ALLEN & OVERY

Global business in a changing Europe

2024

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Contents

Introduction

With Parliamentary elections and a series of national votes in 2024, the EU is entering a pivotal period in its history. In this study, 'Global business in a changing Europe', we speak to corporate leaders across the world to explore the bloc's key risks and opportunities, their views on the EU's regulatory structures – and how they are navigating this increasingly complex environment.

On one level the European Union is a series of contradictions. A federation built on common rules in a world that increasingly rejects them. A monetary union overlaid on divergent economies.

But it is also a place of confidence and ambition, having emerged from some of the toughest challenges in its history united and resilient. The European Union has weathered multiple economic, social and defence emergencies over a difficult few decades, yet remains a hotbed of innovation and a favourable environment for business.

This year the EU is entering a potentially turbulent period in which the long-term effects of various crises may finally translate to real and lasting change at the political level. In upcoming elections, early predictions have far right, nationalist and Eurosceptic parties picking up nearly a quarter of the seats in the European Parliament. Nine national elections across the continent are also being closely watched for a swing towards anti-EU forces.

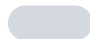
Rising support for radical, far left, and far right political movements in Europe is nothing new: the Eurozone crisis, the arrival of large numbers of refugees, the rising cost of living, and varied responses to COVID-19 have pushed voters towards political movements that have historically been on the fringe.

So far, this has not had the destabilising effect on the bloc that many had feared. Far right parties have tended to temper their extreme policies to win votes, and when in coalition governments have not generally been the radical disruptors they claimed to be.

Despite many elections bringing far-right forces into or close to power, the EU has continued to forge ahead as a regulatory innovator and extend its competence over areas as diverse as sustainability, climate policy, data protection, artificial intelligence and employment. But some are predicting that the scale of support for extremist voices means this time may be different.

Against this backdrop we have conducted a study to explore what being in Europe means for global organisations. In compiling the research, we carried out a series of in-depth interviews with business leaders across a range of sectors and would like to thank them for their support. We also surveyed 200 senior executives around the world working for companies with annual revenues over £200 million. The findings from this work are used throughout.

Through their eyes we have built a picture of Europe's risks and opportunities, and how they deal with European regulations. We have gauged opinion on the EU's green agenda, heard how businesses are scrambling to harness artificial intelligence, and explored their investment priorities. Our research lifts the lid on the methods they are using to manage risk and seek opportunities, and the areas where those structures are not yet fully mature.



> "There is no future for the people of Europe other than in union."
>
> Jean Monnet, founder of the EU

We have overlaid this intelligence with insights from our pan-European teams who are helping global organisations set their strategies for the future.

Our study shows that Europe remains a centre of opportunity, offering both global leadership and a stable policy environment for trade and investment. But while this is where Europe is today, it is unclear what tomorrow holds.

The EU's policy agenda is proposed by its executive branch – the European Commission – and voted on by the European Parliament, which in the 2019-2024 mandate has been dominated by centre right, centre left, and liberal groupings.

Changes to the composition of the Parliament for the next five-year term could bring policy and regulatory upheaval. Many of the issues far right forces have railed against are the very areas where the EU is seen as a global leader.

Protests by farmers against environmental policies have galvanised support in many member states for far-right parties who oppose aspects of the European Green Deal. Similarly, debate over the impact of the EU's liberal trade policies is expected to define the upcoming vote, along with migration and border controls. Overall, a general tone of Euroscepticism underpins much of the prevailing rhetoric.

What does this mean for EU policy?

How this impacts the direction of the EU will depend on how many seats the nationalist and far-right parties win, and on their ability to overcome their own divisions. Disrupting the EU's long-standing policy agenda will require lasting coalitions to be formed. Established centrist parties will establish their own alliances in a bid to keep them at bay.

When it comes to defence and energy security, analysts are expecting support – military, financial, logistical – for Ukraine to continue. But an increase in Euroscepticism could result in more economic, fiscal and regulatory freedom for member states rather than greater control from Brussels, with a return of competencies to national governments a key demand of the EU's critics.

It could also lead to reform of EU asylum policy and tighter immigration and border controls, potentially making it more difficult for businesses to attract talent from outside the bloc in an already competitive global labour market.

Protecting EU industry, jobs, and agriculture are likely to be priorities for many of the forces in the European Parliament moving forward. Protests are growing against policies targeting the agricultural sector, and should parties opposed to climate goals gain significant support in the European Parliament elections, the EU's Green Deal could come under pressure.

Even before the vote, this changing mood was starting to be felt. The Corporate Sustainability Due Diligence Directive – designed to hold businesses above a certain size to account for identifying and mitigating any detrimental environmental and human rights impacts of their supply chains – reportedly stalled when it was put to a vote among member states. It was eventually approved, but only after the turnover threshold was raised so only businesses with global revenues above EUR450 million were in scope.

What happens with EU environmental rules after the election remains to be seen. But as our survey shows, businesses are forging ahead with the green transition, and there is widespread public support for renewables in the wake of the energy price surge that followed the invasion of Ukraine.

A culturally and geographically diverse continent will always face challenges finding common ground, particularly in such an uncertain and volatile geopolitical environment. Transatlantic trade and defence cooperation could be upended in the event of another Trump presidency; Europe's supply chains could be further disrupted by the conflict in the Middle East; Russian aggression on the continent could spread further. But the foundations upon which the EU is built have proved to be resilient and will likely continue to be so in a pivotal 2024.

The challenges facing global business

EU institutions continue to use regulation and enforcement to pursue their goals within and outside the bloc, with more than 2,500 "basic acts" (i.e. new pieces of legislation rather than amendments to existing acts) introduced between 2019 and 2023.

Year	Number of basic acts
2019	503
2020	507
2021	554
2022	529
2023	454
Total	**2,547**

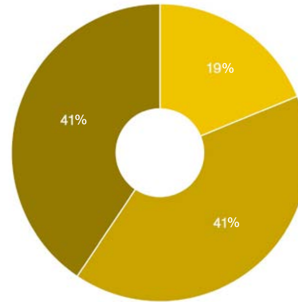
Source: **https://eur-lex.europa.eu/statistics/2024/legislative-acts-statistics.html**

Europe's laws and regulations create a mix of harmonisation and fragmentation across areas of EU competence and those of national governments. Business leaders need a nuanced view on how to navigate them to achieve their goals, and on the opportunities created by the obligations imposed on them by European regulatory frameworks. With potential change on the horizon, it is more important than ever to make strategic decisions with care.

Ultimately, success in Europe depends on the ability to stay ahead of regulatory change, and a deep knowledge of how European regulatory regimes and enforcement priorities interact with national laws, courts and authorities. By taking a balanced view across all these factors, companies can manage Europe's complexities with confidence.

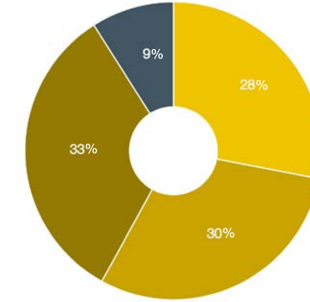
Our survey sample

Business turnover/revenue in previous 12 months



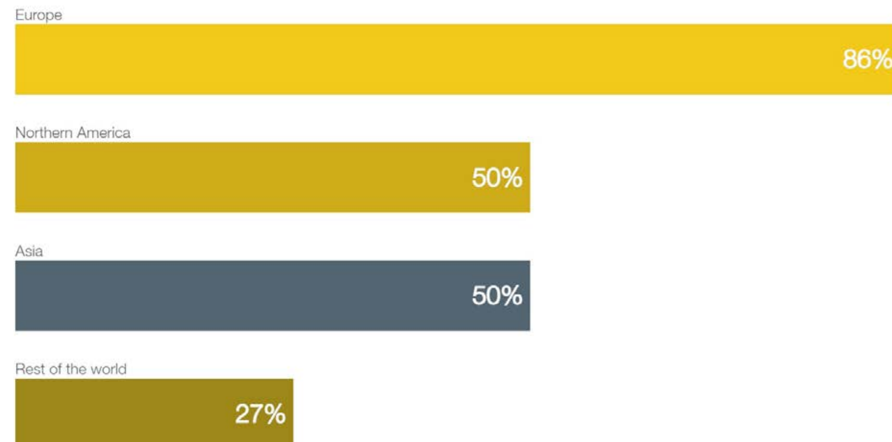
- £200m-£274m
- £275m-£349m
- Over £350m

HQ location



- Northern America
- Europe
- Asia
- Rest of World

Regions with an organisational presence



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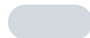

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Executive summary

Europe's competitiveness on the global stage

Historically, the EU's competitive position stems from its common approach to organising – or socialising – free markets. Perhaps more importantly, the EU's purpose has rested on a social contract between governments, businesses and citizens that has been built on high standards of consumer and environmental protections, measures to limit tax competition between member states, and the use of proportionate regulation to mitigate against risks and potential market failures.

These sands have started to shift in the run-up to the EU Parliamentary elections. With polls suggesting a more extreme-right leaning, nationalist assembly over the next five-year term, some analysts are predicting a change in approach at EU level, with Eurosceptic forces questioning the value of the shared economic and social ideals at the heart of the European project.

Our research showed that many businesses would favour a loosening of the EU's strict regulatory rules, echoing wider calls – including from French President Emmanuel Macron – for an EU "regulatory break" around new green regulations to boost competitiveness.

Our study revealed that business leaders were generally positive about the future performance of their businesses within the EU, with the majority (56%) optimistic and 31% pessimistic. There was a further sign of confidence visible in our respondents' views on M&A. Of the one in five whose businesses had acquired another company within the past two years, most had done so within the EU.

The EU's energy market and its impact on competitiveness will be an area to watch in the coming years. Energy costs surged in the aftermath of Russia's invasion of Ukraine, shining a spotlight on energy security and prompting EU legislators to launch a renewed push to build renewable capacity.

National laws and regulations play a significant role in Europe's energy landscape. While the Lisbon Treaty includes solidarity in matters of energy supply, many competencies rest at member state level, with progress across the bloc relying on cooperation between national governments. To accelerate the construction of new renewable infrastructure, steps have been taken in some member states to streamline permitting and limit the rights of third parties to challenge projects through the courts.

Our interviewees were united in their calls for more coordinated EU energy policy to align Net Zero strategies across borders, foster the development of green energy supply chains and improve grid connections for offshore production facilities. But if more Eurosceptic voices enter Parliament it's hard to see how this level of cooperation moves closer, with nationalist and far-right parties advocating for the return of more powers to national governments.

Europe, regulator of the world

Regulation and enforcement are the primary levers the EU uses to achieve its strategic goals and promote its values both within and outside its borders.

European regulations invariably set a high bar that requires extensive investment in disclosure and risk management. Yet this isn't seen as a negative by businesses, with almost half (43%) of our survey respondents viewing the EU's regulatory structures as "very favourable", far higher than those of other global jurisdictions.

Our interviewees gave a more nuanced response, describing some of the EU's frameworks as burdensome, even where they supported the regulations' intentions. The business leaders we spoke to highlighted the fact that compliance is easier for larger organisations with more extensive resources, while smaller companies are at a disadvantage and could experience a regulatory drag on their ability to innovate.

Our interviewees described how they hire risk-management specialists from industries where European regulations bite hardest or from organisations that have a strong interest in particular issues – for example bringing in heads of sustainability from environmental charities and heads of data privacy from major tech companies.

Among some member state governments, there is a growing sense that there may be some regulatory overreach from Brussels, and in response, the European Commission President, Ursula von der Leyen, has acknowledged the need to reduce red tape "to make business easier".

Our interviewees also noted that regulation can be a driver of innovation, pointing out that requiring businesses to track granular emissions data across their operations would potentially involve a technological solution, which could improve risk monitoring and agility.

Europe's wave of new regulations and the rise in collaboration agreements between businesses developing innovative solutions to global challenges creates a heightened risk of anticompetitive information-sharing.With the European Commission keenly focused on tackling allegations of collusive behaviour – and the Private Damages Directive raising the possibility of significant damages claims – companies must tread carefully.

Charting a path through the EU's sustainability landscape

Our interviewees identified Net Zero transition plans – which feature in regulatory regimes including the Corporate Sustainability Reporting Directive and the Sustainable Finance Disclosure Regulation – as a significant challenge.

The regulatory framework for guiding businesses along the path to Net Zero is expected to be a major focus of the 2024-2029 EU mandate, but whether we will see a continuation of the 2019-2024 trajectory towards ever-tighter sustainability regulation remains to be seen.

The stalling of the Corporate Sustainability Due Diligence Directive (CSDDD) as it moved through the legislative process could be a sign of things to come. After four years of negotiations, support began to unravel as the directive reached its final stages following criticism of the impact on business.

The Directive was eventually approved, but only after its turnover thresholds were raised significantly (taking all but the largest businesses out of scope), and removing provisions that would have enabled trades unions to launch civil actions against noncompliant businesses.

Our survey showed that global businesses recognise the strategic importance of sustainability and Net Zero, with 45% of respondents saying their organisations were devoting significant investment into planning and implementing sustainability initiatives, including climate disclosures and initiatives to reduce emissions.

Just over half (53%) of the business leaders we questioned were confident they would achieve their strategic aims, with only 29% saying they are very confident.

Overall, fewer than one in four (24%) of the leaders we questioned said their businesses were well prepared to meet the expected requirements of frameworks such as the CSDDD, possibly because of the difficulty in seeing through their supply chains to get an accurate picture of what's going on, and, more fundamentally, mitigating any negative impacts at the furthest reaches of their operations. Additionally, fewer than one in seven (14%) of respondents felt well prepared to deliver environmental reporting between global regions that differed in their approach.

This is a potential risk given the anti-ESG backlash that has been growing in certain Republican U.S. states and is driving many global organisations to consider disclosing less about their sustainability activities at the same time as EU rules have been pushing them to publish more granular data.

Any asymmetry in disclosures is a potential source of litigation, with plaintiffs pursuing businesses where they perceive inconsistencies in reporting.

The increase in sustainability data published under the EU's Corporate Sustainability Reporting Directive is set to make Europe a more active destination for sustainability-related litigation in future.

