*, at 35.

⁷⁷ *Ibid.*, at 37.

⁷⁸ Stephen K. Park & Gerlinde Berger-Walliser, “A Firm-Driven Approach to Global Governance and Sustainability” (2015) 52 Am. Bus. L.J. 294-309.

⁷⁹ *Ibid.*, at 294.

⁸⁰ *Ibid.*, at 298.

⁸¹ *Ibid.*, at 302.

the dissemination of best practices” among other practices.⁸² Finally, there is the important step of learning that involves a behavioural change in response to feedback. This may include “changing how they participate in sustainability rulemaking”.⁸³ The NFR Directive is seen as furthering the communication step of CRFLs (Step 2).⁸⁴ Thus, although it is only part of the CSR process, NFR is important in enabling the other steps, and the NFR Directive is also an important part of the international process.

2.2. NFR as Part of an International Process

The NFR Directive is meant to complement measures at the international level to improve financial reporting transparency, such as those of the OECD, the G20 and the G8 (Recital 20, Id.).⁸⁵ When the NFR Directive was first proposed, a focus on internationally recognized CSR principles and guidelines, including the United Nations Guiding Principles, the UN Global Compact, ILO Tri-partite Declaration of Principles Concerning Multinational Enterprises and Social Policy and the OECD Guidelines, was prescribed.⁸⁶ This international focus was furthered by the acceptance of separate reports, included those furnished under international and other frameworks, in lieu of the NFR statement in the management report or consolidated management report. This is in contrast to the rules that preceded the NFR Directive and allows the use of existing frameworks such as the UN Global Compact, ISO 26000, and the Global Reporting Initiative (“GRI”).⁸⁷ Furthermore, the NFR Directive posits that “disclosure of non-financial information is vital for managing change towards a sustainable global economy”,⁸⁸ and as such it should allow for disclosure regarding operations of European companies in host countries around the world, even where such hosts do not require any NFR themselves. Moreover, the NFR Directive reporting requirements “could extend to qualifying European subsidiaries of foreign-based companies, and thus potentially require them to provide more substantive ESG [environmental, social and governance] disclosures than they currently are obliged to disclose in their home jurisdictions”.⁸⁹

⁸² *Ibid.*, at 305.

⁸³ *Ibid.*, at 307.

⁸⁴ *Ibid.*, at 300-301.

⁸⁵ EU, *NFR Directive*, recital 20 [2014] OJ, L 330/1 at 4.

⁸⁶ European Commission, *A Renewed EU Strategy 2011-14 for Corporate Social Responsibility* (Brussels: European Commission, 2011) at 13-14.

⁸⁷ Stephen Kim Park & Gerlinde Berger-Walliser, “A Firm-Driven Approach to Global Governance and Sustainability” (2015) 52 *Am. Bus. L.J.* 300-301.

⁸⁸ EU, *NFR Directive*, recital 3, [2014] OJ, L 330/1 at 1.

⁸⁹ Natalie Nowiski, “Rising Above the Storm: Climate Risk Disclosure and Its Current and Future Relevance to the Energy Sector” (2018) 39 *Energy L.J.* 1 at 23.

3. MEMBER STATE LEGISLATION

The NFR Directive, as a directive, is subject to implementation into member State national law. However, the member State authorities decide on the “form and methods” for implementation of directives,⁹⁰ thus there may be divergence in the scope of such legislation. A study by CSR and GRI groups together data from the implementation of the NFR Directive by the various EU member States confirms such divergence,⁹¹ which is allowed by the text of the NFR Directive itself.

The latter contains specific references to member State discretion with respect to various elements of the legislation. For example, they may allow certain information on “impending developments” being negotiated to be omitted in certain circumstances, where: “the disclosure of such information would be seriously prejudicial to the commercial position of the undertaking, provided that such omission does not prevent a fair and balanced understanding of the undertaking’s development, performance, position and impact of its activity.”⁹² In this case, it is for the company to decide, within the framework of applicable member State law, where such risk of prejudice exists.

