

Sustainable Corporate Governance: A Way Forward

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Abstract

The recently published 'Study on directors' corporate governance duties and sustainable' prepared by Ernst and Young for the European Commission (EY report) has attracted many comments, largely critical. Despite all the justified criticism of the EY report, the potential of company law to make companies more sustainable should not be overlooked. In this article, we advocate the use of procedural regulatory instruments, such as disclosure or consultation requirements. Since the impact of procedural rules on sustainable governance is hard to predict, we also advocate a regulatory mix that may have a combined positive impact. Different procedures may affect different areas of the business of a company. Even if it is challenging to calibrate the variety of potential regulatory instruments, such a mix seems to be the best way forward at this point in time.

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Sustainable Corporate Governance: A Way Forward

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The recently published ‘Study on directors’ corporate governance duties and sustainable’ prepared by Ernst and Young for the European Commission (EY report) has attracted many comments, largely critical. Despite all the justified criticism of the EY report, the potential of company law to make companies more sustainable should not be overlooked. In this article, we advocate the use of procedural regulatory instruments, such as disclosure or consultation requirements. Since the impact of procedural rules on sustainable governance is hard to predict, we also advocate a regulatory mix that may have a combined positive impact. Different procedures may affect different areas of the business of a company. Even if it is challenging to calibrate the variety of potential regulatory instruments, such a mix seems to be the best way forward at this point in time.

Rarely has the report of a private consultancy caused so many reactions, in particular, criticism, in such a short period of time, as the “*Study on directors’ corporate governance duties and sustainable*” that Ernst and Young recently prepared for the European Commission DG Justice and Consumers (EY report).¹ In addition to the responses of various groups of scholars from both Europe and the US,² the Oxford Business Law Blog has launched a specific new series³ and the European Corporate Governance Institute has organized a three-day policy workshop, in order to bring together the presentations of over 20 distinguished scholars.⁴ This intensive debate demonstrates the importance of the topic for future EU policymaking in the area of corporate governance. In this piece, we argue that the main reason the EY report has attracted so much criticism is because it simply started out on the wrong foot. However, this shortcoming should not induce the Commission to misjudge company law’s potential for sustainability. We discuss various measures that target both directors and shareholders, but also other stakeholders. Adopting these measures promises to be the way forward for a more sustainable, corporate governance framework.

¹ Ernst & Young, *Study on directors’ duties and sustainable corporate governance*, July 2020, available at <https://op.europa.eu/de/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en>.

² See, for instance Paul Krüger Andersen, Andri Begthorsson et al. *Response to the Study on Directors’ Duties and Sustainable Corporate Governance by Nordic Company Law Scholars* (7th October, 2020). Nordic & European Company Law Working Paper No. 20-12, available at <https://ssrn.com/abstract=3709762>; Mark J. Roe, Holger Spamann, Jesse M. Fried and Charles C. Y. Wang, *The European Commission’s Sustainable Corporate Governance Report: A Critique* (14th October, 2020). European Corporate Governance Institute - Law Working Paper 553/2020, available at <https://ssrn.com/abstract=3711652>.

³ More details and all contributions available at https://www.law.ox.ac.uk/business-law-blog?terms_15=All&terms_16=All&author=All&date%5Bvalue%5D%5Bmonth%5D=&field_display_date_value_1%5Bvalue%5D%5Byear%5D=&keywords=Directors%E2%80%99+Duties+and+Sustainable+Corporate+Governance&jurisdiction=All&sort_order=DESC&sort_by=field_display_date_value&terms=.

⁴ Programme and presentations available at <https://ecgi.global/content/directors%E2%80%99-duties-and-sustainable-corporate-governance#!event-programme>.

1. Company Law's Potential for Sustainability

The self-declared overall objective of the EY report is to “assess the root causes of short termism in corporate governance”.⁵ Accordingly, most responses focus on the study's initial examination as to whether the current rules are problematic, *e.g.*, whether company law as it stands, gives management an incentive to favour shareholders' value and possible short-termism.⁶ To prove that there is a problem of this kind is difficult, if not impossible. It would require assessing the consequences of legal regulations, which in turn, presupposes a model of human behaviour. While various such models exist (for instance, the *homo oeconomicus* or the *homo sociologicus*), the choice of the most realistic model has always been subject to intense and in depth debate.⁷ By attempting to conclude that current company law promotes short-termism, the study has made itself prone to criticism. It started, so to say, on the wrong foot.