Our survey revealed a global business community that is not only underprepared to track and disclose its environmental impact across the world, but also one lacking confidence in the systems it has in place to manage the risks associated with ESG activism and the uptick in sustainability-related class actions.

While 70% of global businesses report that they have measures in place to mitigate the risk of ESG activism and climate-related mass claims, fewer than three in five (57%) of our respondents were confident these systems mitigate those risks effectively – with only 27% very confident.

Seizing the AI opportunity

Nearly 4 in 5 (77%) respondents to our survey said their businesses viewed AI as a strategic priority over the next two years. Indeed, many are beyond the strategy phase and firmly into integration, with generative AI already being used to write code, support customer services and create content.

Our in-depth interviews revealed further detail on how AI is being applied across sectors, with businesses deploying AI models to boost operational efficiencies, mitigate disclosure risk, manage their contractual estate and support with M&A execution. Others were pursuing more disruptive applications, for example by applying AI to proprietary data sets to create more personalised and informed experiences for their clients.

However, of the 77% of businesses that saw AI as a strategic priority, only 26% were very confident they would achieve their aims. One in three were either not very – or not at all – confident.

Further, only 26% of our respondents said the governance of AI was a business risk that they currently have systems in place to mitigate. Even among the one in four businesses that had implemented risk mitigation systems, fewer than half (41%) were very or fairly confident that they worked effectively. And only one in five of our respondents felt fully aware of – and well prepared for – the evolving legal and regulatory landscape around AI.

Europe as an investment destination

Our survey results revealed a strong desire among global businesses to continue pursuing European acquisition targets. Of our respondents whose employers have completed an M&A transaction in the past two years, most had invested in the EU (41%) followed by the UK (35%) and North America (32%).

The numbers were reversed among those considering transactions over the next two years, with 41% expecting their deal activity to focus on North America compared to 31% on the EU.

Respondents whose businesses have completed an acquisition in the past two years listed cyber security due diligence as the biggest challenge they faced (73%), with managing the risk of leaks among the top five issues (67%). Our respondents whose businesses haven't been active in M&A over the same period put leaks down in 10th place.

The latter point is interesting in the context of public takeovers, given the importance of maintaining confidentiality under the EU Market Abuse Regulation.

Our interviews revealed how businesses are managing regulatory and other risks in the context of M&A transactions. Many of the business leaders we spoke to said smaller deals involving targets that fall below the revenue thresholds for some of Europe's more stringent regulatory regimes are more challenging than bigger acquisitions.

Regulatory risk management through M&A due diligence is particularly important for private equity buyers given their investment horizons, with regulatory investigations in Europe often taking years to resolve. If any issues identified are not addressed prior to completion they may eventually result in enforcement action, which in turn could impact the sponsor's exit options.

Accessing Europe's talent

Our survey shows that while recruiting and retaining talent was a challenge for businesses regardless of location, those based in the EU were particularly feeling the heat. Almost three-quarters of our survey respondents from EU-based organisations (74%) regarded labour shortages as an enterprise-wide challenge, compared to 45% of those in North America and Asia. One in three of our survey respondents did not view the EU favourably in relation to the availability of talent.

Foreign businesses often struggle with Europe's fast-changing, worker-friendly regulatory regime.

Here there is change on the horizon, with moves under way to reduce the reliance on flexible contracting models, including via the Directive on Transparent and Predictable Working Conditions and the Platform Work Directive.

The latter is designed to ensure the correct classification of employment status by introducing a presumption of an employment relationship (rather than self-employment). Once implemented into local law, the new rules are expected to have a material effect. According to the European Commission, almost 20% of platform workers ought to be reclassified from self-employed workers to employees.

Elsewhere the Pay Transparency Directive, which was approved in 2023 and is due to come into force in 2026, aims to tackle pay discrimination and close the gender pay gap across the bloc.

The new rules will require businesses with more than 250 employees to report annually their gender pay gap figures and take action if the differential is above 5%, while those with between 100 and 249 employees will need to report every three years.

The Pay Transparency Directive will provide employees with enhanced rights to challenge their employers on workplace discrimination or failures to disclose pay transparency.

Almost half (49%) of our respondents from businesses with operations in the EU identified employment law as a business risk that they currently do not have systems in place to mitigate. Of our respondents whose businesses have acquired another company in the past two years, over half (54%) found responding to cross-border employment laws a challenge through the process.

Europe's competitiveness on the global stage

"We have a shared belief that we can do something about climate change, and the European institutions give us the opportunity to eliminate boundaries in this endeavour. But when Europe is always at the forefront of making regulations for a better world, it puts European businesses at a disadvantage against companies who are allowed not to care."

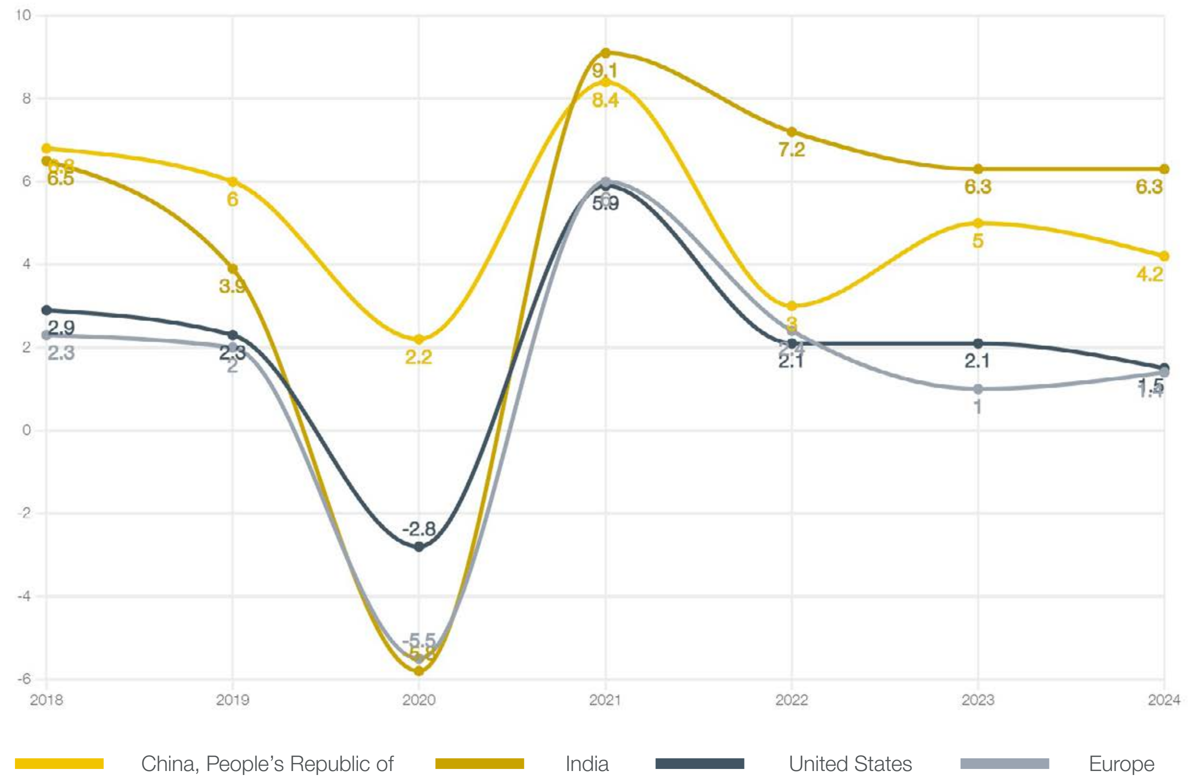
General Counsel and Company Secretary, Energy and Utilities

"Many businesses see a positive in more ambitious levels of sustainability reporting. They believe that by mainstreaming this thinking into their operations it will make them more competitive in the long run."

Jurei Yada, Programme Leader for EU Sustainable Finance, climate change think tank E3G

Global GDP growth figures show a European economy that consistently tracks lower than those of other major markets. Some of that is down to it being a relatively mature market. But there are other factors at play.

Real GDP growth – annual % change



Source: IMF; data correct to November 2023

The EU's competitive position stems from its common approach to organising – or socialising – free markets. The bloc is founded on the four principles enshrined in the Treaty of Rome in 1957; freedom of movement for capital, people, goods and services. The Single Market legislation in 1986 created two additional freedoms – freedom of establishment and freedom of service – which helped to further embed the Rome treaty's principles.

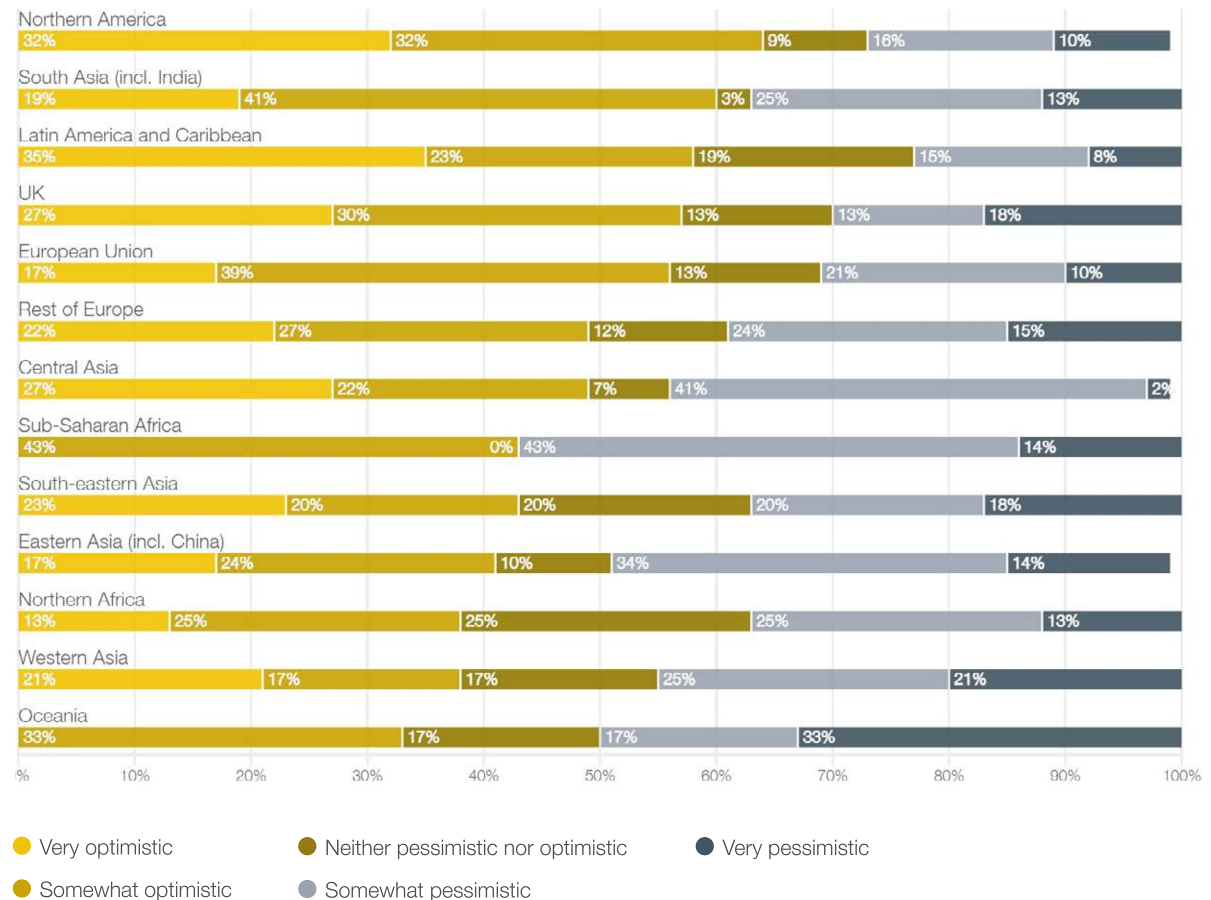
Perhaps more importantly, the EU's purpose (which includes "achieving sustainable development based on balanced economic growth and price stability and a highly competitive market economy with full employment and social progress") has rested on a social contract between governments, businesses and citizens. This arrangement is built on high standards of consumer and environmental protection, measures to limit tax competition between member states, and the use of proportionate regulation to mitigate against risks and potential market failures.

In the run-up to the 2024 Parliamentary elections however, the sands were starting to shift. With polls suggesting **a more extreme right-leaning, nationalist Parliament for the next five-year term**, we may see a change in mindset among the EU institutions, with some Eurosceptic forces questioning the value of the shared economic and social ideals at the heart of the European project.

Our research shows that many businesses would favour a loosening of the EU's strict rules, and indeed there have been growing calls for an EU "regulatory break" (particularly in relation to Net Zero rules) to boost competitiveness. That sentiment however was not universal - other business leaders we spoke to said Europe's legal and regulatory certainty acts as a counterbalance to any perceived ceiling it puts on growth.

Our survey respondents were hopeful about the future performance of their businesses within the EU, with the majority (56%) optimistic and 31% pessimistic. They were more confident about their prospects in North America (where 64% were optimistic), followed by South Asia and India (60%), Latin America (58%) and the UK (57%), but less so for East Asia and China (41% optimistic).

For each region your business operates in, how pessimistic or optimistic are you about business performance over the next 12 months?