Member States also have the discretion to require (or not) that information in the NFR statement or separate report be verified by an independent assurance services provider.⁹³ In addition, member States may exempt certain companies that only issue non-trading shares from some of the content requirements of the NFR Directive, such as from the requirement to detail due diligence policies implemented.⁹⁴

One study on Spain’s implementation of the NFR Directive, described as not going beyond the scope of the EU document,⁹⁵ indicates the effect of such instrument on major firms in that country. The number of companies publishing non-financial information in separate reports dropped after implementation, and regulatory compliance varied based on the sector involved with the oil and gas sector presenting more information as to gas emission and pollution, than the researchers expected. Also, companies that published a sustainability report in

⁹⁰ EU, TFEU, art. 288, [2012] OJ, C 326/13 at 171-72.

⁹¹ CSR Europe & GRI, *Member State Implementation of Directive 2014/95/EU* (Amsterdam and Brussels: GRI and CSR Europe, 2017).

⁹² EU, *NFR Directive*, art. 1(1), [2014] OJ, L 330/1 at 5.

⁹³ *Ibid.*

⁹⁴ *Ibid.*, art. 1(2)(c) at 6.

⁹⁵ Laura Sierra-Garcia, Maria Antonia Garcia-Benau & Helena Maria Bolas-Araya, “Empirical Analysis of Non-Financial Reporting by Spanish Companies” (2018) 8:3 *Adm. Sci.* 5-17.

addition to the required disclosure showed higher rates of disclosure than those not publishing such report.⁹⁶

CSR Europe and GRI's analysis of the implementation of the NFR Directive evidence several cases where the elements of the latter's requirements have been omitted: three cases regarding non-compliance penalties (Estonia, The Netherlands and Spain); and five cases regarding the safe harbour principle (Denmark, Estonia, France, Norway and Slovakia). Furthermore, there are many cases where the other requirements of the NSF Directive have been adapted by member State law.⁹⁷ Some involve an expanded scope of the disclosure: for example, in Greece a circular requires more limited disclosure by firms of more than 10 employees with either net turnover over €700,000 or a balance sheet total over €350,000.⁹⁸ Among the European Economic Area ("EEA") countries, Iceland's law covers companies with more than 250 employees.⁹⁹

Professor Constance Wagner studies two EU member States that had pre-existing laws at the time of adoption of the NFR Directive, which then needed to be amended: those of Denmark and France. She sees similarities in the two, such as both of them "maintaining a strong role for business decision-making".¹⁰⁰ The French law was amended to cover many (but not all) of the reporting requirements of the NFR Directive, and further amendments were pending at the time when she wrote her article. According to Wagner, "some disclosure categories must be added in the areas of human rights and anti-corruption and anti-bribery. In addition, national enforcement mechanisms must be put in place".¹⁰¹ However, earlier France passed a law that requires certain large companies to do the following, going beyond the NFR Directive requirements:

adopt strong due diligence measures sufficient to identify risks and to prevent violations of human rights and fundamental freedoms, health and safety, and damages to the environment that could result from the activities of each covered company, its subsidiaries, and companies it controls, as well as suppliers and subcontractors with which it has established commercial relationships.¹⁰²

⁹⁶ *Ibid.*, at 14-17.

⁹⁷ CSR Europe & GRI, *Member State Implementation of Directive 2014/95/EU* (Amsterdam and Brussels: GRI and CSR Europe, 2017) at 10.

⁹⁸ *Ibid.*, at 22.

⁹⁹ *Ibid.*

¹⁰⁰ Constance Z. Wagner, "Evolving Norms of Corporate Social Responsibility: Lessons Learned from the European Union Directive on Non-Financial Reporting" (2018) 19 *Transactions: Tenn. J. Bus. L.* 619 at 669.

¹⁰¹ *Ibid.*, at 676.

¹⁰² *Ibid.* (citation omitted).