A more convincing starting point would be to state that there is a climate challenge, and to ask whether and how company law may be able to contribute to meeting this challenge. Reform proposals do not need to be based on the assumption that current company law is fundamentally flawed. They can and should rather be built on the premise that company law has the potential to contribute to the climate agenda if there is a political consensus to do so. In fact, there cannot be any doubt that such a political consensus currently exists.⁸ Most (if not all) will agree in substance that we currently face a climate challenge. As a consequence, although the current study may be criticized for its approach, this criticism does not imply that the potential for company law to make companies more sustainable should not be considered. Quite the contrary, there is not even a need to prove that current company law is the issue. As a consequence, the study's potential shortcomings should and must not prevent a debate on the potential for company law to promote sustainability.

In fact, company law can be designed in ways to address the climate change problem,⁹ as sustainability and company law interact closely with one other.¹⁰ Yet the inherent vagueness of the politically pre-defined target makes it difficult to tailor a suitable regulatory approach. Moreover, to date, the relevant areas of company law have only been partially harmonized. Member States still have different management structures and consequently, it cannot be assumed that all European companies are organizing their management in the same way. Liability and enforcement rules are also still very diverse. All this calls for a cautious and subtle regulatory approach. If possible and likely to be effective, soft law should be preferred to hard law, and Member States should enjoy discretion as to how best to adopt respective rules in light of their national context. On the other hand, an approach which relies exclusively on soft law is unlikely to reach its goal. For instance, various Member States may choose not to adopt any respective measures in order to

⁵ EY report (n. 1), p. 1.

⁶ Cf. Paul Krüger Andersen et al. (n. 2), p. 4 (“a debilitating fault with the Study”); Mark J. Roe et al. (n. 2), p. 5 (“the Report's analytical framework is wholly inadequate to shed light on the complex problems we are facing”).

⁷ With regard to these prominent (and further) models of human behaviour that the social sciences have to offer since the studies of Adam Smith and Emile Durkheim, see for instance, Florian Möslein, *Behavioural analysis and socio-legal research*, in: Hans-W. Micklitz, Anne-Lise Sibony and Fabrizio Esposito (eds.), *Research Methods in Consumer Law*, Edward Elgar 2018, p. 441, at 446-450 (with further references).

⁸ Cf. European Commission, *The European Green Deal*, COM (2019) 640 final, p. 1 (underlining “the Commission's commitment to tackling climate and environmental-related challenges that is this generation's defining task”).

⁹ Florian Möslein and Karsten Engsig Sørensen, *Nudging for Corporate Long-termism and Sustainability? Regulatory Instruments from a Comparative and Functional Perspective*, 24 *Columbia Journal of European Law*, 429 (2018); see also Thilo Kuntz, *Regulierungsstrategien zur Durchsetzung von Gemeinwohlinteressen im Aktienrecht*, in: *Festschrift Klaus J. Hopt*, de Gruyter 2020, p. 653.

¹⁰ This interaction is highlighted in detail by Anne-Christin Mittwoch in *Nachhaltigkeit und Unternehmensrecht*, Habilitation thesis, University of Marburg, 2020 (to be published soon).

protect their own national economy. Since the climate challenge is global, the European rule-maker cannot rely on regulatory competition. Moreover, an obvious objection to soft law mechanisms is that they may not be sufficient and that the climate challenge requires more substantial, mandatory legal rules.

In short, company law needs to find a middle ground. While climate and environmental law may well be suited to enact mandatory rules since they aim to achieve specific, well-defined outcomes, tailoring regulatory strategies in company law is more challenging. After all, requiring all companies to act as social enterprises would involve a fundamental shift in how business is conducted. Such a solution is likely to be too radical. What is possible and recommended, however, are so-called nudging approaches to company law. Nudging has in fact been successfully applied in many other areas of law.¹¹ Yet its potential in company law is still largely underrated. Nudging strategies are not limited to soft law but can also include hard law but with a focus on procedural (rather than substantive) rules. While substantive rules determine company actors' incentives directly, procedural rules operate indirectly: instead of modifying incentives substantively, they provide for decision-making procedures to be followed by directors, shareholders and other corporate actors.¹² While the effects of procedural rules – and of nudging approaches in general – may seem more uncertain, the more substantial rules discussed in the EY report do not produce certain outcomes either. It is very difficult to design duties that ensure a specific corporate behaviour, even more so because such duties are difficult to enforce. As a consequence, substantial interventions in company law risk missing the point or lacking precision, and at the same time the negative consequences are potentially huge as they are tinkering with the fundamentals of company law. On the other hand, procedural rules have the advantage of being less intrusive by preserving freedom of choice, and if we get it wrong, the only consequences will be the imposition of additional costs on companies.