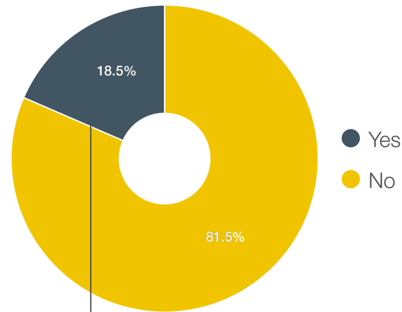


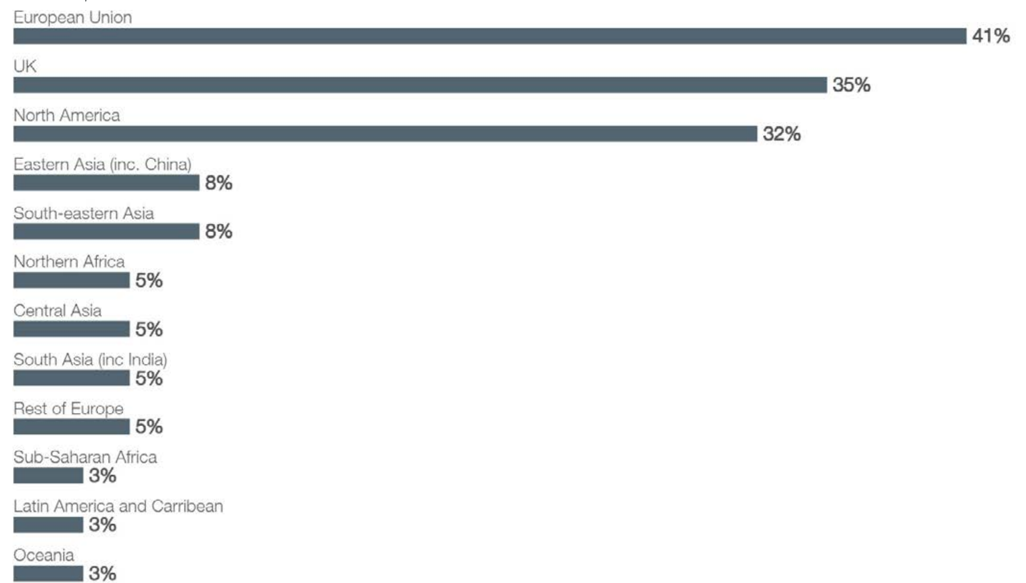
There was a further sign of confidence in Europe in our respondents' views on M&A. Among the one in five corporates that had acquired another business within the past two years, most had done so within the EU (41%), while of the 32% of businesses seriously considering M&A activity over the coming two years, only North America (41%) was a more frequently cited destination for that activity than the European Union (31%).

Read more in our article:
Europe as an investment destination

The dynamics of an internal market with a combined GDP of USD25 trillion and nearly 450 million highly educated consumers make Europe an attractive place to do business. And the EU's regulatory framework has created a stable environment within which to invest with confidence – in particular for businesses in advanced manufacturing. It will be fascinating to see how Europe's regulatory environment evolves in the years to come, and how businesses respond.

Has your firm acquired another business within the last two years?





> “The consequences of Ukraine do not contradict the energy transition. Since the war started there is a renewed sense of urgency at both the national and European level, with initiatives that push for faster project development.”

General Counsel and Company Secretary, Energy and Utilities

Another key area to watch in the coming years will be Europe’s energy market. Before the Ukraine war, the EU imported 45% of its gas from Russia, so when supplies through the Nordstream 1 Pipeline were cut, energy costs skyrocketed. Research from the European Central Bank revealed the subsequent inflationary spike **reduced euro area exports by 0.6%**.

Before February 2022, EU legislators were negotiating enhanced renewables targets under the Fit for 55 package, designed to reduce the EU’s net greenhouse gas emissions by at least 55% by 2030.

When the war shifted the focus to energy security, they swiftly pivoted to launch REPowerEU, a plan designed to end Europe’s reliance on Russian gas by 2027 and ensure 45% renewable energy supply by 2030 (5% more than under the Fit for 55 proposals). Research in 2023 from the International Energy Agency predicted renewable capacity in the EU would **double by 2028**.

Much has been made in the run-up to the election of the potential impact on the EU’s green agenda of a shift to the far right. The EU’s Net Zero timelines – and the regulatory structures it uses to achieve its goals – may be affected by the outcome of the vote. But at the same time, it’s important to understand the role of Europe’s national laws and regulations in the low carbon transition. While the Lisbon Treaty includes solidarity in matters of energy supply, many competencies rest at member state level, with progress across the bloc relying on cooperation between national governments.

Why law and regulation are key to Europe's energy ambitions

Over the past 20 years, member state support measures have proved effective at expanding Europe's renewable capacity, with mechanisms including feed-in tariffs and contracts for difference (CFDs) giving project developers the economic certainty they need to build low-carbon infrastructure. Over time, new risk-sharing structures have emerged, including power purchase agreements (PPAs) through which project owners sell their electricity to "aggregators" who then supply wholesale buyers, or even directly to businesses looking to decarbonise their operations.

Not all of Europe's support schemes have been successful, however. In 2007, Spain introduced generous feed-in tariffs to boost its solar capacity, and while they worked to increase supply, they also gave the government no leeway to reduce the incentives when the price of solar energy fell. As a result, the cost of the policy spiralled, sparking public outcry. The government eventually reduced the tariffs, including via legislation that applied retroactive cuts.
But the U-turn triggered arbitration claims worth billions of dollars from investors looking to recover their losses, many of which are still running.

EU learns lessons from the past

Today there are signs that lessons have been learnt. The EU's proposed electricity market reforms are based on two-way CFDs that have the flexibility to handle energy price shocks. Under these bilateral structures, producers still receive a guaranteed strike price for their electricity, but where it is sold for more on the market, the excess flows back to the state without limitations. Setting clear, stable rules is crucial to guarantee the credibility of the system, which is likely be tested through the low-carbon transition.

Effective permitting is equally critical. The rollout of renewables has been plagued in many countries by the time it takes to secure approvals to build. The EU has been moving since 2022 to require member states to deliver permits within a set deadline (typically a year), although it remains to be seen whether this will work in practice given the lack of resources some authorities have to process applications.

Alongside this, some member states have taken steps to limit the right of third parties to challenge projects, for example by setting time limits on court proceedings or referring challenges directly to appeal or even supreme courts. These moves are designed to counter the risk that investors will refuse to fund projects where there is uncertainty over their future.

> "It is not a price discussion with suppliers – it is whether you are big enough for them to be bothered talking to you. We know a number of developers who are struggling even to get in the room."

Vice President, Energy and Utilities

> "For offshore wind, the supply chain is not unlimited. There are a relatively small number of turbine vendors with a proven track record, and, based on current ambitions, uneven regulatory frameworks and stringent timings, those companies are struggling to make sure that they can keep up with deliveries."
>
> Mathias Verkest, CEO, Otary

Energy industry grapples with supply chain disruptions

Our conversations with industry insiders revealed a series of common concerns. High financing costs and wage inflation, manufacturing shortages and Ukraine-related supply chain disruptions have caused construction budgets to soar, **including for critical renewables equipment such as wind turbines**. The economics of many new and existing green energy projects now don't add up, with developers looking to exit some deals.

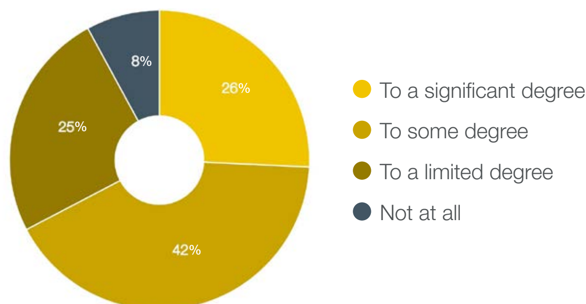
More than two in three of the businesses (68%) in our survey said they had felt the impact of supply chain disruption, with more than one-in-four (26%) reporting a significant hit. The numbers look similar when viewed through the lens of commodity prices, where 57% of respondents said their companies had seen the effects – and 26% a significant effect.

Our interviewees also highlighted the difficulties of navigating Europe's fragmented policy landscape. "Various regulatory systems are in place within the different member states, which makes it tougher for Europe as a whole to go faster [on Net Zero]. In addition, we are struggling with how to resolve the energy dilemma, although more renewables is the endgame," said Mathias Verkest, CEO of Otary. "Europe's regulatory regimes should enable a faster build-up of renewable energy and offshore wind, supporting sustainable business cases while providing local, clean energy at a stable cost."

Calls for more coordinated EU energy policy

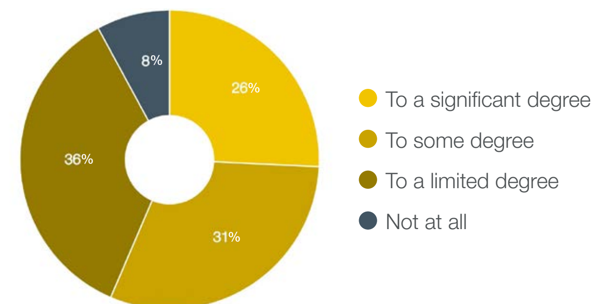
The energy leaders we spoke to were united in their calls for coordinated EU energy policy to align decarbonisation strategies across borders. "I plea for more coordination, and that's not sufficiently happening," added Mathias Verkest. "Grid connections remain key, which need to be developed in basically all countries. These are required before you can develop or add more offshore generating units such as wind farms because you need the connections to bring the power back onshore." If more Eurosceptic voices enter Parliament, it's hard to see how this level of cooperation moves any closer, with nationalist and far-right parties advocating for less pan-European cooperation and the return of more powers to national parliaments.

To what extent are the following macro issues impacting your organisation: supply chain disruption?



- To a significant degree
- To some degree
- To a limited degree
- Not at all

To what extent are the following macro issues impacting your organisation: volatile commodity prices?



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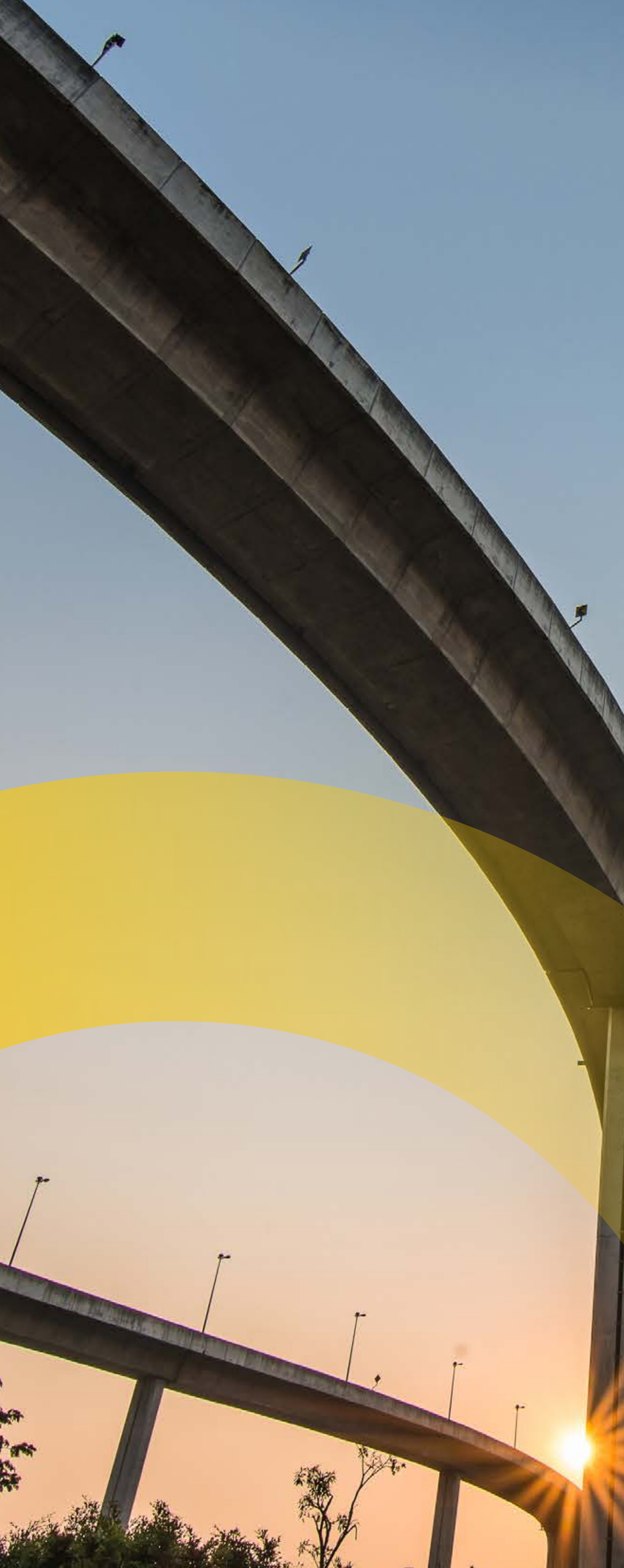

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Europe, regulator of the world

“The EU AI Act brings opportunities because people want trustworthy systems. If European developers are required to build them, they can be at a competitive advantage.”

Richard Mallah, Principal AI Safety Strategist, Future of Life Institute

“Europe suffers from a positioning problem. Its regulation is framed as a compliance exercise, as bureaucracy, rather than as a roadmap through which your business can become a world leader.”

Mike Barry, strategic sustainability consultant

The aims of the European Union are set out in Article 3 of the Lisbon Treaty. Within its boundaries these include ensuring the peace and well-being of citizens; providing freedom, security and justice without internal borders; creating a highly competitive market economy; and enhancing economic, social and territorial cohesion.

The EU also has a purpose that extends beyond its own borders: to uphold and promote its values and interests, contribute to sustainable development, and protect human rights on the global stage.

The primary levers used to achieve these goals have been regulation and enforcement. Indeed, regulatory development can be viewed as one of the EU’s main outputs since its inception. Some business groups have seized on this as a cause of the EU’s sluggish economy, calling for “**regulatory breathing space**” to boost growth and jobs. French President Emmanuel Macron picked up on the theme **when he presented his green industrial policy for France**.

The EU’s regulatory reach is also increasingly extraterritorial, in part because of the competitive impact of European regulation on its own businesses.

As an example, EU state aid rules prevent member state governments from offering certain types of support to companies (such as preferential tax breaks or grants) that would distort competition within the single market, yet businesses from third countries are not bound by the same restrictions in their home markets.

Europe’s global agenda has a domestic objective

During the 2019-2024 mandate, the EU institutions introduced rules to redress this balance, including the Foreign Subsidies Regulation – designed to identify and mitigate distortive subsidies from outside the bloc – and the Digital Markets Act and Data Governance Act, which were introduced to help European companies access the digital resources they need to compete on the global stage.