Pursuant to the NFR Directive, Denmark also amended its existing law, adding new requirements for reporting.¹⁰³ Likewise, Denmark's law as amended, "goes beyond the requirements" of the NFR Directive, applying to a greater range of companies than required under the NFR Directive (based on the Danish legislation prior to amendment to implement the NFR Directive).¹⁰⁴ However, there were some lacunae that the Danish legislature had to address in amending the pre-existing law in order to comply with the NFR Directive.¹⁰⁵

Thus, while member States have certain discretion, this may be used to further the interest of NFR. According to CSR Europe and GRI: "the European Commission (EC) encourages Member States to work towards 'further improvements to the transparency of undertakings' non-financial information'. This call has been met by several Member States adapting and expanding the definitions of large undertakings and public interest entities – thereby increasing the Directive's scope."¹⁰⁶

Furthermore, while the NFR Directive sets a baseline for member States, nothing prevents the latter from adopting stricter standards, as France has done in requiring third party verification of disclosure on environmental and social performance.¹⁰⁷

Finally, the discretion granted to member States may have been necessary in order to obtain consensus, in light of the divergence in national laws. Often, directives are a substantial first step toward harmonization and (later) unification of EU law: they are necessary in order to pave the way for more complete harmonization through the adoption of regulations. In this case, one study referred to the development of the NFR Directive in light of the challenge of what then existed:

By regulating non-financial and diversity disclosure requirements across Europe, Directive 2014/95/EU represents an important step towards standardising reporting and formalising transparency requirements. Achieving this standardisation across thousands of organisations simultaneously, presents a significant challenge. In order to be effective, the Directive 2014/95/EU has had to account for the varying business practices across the EU Member States.

¹⁰³ *Ibid.*, at 683-684.

¹⁰⁴ *Ibid.*, at 684.

¹⁰⁵ *Ibid.*, at 685-686.

¹⁰⁶ CSR Europe & GRI, *Member State Implementation of Directive 2014/95/EU* (Amsterdam and Brussels: GRI and CSR Europe, 2017) at 7.

¹⁰⁷ Barnali Choudhury, "Social Disclosure" (2016) 13 Berkeley Bus. L.J. 190 (referring to Law 2010-788 of July 12, 2010 Bearing on National Engagement for the Environment, as amended).

As a result, the Directive allows state specific requirements to ensure its implementation across the varying national practices and account for existing national requirements for non-financial disclosures.¹⁰⁸

On the other hand, such discretion might make enforcement more difficult. One view is that:

Standardising NFR requires coercive adoption of the same accounting and reporting standards. However, the Directive does not impose specific standards or detailed rules for reporting NFI; it only establishes the minimum requirements for the information to disclose.¹⁰⁹

Furthermore, part of the problem might arise out of the fact that users are not adequately involved in shaping NFR regulations.¹¹⁰

The next logical step would be for the European Commission to propose future legislation intended to go further, ensuring user involvement in the process, and to correct perceived weaknesses of the NFR Directive.

4. PERCEIVED WEAKNESSES OF THE NFR DIRECTIVE AND OPPORTUNITIES FOR IMPROVEMENT

NFR requirements in EU legislation have been seen as one reason that “European countries lead the way in social disclosure requirements.”¹¹¹ The NFR Directive “stands out by introducing an explicit requirement of DD [due diligence] disclosure”.¹¹² The NFR Directive is described as a “major step in the presentation of corporate reports by companies located in EU Member States”.¹¹³

Nonetheless, the NFR Directive has been seen to have weakness, such as an *ex-post* focus, a limited scope in terms of the companies covered by it, a lack of auditing mechanism for the NSR statements, and a lack of harmonization. These are taken in the same order below.

¹⁰⁸ CSR Europe & GRI, *Member State Implementation of Directive 2014/95/EU* (Amsterdam and Brussels: GRI and CSR Europe, 2017) at 7.

¹⁰⁹ Matteo La Torre, *et al.*, “Harmonising non-financial reporting regulation in Europe: Practical forces and projections for future research” (2018) 26:4 MEDAR 598, Section 2.1.1.

¹¹⁰ *Ibid.*

¹¹¹ Barnali Choudhury, “Social Disclosure” (2016) 13 Berkeley Bus. L.J. 190.

¹¹² Karin Buhmann, “Neglecting the Proactive Aspect of Human Rights Due Diligence? A Critical Appraisal of the EU’s Non-Financial Reporting Directive as a Pillar One Avenue for Promoting Pillar Two Action” (2018) 3 B.H.R.J. 23 at 26.

¹¹³ Laura Sierra-Garcia, Maria Antonia Garcia-Benau & Helena Maria Bollas-Araya, “Empirical Analysis of Non-Financial Reporting by Spanish Companies” (2018) 8:3 Adm. Sci. 2-17.

