

French roundtable on corporate governance

Executive Summary

Paris, 14 April 2016

Frank Bold organised a roundtable on corporate governance in Paris with Affectio Mutandi and Cass Business School. Building on previous events held in London, New York, Zurich, and Breukelen (the Netherlands), the discussion in Paris focused on corporate purpose and the creation of long-term sustainable value. Keynote speeches were given by Professor Alexis Constantin (Université de Versailles Saint-Quentin) and Thierry Philipponnat (Institut Friedland, Forum pour l'Investissement Responsable, French Financial Markets Regulator (l'autorité des marchés français, AMF) and formerly of Finance Watch).

Alexis Constantin

Alexis Constantin suggested that corporate governance does not have any legal meaning in France, although the term is found in several fields of law. It seems nevertheless accepted that the corporate governance model must be developed according to an objective specific to the governed entity. This has been extremely complicated to achieve since the notion of the company (legal form) has become maladapted to the concept of the business (meaning its activity).

In fact, a company is defined as the 'thing' that belongs to shareholders while the notion of business encompasses a plurality of actors, i.e. stakeholders that are both internal and external to the company, including commercial partners, creditors and employees. The concept of the 'company' only refers to the legal structure of a corporation while the notion of the business, which includes stakeholders, matters much more in practice due to the growing influence of several external stakeholders

We are today witnessing a breakdown of the concepts of the company and its shareholders and by extension of corporate law as well. Article 1832 of the Civil Code provides that 'a company is created by two or several persons who agree by a contract to appropriate property or their industry for a common venture with a view to sharing the benefit or profiting from the saving which may result therefrom'.

Thus, the current French concept of social interest appears as a closed and residual notion, which is more focused on profit than the Anglo-Saxon version. It is time to adapt it to what really matters, i.e. social interest, and to hence include in its definition the respect of social and environmental aspects. This would actually amount to a simple adaptation of Article 1382 to the rest of French law, as corporate obligations to avoid social and environmental impacts already exist.

Prof. Constantin argued that we therefore need to re-think the notions of enterprise and social interest, by re-taking into account stakeholders. This had driven, among other things, the proposal to change Article 1833 of the Civil Code that was made when the report 'For a positive economy' was published in the Documentation française in 2013: 'Any company must have a licit purpose, and be created and managed in the social interest. The pursuit of social interest requires the conciliation of economic, social and environmental dimensions, together with stakeholders'.

Thierry Philipponnat

In theory, investment is a practice for the long term. It reflects the long-term development prospects since a company grows over the years. However, in practice, a short-term orientation has predominated for the last 20-30 years. Now, we are beginning to see a shift back toward investment for the long term, which entails taking into account all environmental, social and governance (ESG) risks.

Investors generally take into account the criterion of governance, as the quality of governance is the basis of an arbitration quality/risk: when the quality of governance is not sufficient, this represents a significant risk for both the investor and the company.

Moreover, investors think of integrating ESG criteria to foster financial performance. Two studies, one by [Oxford University](#) and the other by [Columbia University](#), demonstrate a convergence between ESG performance and financial success.

However, active investors are a minority of global asset managers, and 20% of this awareness of ESG integration is concentrated in Paris. This trend has been reinforced in France by the adoption of non-financial reporting legal requirements (Article 225 of Law no. 210-788 of 12 July 2010 on national commitment to environment) and by COP21.

Mr. Philipponnat suggested that Environmental and Social criteria are only taken into account by investors in the event of crisis, while governance has a much stronger and lasting impact in the event of proven risk.

Plenary discussion

The discussion revolved around the notions of “Why?” and “How?”.

Today there are provisions for the consideration of ESG criteria, such as article 173 of the law of energy transition. However it was generally accepted that the “How?”, i.e. by which legal means, necessarily follows the “Why?” and implies a transdisciplinary approach.

Share issuers are asking to know the techniques to be used to define socially responsible investment (SRI). There is also the problem of comparability of different international corporate social responsibility (CSR) standards.

Moreover, governments tend to develop their CSR policies on the basis of consensus with industry stakeholders. CSR is presented as a way for business and society to address these environmental and social challenges. In order for companies to fully integrate ESG criteria, it might be wiser to go beyond this approach, which relies on the lowest common denominator, by presenting such integration as a way to obtain financial outperformance and to guard against societal, environmental and reputational risks.

Results of the working groups

Board of Directors

The Board of Directors decides CEO compensation. The working group suggested that variable pay be linked to long-term criteria. The goals to be achieved in the long-term would be defined and a control lasting between 5 to 10 years would say whether the goal is reached. If so, the salary would be paid.

This could therefore happen retroactively, even if the CEO is no longer in office. In practice, this process requires that the Board define long-term financial and ESG criteria, and meet to determine whether the CEO has met her/his objectives. This raises the question of board composition, which should include stakeholder representatives.

Management

This proposal entails a proper revolution of corporate management and is based on the adoption of the law on duty of care and the [Sapin II Act](#) (France). Concretely, it is proposed to integrate stakeholders (employees, subcontractors, etc.) in the board with gender parity. In addition, four committees would be created: audit, compensation and appointment, risks and ethics, and strategy. The risks and ethics committee would be responsible for setting ESG criteria. A direct relationship is further established between investors and the audit committee, on one hand, and between the HR manager and the ethics committee, on the other hand. Finally, an office receiving all ESG-related alerts and information is created with a direct relation to the risks and ethics committee, so as to allow for better consideration and implementation of ESG criteria, as well as the measurement of such implementation. The potential opponents to this proposal are managers, administrators and investors who do not take into account ESG factors. To overcome these barriers, dialogue and use of media are useful, although natural pruning (i.e. retirement) should resolve part of the problem.

Employees

The working group proposed to allow employees to express themselves in the annual CSR report (which is part of the annual management report). In practical terms, employees could publish a statement and their position would be reflected in 1-2 pages of the management report. The Board could oppose such a proposal, having a dim view on that kind of information being expressly stated in the management report. To remedy this opposition, dialogue and coalition-building among NGOs and other SRI actors is necessary. There are also several institutional barriers. Mainly, whereas the state seeks to condense the annual management report, the current proposal would add pages. One solution is to publish the information digitally. Additionally, employees already have a legal right to express an opinion on executive pay but few are aware of this right, and it is even less frequently exercised ([article 2323-8](#) of the French Labour Code). Finally, the proposal echoes the stalled EU draft directive on banking reform (the so-called '[Barnier Directive](#) (2016)) and would come together with the adoption of the French law on duty of care, or even together with a new definition of social interest (Article 1833 of the French Civil Code) that would take into account stakeholders' interests.

Investors (medium and long term - for whom ESG criteria are essential)

The objective of this working group was to discourage short-term investment and promote patient capital. They proposed to create a private mutuality, which would tax short-term investments to collect a fund to compensate the potential losses of mid and long term investors. This proposal reprises an existing practice: the issuance of premium Class A with special voting rights or other benefits to fund innovative projects (thereby promoting the interests of medium and long-term investors).

The final report of the global roundtable series will be presented in Brussels on September 28, 2016.

More information is available on the Purpose of the Corporation Project [website](#).