State support could prove a key focus area during the next EU mandate if calls grow for more powers to be returned from Brussels.

The Carbon Border Adjustment Mechanism was similarly calibrated to support decarbonisation and counter the impact of the EU’s own sustainability rules by imposing an emissions tariff on imports of goods from third world countries that carry a high risk of carbon leakage.

The General Data Protection Regulation aims to safeguard the fundamental rights and freedoms of citizens – including the right to a private life – while allowing data to flow freely across borders.

The forthcoming EU AI Act is intended to apply similar safeguards to the development of artificial intelligence, while the Corporate Sustainability Due Diligence Directive (CSDDD, based on corporate duty of vigilance laws introduced in countries such as France) is designed to confer on large businesses a responsibility to identify – and address – any negative impacts of their activities on the environment and human rights across their global operations.

The Regulation on Deforestation-free products is also built around the imposition of supply chain obligations on businesses, this time to ensure the goods that EU citizens consume do not contribute to deforestation or forest degradation.

The regulation focuses on seven key commodities and the products derived from them – cattle, cocoa, coffee, oil palm, rubber, soya and wood – and will require organisations to conduct due diligence and risk mitigation across their entire supply chains before being allowed to distribute across the European market.

While European regulations invariably set a high bar that requires extensive investment in disclosure and risk management, there is also a predictability to the way EU frameworks are constructed that aligns with the general shift towards a more purpose-driven, responsible corporate environment.

It is perhaps no surprise therefore that almost half of respondents to our survey (43%) viewed the EU's regulatory structures as "very favourable", far higher than those of other global jurisdictions.

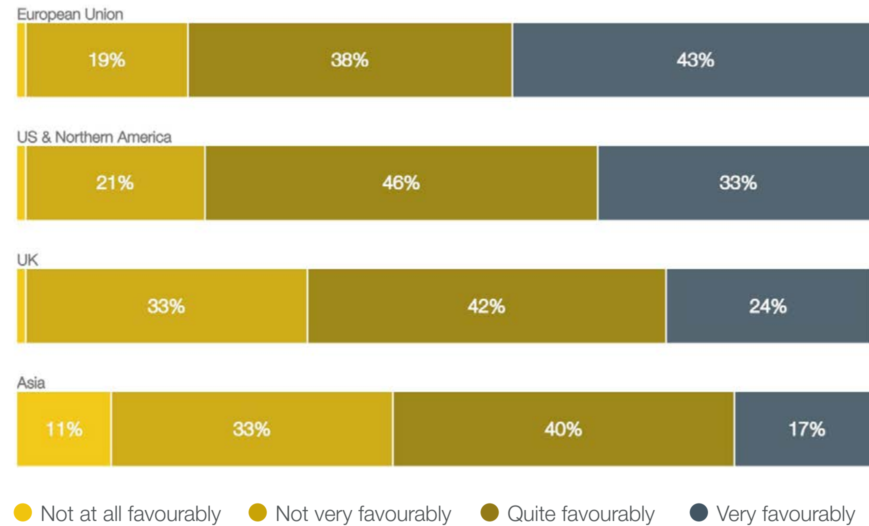
Despite the positive signals from our survey, our in-depth interviews painted a more nuanced picture of the EU's regulatory structures. While some business leaders we spoke to viewed EU regulations as positive – particularly where they worked for larger organisations – others described them as burdensome, even where they as individuals supported the regulations' intentions.

For example, there was a sense that European sustainability rules are significantly more difficult to navigate where they are overlaid on commercial operations in emerging markets.

The proposed EU social taxonomy – which would increase transparency around the "S" of ESG in a bid to drive investment towards activities that improve living and working conditions – was specifically called out as a concern by leaders of businesses with activities in developing countries which have different social structures to those in mature markets.

Given the prevailing sentiment around over-regulation it's questionable whether the social taxonomy will be introduced any time soon ("It's perceived as a very high political capital endeavour right now given the debate around gas and nuclear under the EU green taxonomy," said E3G's Jurei Yada), but the prospect of EU regulatory overreach was a consistent theme in our conversations.

Thinking more broadly about the macro-operating environment, how favourably would you view the following regions in relation to the regulatory environment?



> "Supply chain due diligence is hard. You face the choice of going back to suppliers where you have more of a handle on how they operate or with whom you have greater cultural affinity, and that means businesses in certain geographic areas. But that may put your costs up and potentially lowers profits if you can't pass them on to your customers, which in turn makes you less attractive to investors and less able to innovate."

Global general counsel, Life sciences

There is also a scale point. Greater compliance requirements are more difficult to absorb for smaller organisations, financially and from a skills and resource perspective. This confers an advantage on bigger businesses, and while the European Commission has looked to rectify this through the principle of proportionality, there was a sense among our interviewees that EU regulation has the potential to drag on innovation and growth.

The EU itself has recognised that its structures need to adapt to a fast-changing world. European **state aid rules** for example were reformed to counter the effects of the U.S. Inflation Reduction Act, while the European Commission has signalled its willingness to engage with businesses to discuss the potential antitrust risks of collaborations focused on decarbonisation. There is also debate among countries including France and Germany over whether to raise the minimum threshold of employees for a business to qualify as an SME from 250 to 500, which would cut at a stroke the number of businesses in scope of certain rules. Commission President Ursula von der Leyen herself has acknowledged the need to reduce regulation in order "**to make business easier in Europe**".

Some of our interviewees were positive about the EU's regulatory frameworks as a potential driver of innovation, pointing out that requiring businesses to track granular emissions data across their operations would potentially involve a technological solution, which in turn could improve risk monitoring and agility.

Thierry Breton, the EU's Internal Market Commissioner, made a similar point following political negotiations on the **EU's AI Act**. "The Act is much more than a rulebook," he said. "It's a launchpad for EU startups and researchers to lead the global AI race."

EU Commission focuses on antitrust enforcement to protect economic growth and innovation

As the volume of new EU regulation continues to rise, so does the risk of enforcement. Nowhere is this more apparent than in the antitrust space, where the European Commission is increasingly focused on protecting growth and innovation – and ensuring that the pursuit of other priorities such as the Green Deal doesn't become a cover for collusive behaviour. In this environment, while we have seen antitrust theories of harm evolve to reflect changing market dynamics, more classic allegations of anticompetitive information-sharing remain just as relevant as in years past.

There is broad acceptance among economists that information exchanges between businesses can be pro-competitive, for example where they lead to efficiency gains that benefit consumers. But where the information relates to a company's market strategy, there is potential for co-ordination and collusive behaviour that could act in the opposite direction.

> "We see a lot of regulation especially coming out of the EU which can be on balance positive for the larger companies because the barriers of entry may go up."

Global general counsel, Life sciences

> "Considered regulation establishes a level playing field that protects domestic players from being colonised by multinationals. But where that regulation is indiscriminately applied to smaller companies it can put them at a disadvantage against bigger players who can afford the cost of compliance."

General counsel, Financial services

Increased risk of infringements as pace of regulatory and market change increases

The likelihood of competitively sensitive information being exchanged is greater where there is a significant volume of new regulation, as companies will often engage with their rivals to discuss how to adapt to or implement the new rules. The same is true in a world where more businesses are launching R&D collaborations with their competitors to develop new technologies.

Where these partnerships align with the EU's strategic objectives, for example in relation to electric vehicle batteries or other low carbon systems, the Commission is willing to engage up front and provide informal comfort on how to de-risk the relationship. But where the gap between safe conduct and cartel behaviour is increasingly slim – and with the Commission now using cutting-edge AI tools to enhance its investigative capabilities – companies need a sophisticated understanding of the enforcement landscape and robust compliance frameworks to stay on the right side of the line.

EU Damages Directive generates significant private enforcement in a claimant-friendly legal landscape

The EU Damages Directive, which makes it easier to bring follow-on claims in the wake of a cartel (or abuse of dominance) infringement decision, adds an additional layer of complexity. Before the Damages Directive was enacted, the primary decision for companies alerted to possible misconduct was whether to apply for leniency.

(In Europe, the first company in any cartel to submit a leniency application receives full immunity from any administrative fine if the information it provides is enough to warrant a Commission investigation or find an infringement and the company complies with the other conditions of the leniency notice. Any company that applies for leniency afterwards can also have its fine reduced if it offers information that adds "significant value" to the evidence in the Commission's possession). Any granting of leniency by the Commission will be followed by an infringement decision against the company and other participants in the collusive behaviour, which will then become the reference point for private enforcement action.

But today, the scale of private damages claims is so large that leniency is a less appealing option, particularly when factoring in the complex, costly and lengthy co-operation obligations that come with it. It is critical that companies consider the full lifecycle of a cartel case, and the related risk, when deciding whether to self-report potential collusive conduct.

Settlement discussions require careful consideration

Settling with the Commission is also a tricky process; in theory it's possible to contest the legality of a Commission decision that underpins a settlement, but in practice the margin to do so is very limited. Companies, therefore, face a dilemma – settle to conclude the administrative process quickly and receive a lower fine (even if it means accepting an infringement decision that goes beyond what the business is comfortable with and potentially exposes it to increased risk of private damages claims), or fight on, prolonging the uncertainty and increasing the possibility of a bigger regulatory penalty?

While the Damages Directive entered into force in 2014 and all member states had implemented it into their legal systems by 2018, only recently have the first cases resulted in rulings by the Court of Justice of the European Union in Luxembourg on questions referred to it by national courts. As a result, the procedural issues involved – and indeed the scope of the rules themselves – have only begun to be clarified over the past 18 months or so.

Court of Justice decisions clarify rules and procedures

Guidance coming out of the Court of Justice for example essentially now means that claimants in many EU-wide cartel cases can sue for damages in whichever member state they choose. At a high level, the Court's broad interpretation of the scope of corporate liability implies that where an infringement decision is made against a parent company, claims can be brought in any EU jurisdiction in which one of its national subsidiaries active in the same market operates, due to the degree of decisive influence presumed to flow down from the parent to other group entities.

The influence of the Representative Action Directive – which allows consumers impacted by a breach of EU legislation to bring group claims – adds a further challenge. Recent cartel cases have led to significant private enforcement activity in Germany and the Netherlands for example, both of which have implemented the Directive into their national legal frameworks. But the same conduct has also sparked follow-on claims in Spain, which has not. As a result, defendants may find themselves tackling large group cases in some jurisdictions and literally thousands of smaller ones in others.

Against this backdrop – market changes that raise the possibility of information exchange and anticompetitive coordination amid heightened threat of EU antitrust investigations, and the rise of claimant-friendly private enforcement rules that complicate the decision-making process for senior executives looking to manage antitrust risk– businesses must ensure they can construct a coherent response strategy that minimises their exposure across the EU as a whole.

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Charting a path through Europe's sustainability landscape

"We talk about Net Zero at every board meeting. We have strategy sessions all dedicated to renewable energy, the Green Deal, carbon footprint, everything. It's amazing how much time we spend on it."

Matt Lepore, General Counsel and Chief Compliance Officer, BASF

Our in-depth interviews and survey revealed sustainability rules as one of the key challenges facing businesses in Europe. In recent years the EU has been a trailblazer for sustainability-related regulation, dedicating extensive legislative time to measures designed to support the transition to Net Zero, improve transparency and encourage greater levels of investment in sustainable activities.

The possibility of businesses gaming the system and "greenwashing" their operations saw the EU introduce its taxonomy to classify economic activities that are deemed sustainable. This work has proved controversial however, prompting intense debate over the inclusion of energy sources such as gas and nuclear on the approved list.

Among our interviewees, Net Zero transition plans – which feature in several regulatory frameworks, including the Corporate Sustainable Reporting Directive, and are designed to ensure businesses are aligned to the goals of the Paris agreement – were seen by many as the next big challenge they face.

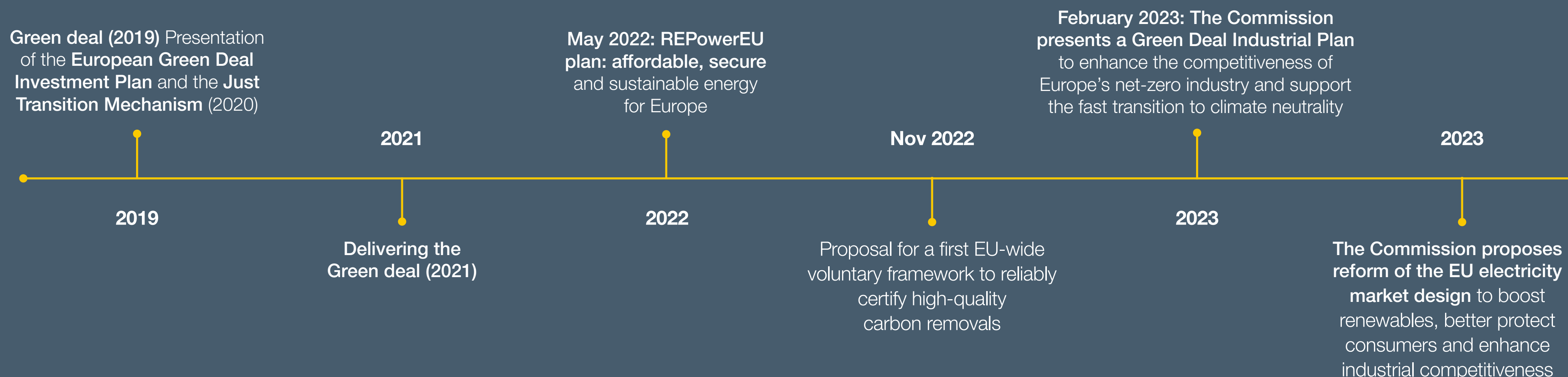
Transition plans represent next big challenge for business

Jurei Yada, Progamme Leader for sustainable finance at climate change think tank E3G, said: "Until now, the EU has been focused on defining 'green', but these activities represent just 10% of the economy. The focus is now shifting to transition planning and creating a regulatory framework to guide businesses and investors through the path to Net Zero. Exactly how this debate will play out is likely to become clearer in the next EU mandate, when the technical implementation of transition planning is expected to take shape, including where this meets prudential regulation."