2. Measures to be adopted

The EY report outlines a range of measures according to the negative 'drivers' they each aim to mitigate. Although the list is long, it is in no way complete, as national law demonstrates examples of additional measures that have been used.¹³ The report even fails to mention measures that have been discussed in other parts of the Commission.¹⁴ While the scope of the report may well require the scope of the analysis to be focused, the report omits important measures that are more in line with the regulatory approach that has been outlined above. Some of these measures will be discussed below. We propose that in the work ahead, the Commission should consider a broader range of measures than those outlined in the EY report.¹⁵

¹¹ Regarding European law, see, for instance, Alberto Alemanno and Anne-Lise Sibony (eds.), *Nudge and the Law: A European Perspective*, Hart Publishing 2015; for constitutional law, see Alexandra Kemmerer et al. (eds.) *Choice Architecture in Democracies – Exploring the Legitimacy of Nudging*, Nomos 2016; for consumer law, see Alberto R. Salazar, *Libertarian Paternalism and the Danger of Nudging Consumers*, 23 King's L.J. 51 (2012); for healthcare law, see Stephen Holland, *Libertarian Paternalism and Public Health Nudges*, in: Michael Freeman et al. (eds.), *Law and Global Health: Current Legal Issues*, Oxford University Press 2014, p. 331; for securities law, see David A. Skeel, *Behaviorism in Finance and Securities Law*, 21 Sup. Ct.Econ. Rev. 77 (2014); regarding a wide range of different areas of law (but not company law), see Klaus Mathis and Avishalom Tor (eds.), *Nudging – Possibilities, Limitations and Applications in European Law and Economics*, Springer 2016.

¹² For more detail, see Möslein and Engsig Sørensen, *supra* 7, p. 397 and 408.

¹³ See references *supra* 7.

¹⁴ In particular, the measure proposed in the Action Plan for Financing Sustainable Growth, COM(2018) 97.

¹⁵ Reading the ongoing consultation conducted by the Commission on sustainable corporate governance, it is not clear that the Commission is aiming to include a broader range of initiatives.

2.1. Starting with directors

Given the directors' key role in the management of most companies disregarding their corporate form, it is logical that any measures adopted should initially target directors. However, targeting directors may not be sufficient as it may also be necessary to consider incentivizing, in particular, shareholders to work towards a more sustainable governance model, as shown below.

The report proposes rephrasing the general duties of directors to ensure that the directors balance all stakeholder views and are obliged to identify and mitigate sustainable risks and impacts.¹⁶ The first impression may be that this measure is the silver bullet that may provide the desired result, but in fact, it is unlikely that this is the case. The general duty is a legal standard which, even if rephrased, will only vaguely indicate what the director should do. In practice, directors may be confronted with many different problems where stakeholders' interests diverge. Imposing a duty to balance all stakeholders' interests may hint at how directors should approach these issues. However, it will not indicate how and when they should strike this balance. For this reason, it will be difficult to enforce such a general duty. In most cases, it is near to impossible to prove that a stakeholder view is not considered adequately, and that this affected the outcome of the directors' decision (causation).¹⁷ Even if enforcement is improved – see below – it seems unlikely that it will be possible to enforce such general duties. Therefore, there is a risk that such a change in the general duties of directors will not result in much change in the behaviour of directors.¹⁸ Given that the governance structures in European companies have not been harmonized, it is also likely that the effect of such a harmonization will vary from Member State to Member State.¹⁹

This does not necessarily imply that it does not make sense to adopt a change of the overall duties of directors. There may be jurisdictions where it is less clear that the law allows directors to consider stakeholder interests.²⁰ It is more likely that there are several jurisdictions where it is not clear that the

¹⁶ EY report, pp. 149-151.

¹⁷ See also Reinier Kraakman et al., *The Anatomy of Corporate Law*, Third Ed., 2017 p. 98. It may be observed that the general directors' duties are seldom enforced in Member States, see the study conducted by Carsten Gerner-Beuerle, Philipp Paech and Edmund Philipp Schuster: *Directors' Duties and Liability in the EU*, April 2013, who on p. 248 conclude: "In the vast majority of Member States, breaches of directors' duties do not normally lead to judicial enforcement of claims against directors as long as the company continues to operate as a going concern."