4.1. *Ex-Post Focus*

A central criticism of the NFR Directive is that it has an *ex-post* focus, whereas an *ex-ante* focus is necessary to prevent harm. While HRDD may be a trigger to action which allows for an *ex-ante* focus, more is needed. For example, reflexive law theory could be used through the adoption of a regulatory strategy to address the economic interests of the firm directly when regulators communicate with it. The thought is that “[i]nsisting on legal compliance is not insignificant, but by the firm may be perceived as external action inviting tick-box exercises without much relevance for the core business.”¹¹⁴ A more *ex-ante* and proactive approach could involve a “strategic learning” approach, stimulating internal change to avoid the negative impacts, and seeing reporting as a process to “support decision-making to avoid risk, including by stimulating proactive DD to prevent harm” unlike the technical disclosure focus of the NFR Directive.¹¹⁵

4.2. *Limited Scope*

The NFR Directive may be criticized on the limited scope of its subject matter, and/or on the limited coverage of companies.

4.2.1. *Limited Scope of Subject Matter*

One criticism that has been made about the NFR Directive's scope is that it only goes so far as implementing sustainability reporting, not evidencing a wide adoption of CSR policies.¹¹⁶ It does not go as far as it could, for example in the area of supply chain, as mentioned above, including in the areas of forced labour and human trafficking (concerns of Dana Raigrodski).¹¹⁷

4.2.2. *Limited Coverage of Companies*

As noted in Part 1.1, the NFR Directive only covers 6,000 or so companies. This is “only a fraction of the 82,000 MNCs in the world”,¹¹⁸ and does not cover SMEs that might have human rights impacts.

¹¹⁴ Karin Buhmann, “Neglecting the Proactive Aspect of Human Rights Due Diligence? A Critical Appraisal of the EU's Non-Financial Reporting Directive as a Pillar One Avenue for Promoting Pillar Two Action” (2018) 3 B.H.R.J. 23 at 38 (citations omitted).

¹¹⁵ *Ibid.*

¹¹⁶ Dana Raigrodski, “Creative Capitalism and Human Trafficking: A Business Approach to Eliminate Forced Labor and Human Trafficking from Global Supply Chains” (2016) 8 Wm & Mary Bus. L. Rev. 71.

¹¹⁷ *Ibid.*

¹¹⁸ Wendy Stubbs & Colin Higgins, “Stakeholders' Perspectives on the Role of Regulatory Reform in Integrated Reporting” (2018) 147 J. Bus. Ethics 491 (citations omitted).

The limits of this coverage — that is, excluding SMEs — may be highlighted using the example of the decision of the Dutch National Contact Point (“NCP”) for the OECD Guidelines for Multinational Enterprises (Dutch NCP) in the case of *FIVAS, the Initiative to Keep Hasankeyf Alive and Hasankeyf Matters v. Bresser (Fivas v. Bresser)*. In that case under the OECD Guidelines, a subsidiary of Bresser, an SME, was contracted to relocate a historic monument — the Zeynel Bey Tomb — in order to make for the reservoir of a proposed dam in Turkey. The complaint filed by an association (FIVAS) alleged that cultural heritage would be degraded, and that the human right to culture would be violated, and that Bresser did not carry out a meaningful consultation with the local population. Furthermore, it asked that Bresser develop a human rights policy that includes ensuring adequate DD is performed.¹¹⁹ The Dutch NCP made the following observations, among others:

The NCP observes that this case shows that Bresser, an SME, has not fully met the expectations and satisfy the due diligence criteria of the OECD Guidelines in practice. However, Chapter I (Concepts and Principles) of the Guidelines, under 6, while acknowledging that small and medium-sized enterprises may not have the same capacities as larger enterprises, states that SMEs should be encouraged to observe the Guidelines’ recommendations to the fullest extent possible.

This includes carrying out risk-based due diligence (II, under 10). The nature and extent of due diligence depend on the circumstances of a particular situation and on the other hand on the severity of the risks. This means that the size of the enterprise does not affect its responsibility to conduct due diligence, but may affect its manner of carrying out due diligence.¹²⁰

The Dutch NCPs observations highlight one weakness that was negotiated into the NSR Directive during the legislative process leading to its adoption: the exclusive of SMEs from the material scope of the legal instrument.