"I have conversations with partners based in the U.S. about CSDDD, and they have questions about the extraterritorial application of the directive. There is a divide in opinion between those that ask if it's in the interest of American businesses, while others see it as a good thing."

Jurei Yada, E3G

A timeline of the EU Green deal (side bar in the main report)



"The European Corporate Sustainability Reporting Directive introduces very significant burdens on European companies that have subsidiaries in places which don't necessarily have the same level of reporting maturity. The challenge is that many of the categorisations used in Europe won't map out neatly on to other markets, particularly from an audit perspective. Reporting on that data with a high level of assurance by 2025 is a very significant project that is going to cost us real money."

General counsel, Financial services

> "We want to work with our supply chains on carbon emissions, but we don't always get the full visibility all the way through the chain that we'd like in certain parts of the world. It's a struggle to get comfortable with that."

Vice President, Energy and utilities

Our survey revealed that global businesses recognise the strategic importance of sustainability and Net Zero – and are diverting significant investment into planning and implementing sustainability initiatives – but remain unconvinced as to the efficacy of their efforts.

According to our survey, 45% of businesses were investing time, resources and budget in environmental sustainability – including climate disclosures and initiatives to reduce emissions. Just over half (53%) of our respondents were confident that they would achieve their strategic aims, with only 29% saying they were very confident.

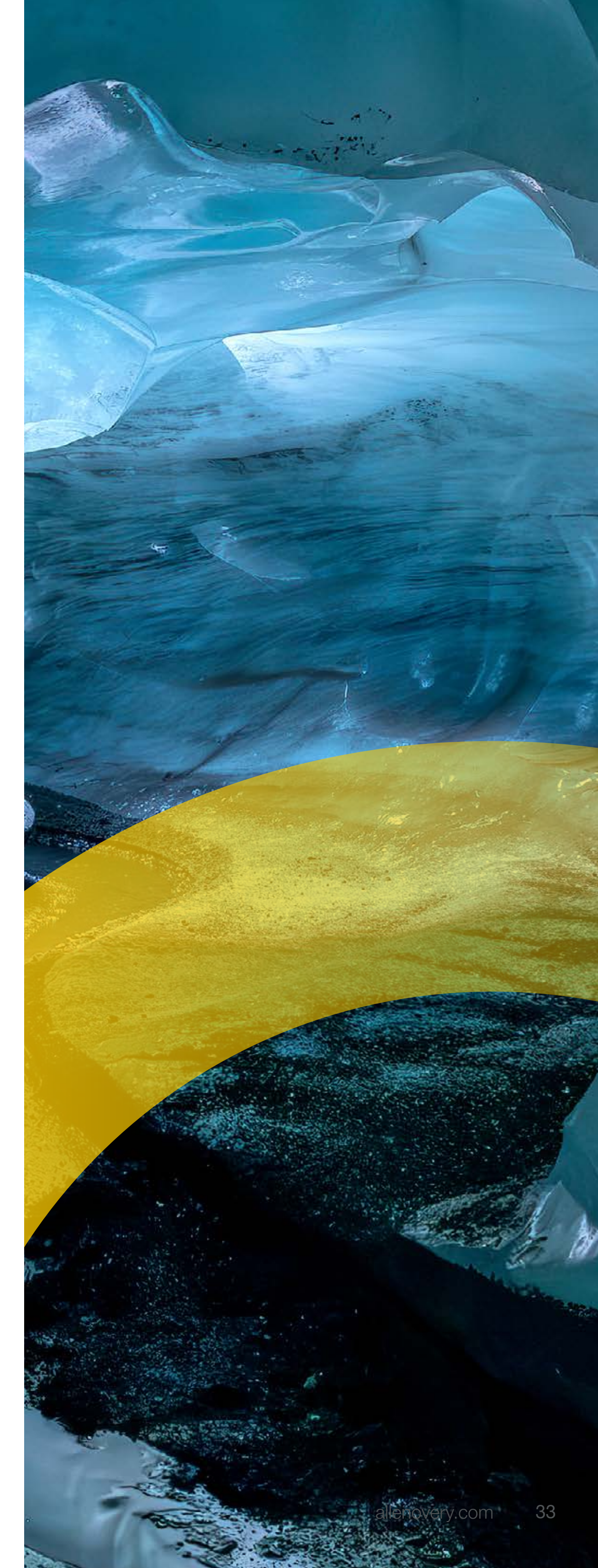
Lack of preparation among businesses for forthcoming regulations

Overall, fewer than one in four (24%) of the leaders we questioned said their businesses were well prepared to meet the expected requirements of the CSDDD, possibly because of the difficulty in seeing through their supply chains to get an accurate picture of what's going on, and, more fundamentally, mitigating any negative impacts.

Our survey also revealed that fewer than one in five (14%) respondents felt well prepared to deliver environmental reporting between global regions that differ in their approach (eg the U.S. and the EU).

In recent years there has been a backlash against ESG investing among Republican states including Kentucky, Texas, Florida and Kansas. Several state attorneys general have launched investigations into whether actions by groups of banks to deny some companies access to services based on their environmental records amount to anticompetitive co-ordination and violate consumer protection laws. There has also been legislation forcing state-sponsored pension funds to divest from entities deemed to be promoting ESG goals, and bills passed requiring government investors to base their decisions only on "pecuniary factors", often defined to exclude ESG analysis.

Against this backdrop, many global organisations feel under pressure to disclose less about their ESG activities at the same time as European regulations have been requiring ever more specific sustainability information (the Financial Times has highlighted a study of U.S. asset managers in which 30 per cent said they were going to be **more circumspect about their ESG-related activities in future public documents**). Any asymmetry is a potential source of litigation, with plaintiffs pursuing businesses where they see inconsistencies in reporting.

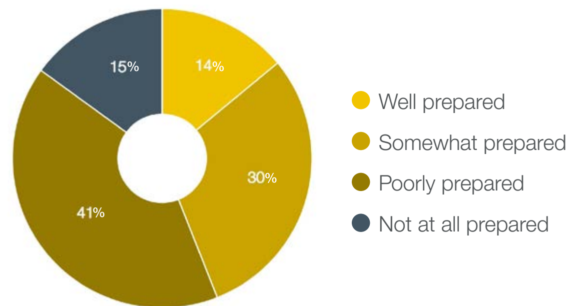


The increase in sustainability data set to be published under the CSRD – and national duty of vigilance laws – is set to make Europe a more active destination for sustainability-related litigation in future.

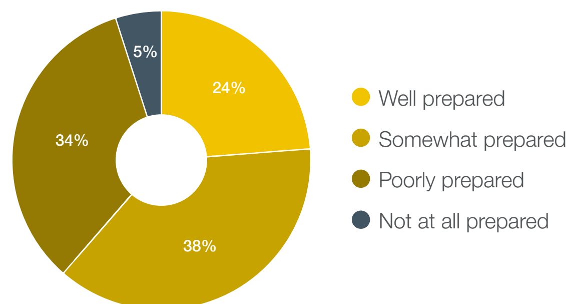
The latest research from the Sabin Center for Climate Change Law reveals a steady uptick in climate claims against businesses in Europe, with hotspots in France, Germany and the Netherlands. The Dutch courts in particular have heard a number of high-profile cases, including in 2021 when a judge ordered Shell to slash its carbon emissions by 45% relative to their 2019 levels within a decade (the decision is currently pending an appeal).

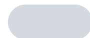
The ruling is important because it applies not only to the company's own emissions but also those created by the use of Shell's products, and was the first time a court had ordered a business to reduce its carbon output in line with Paris agreement. With the CSRD requiring large organisations to publish transition plans expressly aligned with the Paris goals, more such cases could arise in the future.

Given your current internal systems and processes, how prepared is your company to deliver environmental reporting between regions that differ in their approach (eg the U.S. and EU)?



Given your current internal systems and processes, how prepared is your company to disclose the environmental impact of your company's supply chain?





“Europe is a now a higher-risk jurisdiction for climate-related litigation.”

General counsel, Financial services

Trends in European climate litigation

The Sabin Centre’s latest research flags four key themes in EU climate cases.

1. **A surge in greenwashing cases** with high-profile claims against extractives companies for continuing with fossil fuel investments despite Net Zero commitments, challenges to claims of products being “climate-neutral”, suits brought over alleged inconsistencies between climate pledges and corporate lobbying, and allegations of failure to disclose climate risks by banks. This is especially so given the adoption in early 2024 of a directive empowering consumers to act against corporate greenwashing (which bans the use of general environmental claims like “environmentally friendly”, “natural”, “biodegradable”, “climate neutral” or “eco” without proof) and the Green Claims Directive, which sets tighter rules for carbon offsets claims and allows companies only to mention offsetting schemes if they have already reduced their emissions substantially and use those schemes for residual emissions only.
2. **Challenges to the inclusion of natural gas in EU taxonomy**. An uptick in cases challenging the EU’s environmental classification structures which includes a complaint filed by a group of European NGOs challenging the inclusion of natural gas as a low-carbon transition fuel under the EU taxonomy.
3. **Full cycle of fossil fuels**. Plaintiffs have launched lawsuits arguing that climate change impacts were insufficiently considered in the environmental impact assessment process, with a focus on alleged failures to assess emissions produced when fossil fuels are used (Scope 3), rather than those associated with production (Scope 1 and 2). High-emitting activities are now more likely to be challenged at different points in their lifecycle, from initial financing to final project approvals.
4. **‘Turn off the taps’ cases**. Alongside ongoing challenges to project approvals, there are also cases focused on fossil fuel supply. One, filed in February 2023 against a leading bank in France, alleged that it has failed to comply with its obligations under France’s duty of vigilance law.

Claims are also being brought in Europe under consumer protection and advertising laws, as well as the EU’s Unfair Commercial Practices Directive. Here, lawsuits are testing whether consumers fully understand concepts such as “climate neutrality” or “Net Zero”, which often involve the reduction or offsetting of emissions rather than their eradication. We are also seeing claimants pushing companies to disclose the negative impacts of their operations, instead of simply focusing on the positives.

Net Zero disclosures are increasingly a trigger for greenwashing claims, with energy majors and mining companies targeted over whether their environmental commitments are misleading given their current fossil fuel investments. The EU legislature also introduced the Green Claims Directive to address false environmental claims relating to the environmental aspects of a product or a business itself. Under these rules, companies can only mention offsetting schemes if they have already cut their emissions substantially and only use the schemes for residual emissions. Any carbon credits generated by offsetting schemes will also have to be certified under the EU’s Carbon Removals Certification Framework, which is currently being negotiated. (You can read more about decarbonisation disputes in Europe **here**.)

Our survey revealed a global business community that is not only underprepared to track and disclose its environmental impact across the world, but also one lacking confidence in the systems it has in place to manage the risks associated with ESG activism and the uptick in sustainability-related class actions.

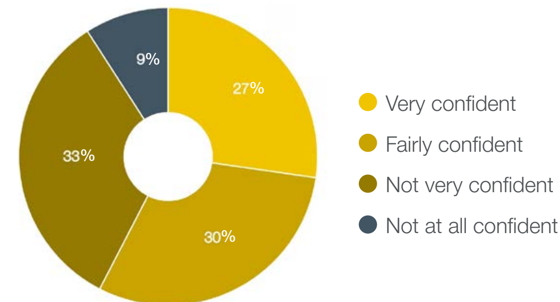
While 70% of global businesses reported that they had systems in place to mitigate the risk of ESG activism and climate-related mass claims, fewer than three in five (57%) of our respondents were confident these systems mitigated those risks effectively – with only 27% very confident.

Some analysts have predicted that a Parliament with more far-right representation could see the EU's sustainability rules loosened over the next five-year term. If this in turn causes businesses to backslide on their own low carbon ambitions, it could see an even more hostile litigation landscape as NGOs and civil society groups attempt to redress the balance.

Others have proposed a **less-pessimistic outlook**, whereby politicians remain convinced of the energy security benefits of increasing renewable investment and reframe Net Zero in the context of job creation. And as our survey shows, many businesses remain committed to Net Zero and recognise the opportunities it brings.

To what extent would you say that ESG activism & a rise in class actions is a climate related business risk applicable to your organisation?

How confident are you in these systems mitigating those risks effectively?



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Seizing the AI opportunity

"I recently read that if all AI technology advancement were halted tomorrow, there would be about 20 years' worth of high GDP growth still to come simply from implementing current systems. I think that is very plausible, given there is so little adoption."

Richard Mallah, Future of Life Institute

"We are using AI to innovate within our business. As a vertically integrated company, we make machines and we have a huge amount of patient data from our clinic and our machines – more than a pharma company or a medical device company – because they don't get into direct contact with patients daily, unless they are doing a clinical trial. AI will be a great tool to optimise healthcare in a personal way, which is a huge opportunity to make lives better."

Global General Counsel, Life sciences

"We have our own AI tool where we've filed every company report we've published over the past 50 years. If I want to find what we've said on any issue, I can."

Matt Lepore, General Counsel and Chief Compliance Officer, BASF

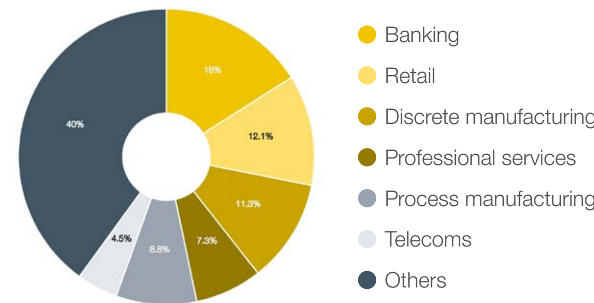
"AI is helping us crunch data around M&A deals and lower the costs of due diligence."