¹⁸ It should be mentioned that the EU has already regulated the general directors' duties, more specifically when there is a likelihood of insolvency, see Directive 2019/1073, Article 19, and in the context of a takeover, see Directive 2004/25/EC, Article 3(1)(c)). These two examples of regulatory intervention in the general directors' duties may have a better chance of making an impact since they regulate the directors' duties in a specific context. Even so, it is still debatable how effective this type of regulation is. The Commission has also contemplated regulating the duties of directors who sit on boards of subsidiaries, as the Commission aims to recognize the interests of a group of companies, see COM(2012) 740, p. 15. This again deals with directors' duties in a specific situation, but it is clear that the problems faced by the directors of a company, affiliated to a group, are complex. Therefore, it is easy to foresee that such a regulatory approach will be problematic, see Wolfgang Schön, *Organisationsfreiheit und Gruppeninteresse im Europäischen Konzernrecht*, *Zeitschrift für Unternehmens- und Gesellschaftsrecht*, 343, (2019) and Karsten Engsig Sørensen, *Recognising the interests of the group – another attempt to harmonise the rules regulating groups of companies in the EU* in Antigoni Alexandropoulou (Ed.): *Modernisation of European Company Law. Recent Legislative Achievements and the Future of European Company Law*, Bruylant, expected early 2021.

¹⁹ Apart from the European Company, there has not been any harmonization of the internal governance of private or public companies as the attempt to do this – the Fifth Company Law Directive – was abandoned long ago as the comparative legal differences had proven insurmountable, see Stefan Grundmann, *European Company Law*, 2nd Edition, 2012, pp. 12, 14, 247-276 and 318-352.

²⁰ The EY report claims that no jurisdictions were found where this was the case, see p. 93 and 97.

directors have a duty to consider stakeholder interests and should mitigate sustainability risks and impacts. In these jurisdictions, a change, as outlined above, may send a clear signal that change is required, and the rephrasing of the general duties may have some effect. But even in jurisdictions where such an effect is less likely, a change may have symbolic importance at least. Nevertheless, a change in the overall duties of directors is unlikely in itself to trigger a change towards sustainable governance. Therefore, alternative or additional measures should be contemplated.

Other company law measures proposed in the EY report also address substantive company law, such as measures addressing board composure and directors' remuneration.²¹ For the reasons outlined above, such substantive intervention does not seem to be the best way forward. Procedural rules seem preferable. Such procedural rules should aim to stipulate that directors take steps that are likely to ensure that they make balanced and thus sustainable decisions. Such rules do not dictate the end result but render it more likely that the directors will eventually arrive at the correct decisions. In short, even though we cannot say how a company should act, we can still make certain that decisions are taken in a way that provides the optimal circumstances for the best result.

Thus, instead of changing the general duties of directors, duties that are more specific should be considered. Introducing these specific duties may have the effect that the general duties of directors will be interpreted differently. Consequently, in the end, the intervention may amount to a change in the general duties of directors, however, even though the end result may be the same or similar,²² the way of arriving at that end result may be different and the impact on directors' behaviour is likely to differ.

In our opinion, the introduction of several measures of a procedural nature advocated here, should be considered. Given the fact that the impact of procedural rules on sustainable governance is hard to predict, it seems better to try a mix that may have a combined positive impact. As shown below, different procedures may affect different areas of the business of a company. Each measure may impose costs on the company, but given the urgency of the policy agenda, costs are acceptable. An impact assessment should be conducted to ensure that the overall costs are acceptable, and this may also influence which measures should be imposed on which companies.

Looking at the initiatives that have already been adopted in the EU, the best example of a measure with procedural elements is the reporting requirement on non-financial information, adopted with Directive 2014/95.²³ This directive covers the so-called public interest entities that include listed companies, financial institutions and insurance undertakings, with more than 500 employees. The directive requires the management to report on policies relating to different aspects of sustainability²⁴ and the result thereof. This report may not only make a difference to those reading it, but may also have an impact on the directors

²¹ See the proposals suggested to mitigate drivers 3-4.

²² Again, it will depend on how the duties of directors evolve in the different Member States, and there is no guarantee that the introduction of procedural duties will have the same effect on the general duties of directors in all Member States.

²³ Directive 2014/95/EU amending Directive 2013/34/EU as regards the disclosure of non-financial and diversity information by certain large undertakings and groups. See, for example R. Eccles/ B. Spiesshofer, *Integrated Reporting for a Re-imagined Capitalism*, in: D. Barton/D. Horváth/M. Kipping (eds.), *Re-imagining Capitalism*, 2016, p. 207, 219 ("the most important example of legislation in support of the disclosure of non-financial information"); for more general information on this directive, see D. Szabó/K. Engsig Sørensen, *New EU Directive on the Disclosure of Non-financial Information (CSR)*, ECFR 307 (2015); P. Hell, *Offenlegung nicht-finanzieller Informationen*, Mohr Siebeck, 2020.