4.3. Lack of Auditing Mechanism

One blaring gap in the NFR Directive is its lack of the requirement of auditing of NFR statements. As discussed in Part 1.2.1, auditors merely have to verify that the management report contains the NFR statement; there is no requirement that its content (or that of a separate report, if provided in lieu of an NFR statement) has to be audited. This allows a criticism that is in general made with respect to mandatory reporting — that it is contested because of “the lack of enforcement mechanisms and

¹¹⁹ Dutch National Contract Point (NCP), *Final Statement: FIVAS, the Initiative to Keep Hasankeyf Alive and Hasankeyf Matters vs. Bresser* (The Hague: Dutch Ministry of Foreign Affairs, 2018).

¹²⁰ *Ibid.*, at 5.

credit report assurance practices and standards”¹²¹ — to be made with respect to the NFR Directive. Thus, the Directive focuses on “formal reporting, access to reports, and sanctions for non-reporting”, with an underlying assumption that NGOs will monitor the statement’s reflection of real practices.¹²² Tied to its *ex-post* focus, the NFR is limited by this lack of auditing: its “effectiveness in generating organizational learning and internal change to identify and prevent adverse impact is undermined by the emphasis on legal compliance and sanctions for non-reporting, both of which are limited to the disclosure requirement and not the extent and quality of the information disclosed”.¹²³ Furthermore, the NFR Directive, with respect to its “comply or explain” requirements, “does not provide a mechanism ensuring that the explanations are clear and reasoned”.¹²⁴

4.4. No Integrated Reporting

The NFR Directive “has not considered the possibility of regulating the presentation of integrated reporting (IR)”.¹²⁵ IR, involving the combination of all a firm’s reports into a single document, has been described as providing information in a format gives a broader view of performance, and better satisfying investors’ needs.¹²⁶ Indeed, the NFR disclosure is not integrated with the financial reporting.¹²⁷ IR focuses not just on sustainability impacts but also on value creation “through the lens of six capitals (financial, manufactured, intellectual, human, social and relationship, and natural)”.¹²⁸ Thus, the logic goes, having IR would result in better NFR, although companies today prefer voluntary IR over regulatory reform.¹²⁹

¹²¹ Wendy Stubbs & Colin Higgins, “Stakeholders’ Perspectives on the Role of Regulatory Reform in Integrated Reporting” (2018) 147 J. Bus. Ethics 492.

¹²² Karin Buhmann, “Neglecting the Proactive Aspect of Human Rights Due Diligence? A Critical Appraisal of the EU’s Non-Financial Reporting Directive as a Pillar One Avenue for Promoting Pillar Two Action” (2018) 3 B.H.R.J. 23 at 29-30.

¹²³ *Ibid.*, at 42.

¹²⁴ Joseba Fernández Gaztea & Alberto Muñoz Fernández, “‘Comply or Explain’ in the EU, or the New Human Rights Reporting Obligation: An Analysis of Directive 2014/95/EU” (2017) 9:1 Cuadernos de Derecho Transnacional 285 at 295.

¹²⁵ Laura Sierra Garcia, Maria Antonia Garcia-Benau & Helena Maria Boyas-Arraya, “Empirical Analysis of Non-Financial Reporting by Spanish Companies” (2018) 8:3 Adm. Sci. 5-17.

¹²⁶ *Ibid.*

¹²⁷ Jill E. Fisch, “Making Sustainability Disclosure Sustainable” (2018) U. Penn. Inst. L. & Econ. Research Paper No. 18-27 at 25.

¹²⁸ Wendy Stubbs & Colin Higgins, “Stakeholders’ Perspectives on the Role of Regulatory Reform in Integrated Reporting” (2018) 147 J. Bus. Ethics 490.

¹²⁹ *Ibid.*, at 503.