Global General Counsel, Life sciences

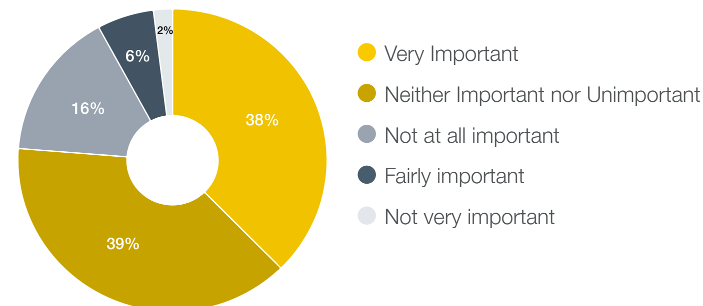
In December 2022, MIT Technology Review named generative AI as one of its **10 breakthrough technologies of 2023**. Less than a year later, respondents to a KPMG survey of CEOs ranked generative AI as their **top investment priority globally**. AI innovation is continuing at breakneck speed, with studies showing that AI models are now capable of **learning from human behaviour**.

According to **research from the International Data Centre (IDC)**, spending on artificial intelligence, including hardware, software and services for AI-related systems, could more than double to USD300bn annually by 2026. And while the majority of that investment will flow to the U.S., 20% will be directed into Europe.

European AI Market: Top industry based on 2023 market share[1]



How important is exploring or embedding opportunities associated with AI as a strategic priority for your business?

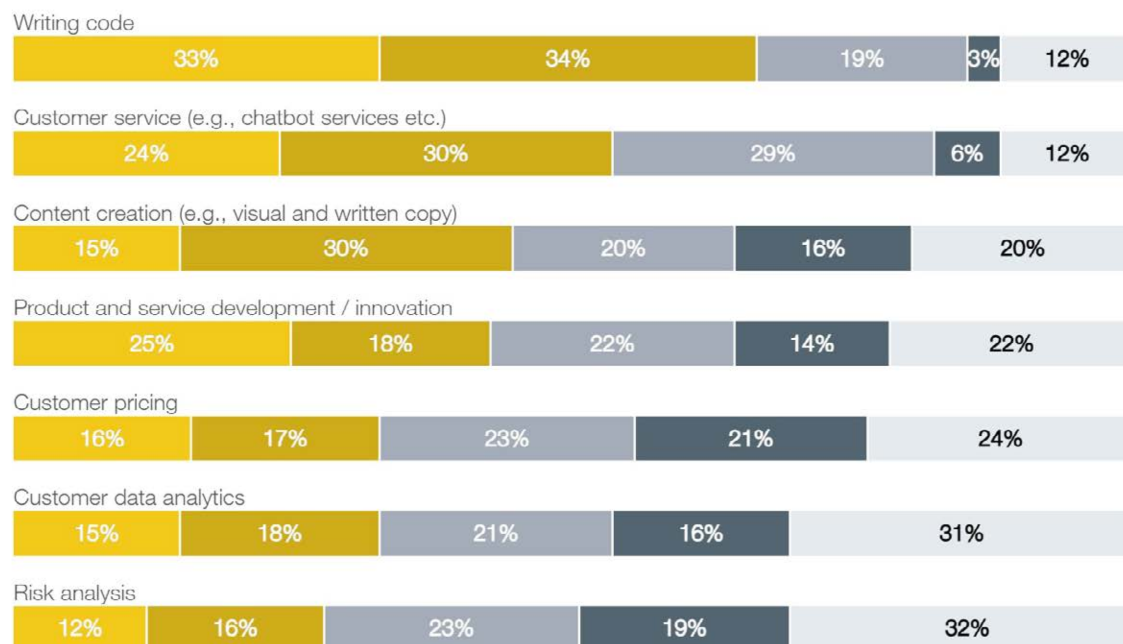


[1] IDC, **European spending on AI in 2023**, March 2023

Among respondents to our survey, nearly 4 in 5 (77%) said their businesses viewed AI as a strategic priority. Indeed, many said they were beyond the strategy phase and firmly into integration, with AI already being used to write code, support customer services and create content.

Our in-depth interviews painted a fascinating picture of how AI is being deployed across sectors, with businesses deploying AI models to boost operational efficiencies, mitigate disclosure risk, manage their contractual estate and support M&A execution. Others were pursuing more disruptive applications, for example by applying AI to proprietary data sets to develop new digital products, increase the efficiency of market-facing activities, and to create more personalised and informed experiences for their customers.

While the potential of generative AI is enormous, the technical, regulatory and legal complexities involved are equally large, with potential for significant challenges if they are not adequately managed. Our survey showed that of the 77% of businesses that saw AI as a strategic priority, only 26% were very confident they would achieve their aims over the same period. One in three were either not very – or not at all – confident.

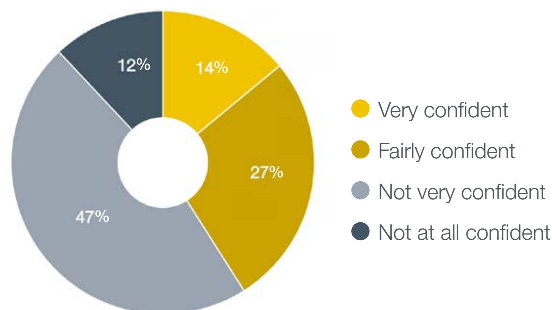


Further, only 26% of our respondents said the governance of AI was a business risk that they currently have systems in place to mitigate. Considering the high numbers of corporates who said they were already working with AI, it appears that many are doing so without the right checks and balances in place. Even among the one in four businesses that had implemented risk mitigation systems, fewer than half (41%) were very or fairly confident that they work effectively. And only one in five of our respondents felt fully aware of – and well prepared for – the evolving legal and regulatory landscape around AI.

> "The big factor at play right now is the AI race. The valuations might be crazy, but people feel the need to have a foot in the door through a relationship with AI vendors. Strategic investments in this space have picked up as a result."
>
> Trey White, SAP

To what extent would you say the application and governance of AI is a risk to your organisation?

How confident are you in these systems mitigating those risks effectively?



- Very confident
- Fairly confident
- Not very confident
- Not at all confident

> "While we are awaiting the final text, the EU AI Act is based on developers keeping a record of what they do, for example what data was used for training, how the model was trained, and if they have used protected data."

Christophe Carugati, Affiliate Fellow, Digital and Competition, Breugel

EU AI Act proposes tiered approach to regulation

Here, the EU AI Act is the most comprehensive attempt at regulating the technology undertaken by any legislature globally. The proposed law is intended to align with the Lisbon Treaty to focus on the level of risk a given AI implementation could pose to the health, safety or the fundamental rights of a person – including the right to non-discrimination, data protection and privacy – as well as the rights of the child.

In December 2023 the EU Parliament, Council and Commission reached political agreement on the AI Act after protracted negotiations. While the final text of the legislation is awaited, the key principle underpinning it is to target applications of AI based on whether they pose minimal, limited, high or unacceptable risks.

Minimal risk systems will be free from any additional regulatory obligations, while those deemed limited risk will need to follow basic transparency requirements.

Alongside this risk-weighted, application-focused approach, there will be separate requirements that apply to certain types of AI models, including general purpose systems such as ChatGPT and Gemini. Businesses developing or adapting these models will need to keep a record of how their systems are trained, including what type of data was used, whether any of that data was protected, and what consents they had in place to use it. They will also be required to inform end users that they are interacting with an AI system rather than a human being.

Developers of high-risk systems (which include CV-screening tools for job applications and robotic surgeons) will be subject to a conformity assessment and must be registered on a special EU database before these products and services can enter the EU market. Once in use they will be overseen by national authorities and the European Commission.

Negotiations expose differing approaches between MEPs and member state governments

The negotiations around the Act sparked intense debate between MEPs keen to protect fundamental rights, and member state governments keen to use AI to protect national security. In the end, real-time AI facial recognition systems will now be permitted for a narrow set of law enforcement purposes including to search for victims of human trafficking and counter terrorist threats, but the use of AI to categorise people in relation to sensitive characteristics such as gender, religion, race or ethnicity – as well as for social scoring, predictive policing and emotional recognition in workplace and educational settings – will be banned.

It is not solely through the AI Act that Europe is attempting to influence the evolution of AI. Cooperation between the Big Tech companies and AI developers remains under intense scrutiny from antitrust authorities across Europe as a whole. In the UK, the Competition and Markets Authority (CMA) has stated its intention to scrutinise such partnerships to assess their impact on competition and consumer protection. Speaking at a Fordham University antitrust event in New York in September 2023, Andreas Mundt, the head of the German Competition Authority, expressed similar concerns when he said: "… we should be extremely alert on the terms of cooperation between 'Big Tech' and these new AI companies."

AI's risks for business

Generative AI models create two broad areas of legal risk for the companies that deploy them. **The first relates to the expectation of errors (the so-called "black box" problem).** Here, there is a likelihood that the models "hallucinate" and give incorrect responses that, in certain contexts, could lead to legal liability for tort, breach of advisory duties, consumer harm and/or regulatory violations.

Hallucinations could be a function of incorrect or out of date data in the model's training set, inaccurate mathematical predictions based on the weighting of sources of randomisation, or historical bias in the information used to develop the model. They are also simply a product of the way the technology works. The output generated by any AI system is nothing more than a prediction, and no prediction will be 100% accurate. The models underpinning generative AI systems are no different, save that the risks are likely amplified in practice given their general-purpose nature and their wide range of potential use cases.

At the same time, the outputs of generative AI models are inconsistent and unpredictable, making it extremely difficult to ensure standards of quality and accountability are met. The same questions will produce different answers, and where AI models are deployed to deliver (or assist in delivering) financial advice for example, this can lead to variances in outcomes for consumers.

The second risk derives from the fact that AI models take human-generated content and account for it in a mathematical response. This – coupled with the fact that AI developers are incentivised to access as much data as possible to train their models – raises the possibility that someone else's data may be used without permission or credit, which in turn creates real risks for both the developer and the AI user, and raises the possibility that the user may not be able to assert ownership over the model's output. Crucially, the model may also automatically retain and learn from a user's own IP. Questions in relation to data privacy and protection also arise in instances where the model has been trained using personal data (which is often the case for large language models) or where users input personal data in their prompts.

- If an AI model has been fed with illegally scraped information, not only would the AI developer be likely to infringe third party IP rights (most likely copyright) at the point of training the model, but so would the user of the AI model at the point of use. This is because AI models "memorise" their training data and there is a risk that they reproduce a substantial part of an individual copyright work in an output. These issues are currently being tested through litigation, with the likes of OpenAI, Microsoft and Stability AI (the developer of AI image generator Stable Diffusion) being sued for copyright infringement, among other things, in various actions in the UK and the U.S.
- There are various tools to mitigate these risks, from internal governance to operational controls and contract terms. Some developers have created what they refer to as "IP safe" AI by training their models only on licensed content, proprietary IP and rights-free information in the public domain, and are offering to indemnify users against any IP claims linked to content created by their tools. However whether this will become standard practice remains to be seen.
- Another risk is that in in most jurisdictions, the outputs of AI systems do not benefit from copyright protection. As a result, any user looking to protect the commercial value of the outputs of an AI model will need to consider alternative forms of protection, such as trade secrets. The test for whether something qualifies as a trade secret is both evidentiary and practical, and any trade secret strategy requires careful consideration across multiple stakeholders in a business. Who has access? How is that access controlled? What security protections and encryption protocols are deployed? Are the appropriate non-disclosure agreements in place?
- Investors will also need to assess open-source software risk given that the model may have been trained using publicly available source code repositories such as Github. A proposed class action lawsuit has been launched against major AI developers in the U.S. alleging licence breaches, fraud, negligence, "unjust enrichment", unfair competition and privacy violations linked to the use of open source code to train large language models (LLMs). Open source software risk is particularly important to consider where the AI is being used to generate software code, as the output from the model may reproduce parts of the open source software from the training data set which in turn can raise broader IP risks for the business.
- Appropriate governance can help reduce the IP risks once the model is in use, for example by designing controls to ensure users avoid prompting the model with an instruction to copy, or via reference to any known trademarks or individuals. Likewise, clearly labelling outputs as the products of generative AI can guard against them being deployed for purposes beyond their intended use case. Other issues to consider include whether the outputs are for public or internal consumption, and whether they can be used verbatim or "for inspiration".

Deploying AI: three risk management pillars

Use case+

Businesses deploying AI must articulate clearly and exactly what the model is to be used for, and, given the sweeping abilities of LLMs and the risk that they can be deployed for other purposes, implement strict governance controls to keep the system's use within the original design. This means the use case needs to be reinforced with playbooks, training, system settings and working practices to reduce the likelihood that they are used in ways that were not intended (eg it is not enough to implement a contractual restriction designed to protect trade secrets if operational steps such as encryption aren't also introduced).

Operational

Businesses must also implement operational measures to integrate generative AI safely into their operations. Here, legal functions need to work closely with information security and technology teams. This includes in relation to security measures, the configuration of the model, and the use of privacy enhancing technologies such as homomorphic encryption and differential privacy, a process which adds "statistical noise" to a data set so AI models can still look for patterns without breaching privacy rules. The interdependence between legal, operational and security stakeholders is higher in generative AI rollouts than for other types of IT project.

Contractual

Various terms help mitigate legal risk, both in contracts between the company deploying the AI and the model's developer, and between the deployer and any end user (where generative AI is built into consumer-facing products or services). Businesses deploying AI systems will need to adapt their contracts with developers around sector-specific requirements and conduct pre-contract due diligence – for example exploring how the model was trained and what data was used to quantify the nature and extent of any IP infringement risk. The market continues to evolve in novel areas of contracts negotiation.

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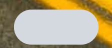
Europe as an investment destination

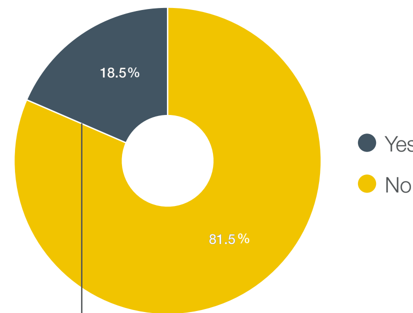


“Even with the complex European regulatory landscape, the more aggressive approach of U.S. antitrust authorities and the UK CMA makes Europe feel slightly easier to manage right now as a jurisdiction for M&A. We’re seeing strategic investment in the EU picking up.”

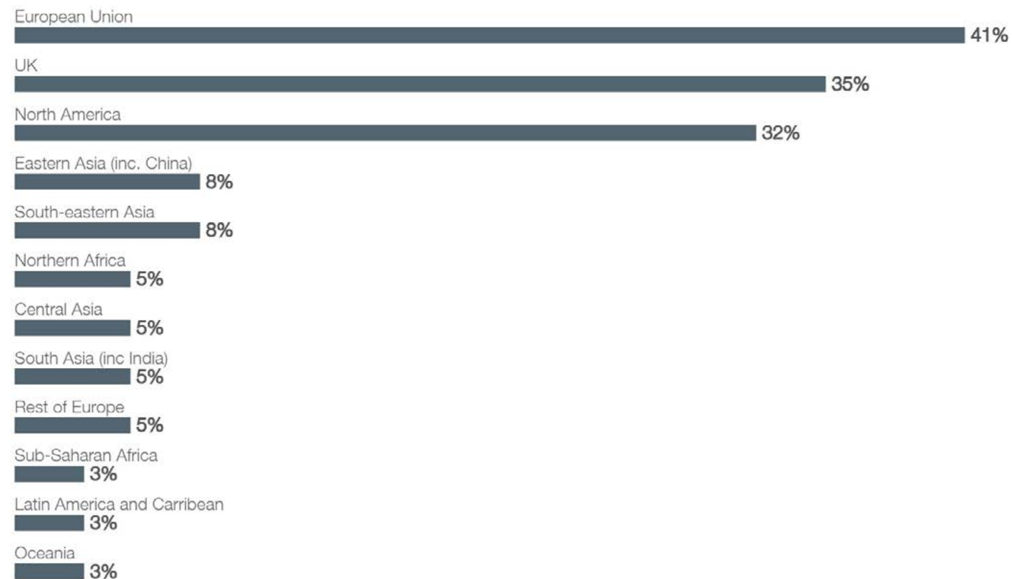
Trey White, Vice President of Corporate Development, SAP

Our survey respondents said Europe remained an attractive market for M&A, with many maintaining a strong desire to continue pursuing European targets. Of our respondents whose employers had completed an acquisition in the past two years, most had invested in the EU (41%) followed by the UK (35%) and North America (32%). However, the numbers were reversed among those considering future transactions, with 41% saying they expected their deal activity to focus on North America compared to 31% on the EU.

Has your firm acquired another business within the last two years?



Where was the business you acquired situated?



M&A activity globally is suppressed as a result of high interest rates, equity market volatility, a more febrile geopolitical environment and supply chain issues that are eroding profits and driving businesses to turn their focus inward. On the flip side, inflation is falling in Europe, and despite continued price pressure from rising wages, a **weakening EU labour market** provides a counterbalancing effect.

EU regulators play outsize role in global M&A

The European Commission remains among the toughest merger control enforcers in the world, even when considering the global trend towards greater regulatory intervention in big-ticket M&A deals. Authorities globally are increasingly aligned with politicians in their view that the merger control enforcement environment has been too lenient in recent years, resulting in industries being allowed to consolidate to the detriment of competition and consumers.

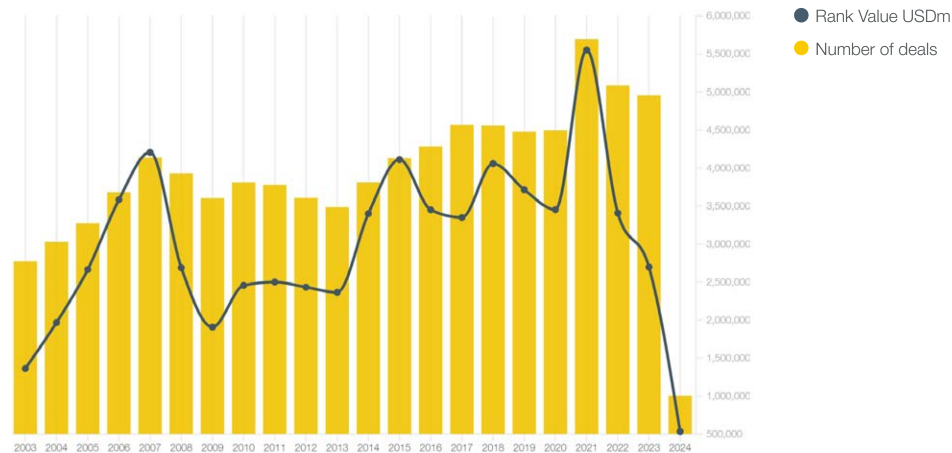
At the same time, the UK Competition and Markets Authority (CMA, which is carving a reputation as a fearsome and unpredictable authority post-Brexit), and the US Federal Trade Commission (FTC) and Department of Justice (DOJ), have been even more interventionist than their counterparts in Brussels in recent times. This dynamic prompted one of our interviewees to admit that “M&A in Europe feels a little easier to manage right now.”

Data and tech remained a priority for the current Commission, which has intervened in recent transactions over issues including interoperability and data access. As far as the latter is concerned, the EU has introduced the Digital Markets Act as another way to apply pressure on the global tech giants, alongside its use of pure competition law.

While the EU maintains it is open to foreign direct investment, three years on from the introduction of the EU FDI Screening Regulation, **the proportion of foreign investments being formally reviewed continues to rise.** Elsewhere, EU Foreign Subsidies Regulation – which is designed to protect the level playing field within the single market by introducing a notification regime for deals involving parties that have received distortive “foreign financial contributions” – adds a further layer of complexity to the deal approval process. This is particularly so for private capital firms, which now face the challenge of putting in place measures to **track the relevant data at both fund and asset level**.

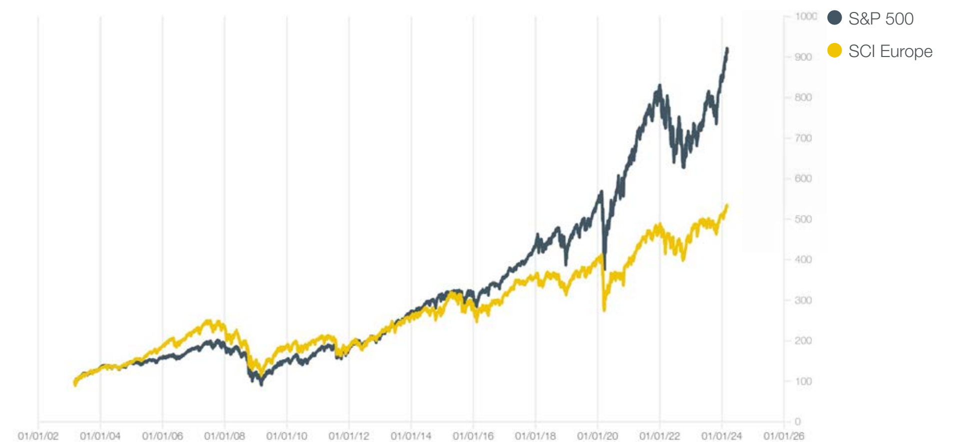
Analysts have speculated that the forthcoming election could result in more Eurosceptic voices in Parliament on both the far left and far right, which could lead to calls for more freedom for member states to set their own economic, fiscal and regulatory policies. If these predictions prove correct, it could make the investment environment more fragmented in the years to come.

Global M&A value and volumes



Source: Pitchbook

U.S. vs European equity performance, 2003-2023



Public takeovers require understanding of Europe's nuances

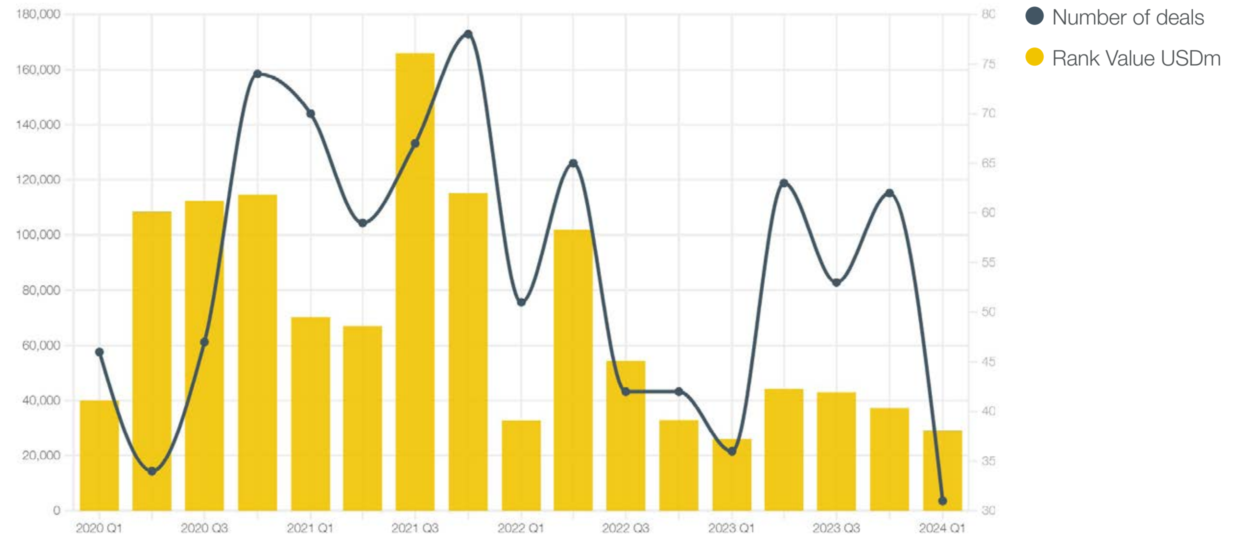
A deep understanding of Europe's nuances is needed when considering public company takeovers. Europe's listed businesses have proved attractive acquisition targets in recent years, with public takeover activity peaking in 2021. While deal values and volumes have fallen since, European equities have been trading below U.S. stocks for some years. Returns from the S&P 500 began to outstrip those of the MSCI Europe (which comprises large- and mid-cap businesses across 15 markets) in 2011 and are now 2.5 times higher.

We have seen some big-ticket public takeovers in Europe in recent years, but more often public-to-private deals involve mid- and smaller-cap companies who are out of the analysts' spotlight and struggling to access liquidity with their shares trading at a discount. Here, a de-listing via a strategic combination or private equity buyout can be a lifeline. Strategic buyers currently have an advantage over financial investors because they can use their shares to fund acquisitions rather than having to seek bank syndicated loans. Other financing sources are available but can be expensive, leaving financial sponsors struggling to achieve the sorts of returns they have enjoyed in the past.

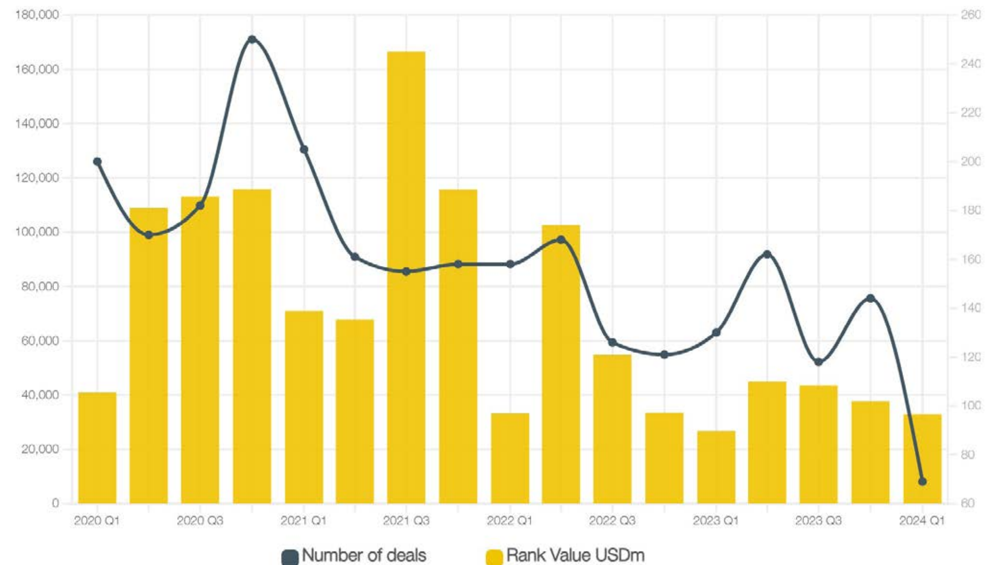
Against this backdrop, our survey painted a fascinating picture of real and perceived deal risks. Respondents whose businesses have completed an acquisition in the past two years listed cyber security due diligence as the biggest challenge they faced (73%), with managing the risk of leaks among the top five issues (67%). Our respondents whose businesses haven't been active in M&A over the same period had leaks way down in 10th place.

The latter point is interesting in the context of public takeovers, given the importance of maintaining confidentiality under the EU Market Abuse Regulation (MAR). Understanding the differences between Europe's myriad public M&A markets is critical to successful transactions.

European public M&A activity, 2020-23



European public M&A (All public deals), to 7 March 2024



Source: Refinitiv

European public takeovers: 12 issues to consider

1. Secrecy is critical in all European markets. Buyers must limit the number of insiders and use codenames and passwords to preserve confidentiality, while NDAs and standstill agreements with the target are usually needed before non-public information can be shared. Even in the earliest stages, any leaks or even general market rumours can trigger a requirement to formally announce under market abuse regulations or specific takeover rules– and in some markets can cause the bidder to lose control of the process. In Germany, a share price rise after a leak increases the mandatory minimum price the bidder must offer if it proceeds with the bid.

2. Due diligence in public takeovers is shorter and more limited than in private M&A deals, which helps to reduce the risk of leaks. Price-sensitive information should already be in the public domain due to MAR requirements, meaning targets typically see the DD process as more an exercise in confirmation than discovery.

3. In some jurisdictions including Spain, France and Belgium, targets are required to share the same diligence information with all bidders, which can cause some to withhold information in case any of their competitors emerge among the potential buyers. In the Netherlands, Germany and Italy, asymmetric disclosure is permitted.