4.5. Lack of Harmonization

The divergence in transposition of the NFR Directive may be considered a weakness. Indeed, it may bring difficulties in compliance for firms with subsidiary operations in various member States. Furthermore, the baseline approach might not be seen as helpful in the use of NFR to help reach treaty goals of “a high level of protection and improvement of the quality of the environment”.¹³⁰ Moreover, the discretionary elements of a member State’s implementation of the NFR Directive potentially constitute one more consideration that a regulatory-adverse company might use in selecting the member State in which to establish itself in the EU. In addition, while the purpose of the NFR Directive consisted “in offering to all the investors and stakeholders a framework on sustainability policies that will be comparable at European level”,¹³¹ divergence negatively impacts such comparability. Insofar as content and format go, the NFR Directive fails to adopt uniform reporting standards.¹³²

5. OPPORTUNITIES FOR IMPROVEMENT

There is the opportunity for legislative reform in order to improve the NFR Directive. As noted by one scholar, “[d]ue to its novelty, its effects are likely to be closely scrutinized in the coming years by non-governmental organizations (NGOs), companies and regulators with a view to revisions, strengthening and lessons for other jurisdictions.”¹³³

Any review by the Commission could be the opportunity for improvements regarding the placing of NFR into a process, with incentives for companies to actually use the information from HRDD to seek to avoid human rights impacts. Perhaps the requirement that NFR statements (and separate reports) be audited could be one way to encourage companies to go further.

In addition, this could be the opportunity for improvement of the scope of the legislation. There could be the introduction of an obligation for issuers to carry out supply chain due diligence when sourcing minerals to ensure that there are no connections to conflict parties, as

¹³⁰ EU, TEU, art. 3(3), [2012] OJ, C 326/13 at 17.

¹³¹ Cristian Carini, *et al.*, “Ex-Ante Impact Assessment of Sustainability Information – The Directive 2014/95” (2018) 10 *Sustainability* 6-24.

¹³² Constance Z. Wagner, “Evolving Norms of Corporate Social Responsibility: Lessons Learned from the European Union Directive on Non-Financial Reporting” (2018) 19 *Transactions: Tenn. J. Bus. L.* 691.

¹³³ Karin Buhmann, “Neglecting the Proactive Aspect of Human Rights Due Diligence? A Critical Appraisal of the EU’s Non-Financial Reporting Directive as a Pillar One Avenue for Promoting Pillar Two Action” (2018) 3 *B.H.R.J.* 23 at 26.

discussed in Part 1, going beyond the specific requirements of Regulation (EU) 2017/821. Furthermore, SMEs could be added to the scope of the reporting requirements, potentially with some flexibility added in to account for their size and resources, but an HRDD requirement, nonetheless, intended to help SMEs work *ex-ante* to avoid HR impacts.

Finally, if the thought is that member State practices have been standardized adequately in order to permit further harmonization, the Commission could consider recasting the NFR Directive as a regulation, instead. For example, that is the form of instrument recently proposed by the Commission for disclosures regarding sustainable investments.¹³⁴ Unlike directives, regulations have general application and are directly applicable in each of the member States, and are binding in their entirety.¹³⁵ However, it has been recognized that the way NFR is presented, may vary following cultural difference,¹³⁶ which might result in the failure of the proposal of a regulation, or at least the need to insert flexibility into the text.

Conclusion

The EU's NFR Directive has the advantage of being a first step in the field of mandatory sustainability reporting. It encourages companies to engage in HRDD activities and provides the requirement of either an NFR statement, or a separate report, which may be based on one of several international sustainability reporting guidelines. Nonetheless, the NFR Directive has many shortcomings.

The NFR Directive has been criticized as having too much of an *ex-post* focus, unlike certain member State laws. This could be alleviated by focusing communication on economic interests of companies and ensuring that the HRDD process involves learning and continuing accountability for firms.

Any future review of the NFR Directive by the Commission would provide the ideal opportunity to seek to improve the legal instrument through the proposal of amending legislation.

¹³⁴ European Commission, Proposal for a Regulation of the European Parliament and of the Council on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341 (Brussels: European Commission, 2018).

¹³⁵ EU, TFEU, art. 288, [2012] OJ, C 326/47 at 171-72.

¹³⁶ Laura Sierra-Garcia, Maria Antonia Garcia-Benau & Helena Maria Bolas-Araya, "Empirical Analysis of Non-Financial Reporting by Spanish Companies" (2018) 8:3 Adm. Sci. 3-17.