4. It's common for buyers to seek early engagement with senior management (and in Germany possibly the chair of the supervisory board) before making a formal approach. Managers may – and sometimes in some jurisdictions should – brief their directors, but could initially maintain confidentiality; if PE bidders jump the gun on discussions around topics like management incentives and/or equity rollovers it can jeopardise the deal.

5. In jurisdictions such as the Netherlands, it's standard practice to submit a non-binding offer to the target board that includes, among other things, details on price, strategic rationale, financing and high-level plans for management and employees. Here, unilateral engagement with shareholders may be viewed as hostile and may be restricted under the terms of the NDA. Spanish and German public companies typically have a controlling shareholder; in these jurisdictions it's common for the buyer to make a direct approach to them either before, or alongside, any talks with the target board.

6. Some degree of certain funds financing is required in all European markets before launching a cash bid, but there is variance among regulations and market practice in relation to the level of certainty of funding, the timing and the evidence required. For example, bank guarantees/letters of credit are required in France, Spain, Italy and Germany (although funds can be placed in a blocked account in the latter as an alternative to a bank guarantee).

7. The most common way for a bidder to achieve control is via a tender offer recommended by the target's board. However, depending on the jurisdiction, different levels of shareholder acceptance are required to delist the target and execute a squeeze-out to reach 100% ownership. In France and Germany, the threshold for squeezing-out minorities is 90%. In the Netherlands – where public takeovers are executed via so-called "pre-wired back-end" structures – the market practice acceptance threshold is 80% (you can read more about trends in Dutch public M&A **here**).

8. Directors' fiduciary duties play a critical role in negotiations, and again vary across borders. The German and Dutch legal systems for example operate a stakeholder model whereby directors must take into account a broad range of interests, including what's best for the business in the longer term.

9. Takeover regulators are equally important to the process, although at what level varies from market to market. The Spanish CNMV and Italian CONSOB are heavily involved from the outset and throughout. By contrast, the Dutch AFM and Germany's BaFin are more reactive.

10. Interloper risk is significant, particularly in Italy where many deal protections for the bidder (including break fees, "no shop" clauses and exclusivity) are prohibited. In other jurisdictions, including the Netherlands, meaningful no-shop and break fees are seen.

11. Buyers have limited ability to walk away from a deal post-announcement. In some markets, many types of condition (for example, material adverse change (MAC) conditions) are either prohibited or not invocable except in limited circumstances.

12. Deal timetables are similar across Europe given they are largely driven by regulatory processes (eg merger control, foreign direct investment and financial regulatory).

Managing regulatory risk in deal execution

Our interviews also revealed how businesses are managing regulatory and other risks in the context of M&A transactions. Firstly, many of the business leaders we spoke to said smaller deals involving targets that fall below the revenue thresholds for some of Europe's more stringent regulatory regimes are more challenging than bigger acquisitions.

A general counsel at a financial services firm said: "These companies may not be capturing all the climate data we require, or might not have wholly baked compliance programmes in place in other areas." Any key regulatory compliance issues identified through the due diligence process become conditions precedent in deals, because "if we don't articulate these things, we could be mispricing the deal".

Trey White, vice president of corporate development at SAP agreed. "Anything we're buying will need to meet our highest-common-denominator regulatory requirements. When we're doing a deal with a big enough company, say USD1bn or above, they're already taking this stuff into consideration. Smaller companies however may have little to nothing in place. This means our teams have more work to do, which results in higher costs for the integration process and puts more strain on the business case going to the board. Over the last couple of years our due diligence request list has grown substantially and now covers questions relating to data privacy, compliance, export control, government relations, supply chains, human rights and more."

Regulatory risk management through the deal process is particularly important for private equity buyers given their investment horizons. Regulatory investigations in Europe can take years to resolve, and if issues are not identified and addressed prior to completion they may result in enforcement action. This, in turn, could impact the sponsor's exit options.

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Accessing Europe's talent

"I can only see the war for talent intensifying in the future. Obviously more and more Europeans in our sector are moving to work on other continents such as Asia-Pacific and the U.S. We need to continue to invest in our people so that they can grow their careers with us here in Europe if we want to be successful in achieving our very ambitious European target."

Mathias Verkest, CEO, Otary

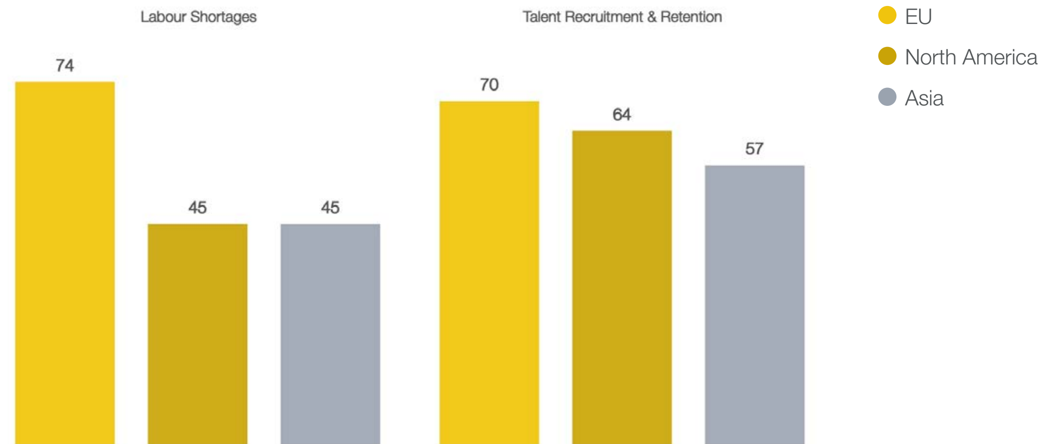
"We need much more focus in our investment on professional education and upskilling. We need better cooperation with companies, because they know best what they need. And we need to match these needs with people's aspirations. But we also have to attract the right skills to our continent, skills that help companies and strengthen Europe's growth."

Ursula von der Leyen, President of the European Commission

Europe's education systems, open borders and industrial heritage have created a huge skills base with deep pools of specialisation in everything from engineering to pharmaceuticals. But Europe also exists in a fiercely competitive global labour market where individuals with skills in science and technology are highly coveted.

Today, with migration already in the spotlight and a potential for even greater focus if far right parties succeed at the polls, attracting world-class talent could become more challenging. And despite all Europe's cultural riches, accessible healthcare services and social protections, European wages cannot match those on offer in the U.S. Against this backdrop, the war for talent will be fierce in the years to come and play a critical role in Europe's economic prospects.

To what degree are the following an enterprise-wide challenge to your organisation?



"One of the biggest challenges we face is access to talent. There are not as many people working in the tech industry here in Europe as there are in other markets. In this industry, we are competing with global players, and people want to have those brands on their CVs."

General counsel, Financial services

Our survey showed that while recruitment and retention is a challenge for businesses regardless of location, those based in the EU were particularly feeling the heat. Almost three-quarters of our survey respondents from EU-based organisations (74%) said labour shortages were an enterprise-wide challenge, compared to just 45% of those in North America and Asia. One in three of our survey respondents did not view the EU favourably in relation to the availability of talent.

Our findings are borne out by official data showing the number of job vacancies in the EU is significantly higher than during the pre-pandemic period. And while the number of ICT specialists working in the EU has risen over the past decade, tech professionals represent just 4.6% of the total EU workforce.

Europe's fast-changing employment landscape

Foreign businesses often struggle with Europe's fast-changing, worker-friendly regulatory regime. Moves were under way during the 2019-2024 Parliament to reduce the reliance on flexible contracting models, including via the Directive on Transparent and Predictable Working Conditions and the Platform Work Directive. The former aims to make employment patterns more predictable, enhance cost-free mandatory training and limit the precarity of flexible non-standard forms of work, with the number of people working through one or more digital labour platforms expected to rise from 28 million in 2022 to 43 million in 2025.

The Platform Work Directive is designed to ensure the correct classification of employment status and introduces a presumption of an employment relationship (as opposed to self-employment), that is triggered when facts indicating control and direction are found. Those facts will be determined according to national law and collective agreements, while taking into account EU case law. On 11 March 2024, the Employment, Social Policy, Health and Consumer Affairs Council (EPSCO),

How favourably would you view the following regions in relation to access to talent?

which comprises the relevant ministers (or state secretaries) of the EU member states, agreed on the Directive, which now has to be formally adopted by the Council and the European Parliament. Once implemented into local law, the new rules are expected to have a material effect. According to the European Commission, almost 20% of platform workers ought to be reclassified from self-employed workers to employees.

The Pay Transparency Directive, which was approved in 2023 and is due to come into force in 2026, is designed to tackle pay discrimination and close the gender pay gap across the bloc. The new rules will require businesses with more than 250 employees to report annually their gender pay gap figures (beginning four years after the directive enters into force) and take action if the differential is above 5%, while those with between 100 and 249 employees will need to report every three years. Here, the obligation kicks in four years after the directive enters into force for employers with between 150 and 249 employees, and eight years for those with 100 to 149. Member states are also allowed to make reporting mandatory for companies with fewer employees.

Alongside these disclosure obligations, it will be compulsory for employers to be transparent with candidates about salaries, either in job adverts or in advance of an interview. Once on board, employees will be able to demand information on average pay, broken down by sex, for categories of people doing "similar work or work of similar value". In addition, employers must make information available to their workers about the criteria used to determine pay, pay grade (the gross annual pay and the corresponding gross hourly pay), and the pay progression of workers.

Under the directive, workers will also be entitled to compensation if they suffer pay discrimination based their gender, while the burden of proof will be with the employer, which will have to prove it has not broken any rules on equal pay or pay transparency.

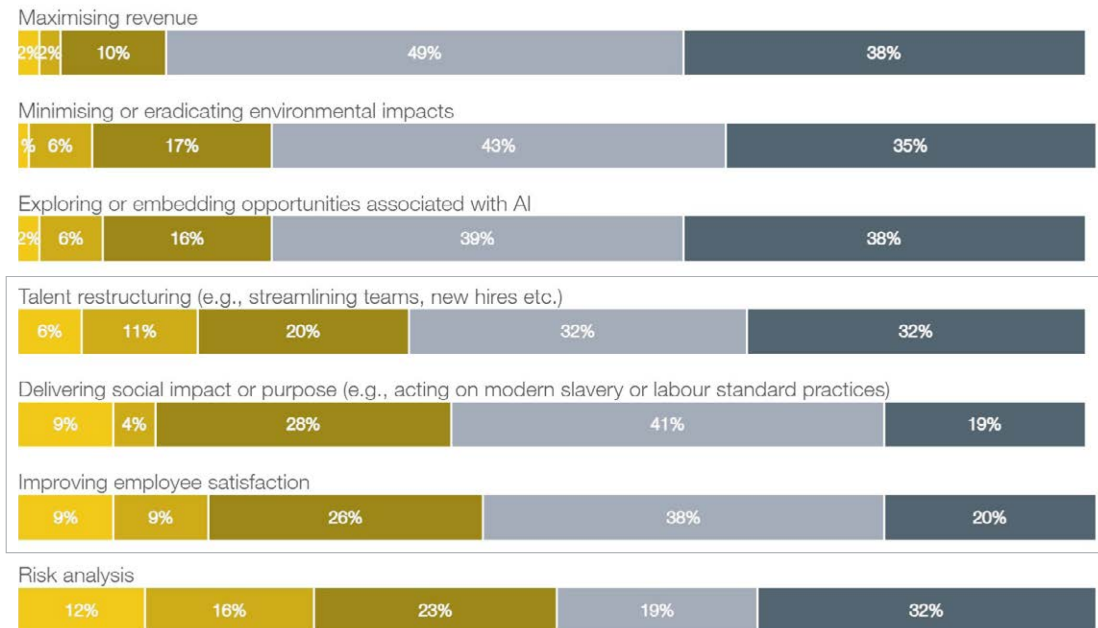
Surprising lack of focus among businesses on mitigating employment law risk

Improving employee satisfaction and delivering on their employer's social impact strategy or corporate purpose were important strategic priorities for three in five of our survey respondents.

However, given the fact that the Pay Transparency Directive will provide employees with enhanced rights to challenge their employers on workplace discrimination or failures to disclose pay transparency, it's perhaps surprising that almost half (49%) of our respondents from businesses with operations in the EU identified employment law as a business risk that they did not have systems in place to mitigate.

Furthermore, businesses looking to do deals into Europe must not underestimate the effort required to secure and retain talent. Of our respondents whose businesses had acquired another company in the past two years, over half (54%) said they found responding to cross-border employment laws a challenge through the process.

How important are each of the following strategic priorities to your organisation over the next two years?



- Not at all important
- Not very important
- Neither important nor unimportant
- Fairly important
- Very important

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Navigating the future

As our research shows, global businesses see both risks and opportunities in Europe. Many of the challenges are common around the world after a period of unprecedented turmoil: supply chain problems and energy supply issues; the interlinked headaches of inflationary pressure and labour shortages.

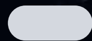
Others are unique to the European Union, whose regulatory environment provides stability and certainty but also the need for extensive risk management. Some businesses see an opportunity for innovation in Europe's approach, while others – particularly those with extensive operations in emerging markets – admit they find it a struggle.

Looking to the future, the impact of Europe's changing political landscape will inevitably be felt at the policy level. While it remains to be seen how many far right, nationalist and Eurosceptic parliamentarians enter the legislative body – and how effective or unified a force they will be – EU policy areas including sustainability, environment, trade and migration could be affected.

Navigating Europe's complex regulatory landscape during a period of potential change requires careful judgement. Strategic decisions must weigh the impact of European law and the EU agencies' enforcement priorities while appreciating where the EU's jurisdiction ends and those of national authorities take over.

Doing business in Europe means navigating the different competencies of the EU bodies. Regulatory rules around antitrust, data protection and financial services are set by the EU institutions, but national governments retain competency over areas including employment and energy.

Global organisations looking to achieve their ambitions in Europe need to understand both the regulatory and political dynamic and adapt their approaches accordingly. The answers to business-critical questions will rarely lie at either EU or member state level, but rather a combination of both. Multinational businesses must stay ahead of Europe's myriad developments in real time to proceed with confidence.



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