²⁴ According to Article 19a(1), this includes, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.

themselves.²⁵ It must be assumed that in preparing the report, the directors will focus their attention on these sustainability issues and are also likely to want to present the company at its best. This effect is strengthened if the directors assume that the information is important to the reader and/or is important when the company is benchmarked against other companies. *Ex ante*, when they make decisions, the directors will be able to refer to the information obtained while making the report available, and it is more likely that they will consider these aspects of the companies' business when they make decisions.²⁶

Even though the regime of disclosure on non-financial information has been operating for some years, its full effect has not materialized, since companies are struggling to comply.²⁷ The directive itself has deficiencies, and efforts are already underway to improve the reporting system. Initially, this was carried out by means of the publication of guidelines,²⁸ but the Commission is in the process of working out a proposal with a substantial revision of the directive.²⁹ Thus, it is likely that the impact of the directive will improve and that this may help the transit towards more sustainable governance. The EY report mentions that the current operation of the directive may not be optimal but fails to acknowledge that an improved directive also has the potential to contribute to the sustainable governance agenda.³⁰

The directive on non-financial reporting will hardly be sufficient to ensure the desired change of behaviour.³¹ However, the directive may be expanded to make such a change more likely.³² An important feature of the current regime on non-financial reporting is that the companies are required to report, but are not told how best to act sustainably. Instead, the companies are encouraged to formulate their own policies and targets. Since it will be impossible for EU legislators to formulate overall policies and targets for all companies, it makes sense to leave it to the companies themselves to set the policies and targets, and then force them to adhere to these policies and targets. This regulatory model may also be extended to other core areas of the business, *e.g.*, this could take the form of asking directors to disclose how they will integrate sustainability into their business strategies, which is one of the suggestions in the EY report.³³ A similar goal may be achieved by requiring companies to formulate and disclose their corporate purpose. The idea of formulating a corporate purpose has been developed, *i.a.*, in France, where since 2018, the law has allowed companies

²⁵ See Möslein and Engsig Sørensen, *supra* 7, at p. 413 with further references.

²⁶ This effect is not recognized by the EY report which states on page 61: 'Moreover, the identification of sustainability risks and impacts will continue being substantially perceived as a retrospective exercise resulting from non-financial disclosure obligations, rather than an integral part of directors' duty of care.'

²⁷ See, *e.g.*, the deficiencies reported in the study by Alliance for Corporate Transparency: 2019 Research Report. An analysis of the sustainability reports of 1,000 companies pursuant to the EU Non-Financial Reporting Directive, is available at <https://www.allianceforcorporatetransparency.org/>.

²⁸ Thus, guidelines were published in both 2017 (C/2017/4234) and 2019 (C/2019/4490).

²⁹ Thus, in its communication on the European Green Deal, COM/2019/640, p. 17, the Commission announced its intention to amend the directive. However, the intention to amend the supplement to the directive was already taken with the adoption of the Action Plan for Sustainable Growth, COM (2018) 67, see, *i.a.*, Florian Möslein and Karsten Engsig Sørensen, *The Commission's Action Plan for Financing Sustainable Growth and Its Corporate Governance Implications*, *European Company Law*, 221 (2018), Danny Busch, Guido Ferrarini and Arthur van den Hurk, *The European Commission's Sustainable Finance Action Plan*, Working Paper 2018, available at SSRN: <https://ssrn.com/abstract=3263690>; Eckart Bueren, *Sustainable Finance*, *Zeitschrift für Unternehmens- und Gesellschaftsrecht (ZGR)* 2019, 813.

³⁰ The deficiency of the directive is pointed out on p. 39 of the report.

³¹ This is also concluded in the EY report p. 144.

³² The EY report mentions that it may be possible to build on the directive instead of issuing a new directive, see p. 77.

³³ See the EY report, pp. 154-157.

to state not only their object but also their purpose (*raison d'être*).³⁴ In December 2020, the Danish Corporate Governance Committee amended the Danish Code with a new recommendation, according to which the board should decide on the purpose of the company and report on this in the management report.³⁵ The purpose is the company's overall aim for long-term value creation, which the company delivers to its shareholders, other stakeholders and society.³⁶ By requiring³⁷ directors to address how they will formulate either their strategy or their corporate purpose, sustainable directors are forced to address the problem, but it is still left to the directors to find the best way to act sustainably. Words are cheap, and therefore, it is not enough to outline the strategy or the purpose; companies should also be required to formulate and disclose more specific targets, outlining how they will achieve them, and finally they should report on what has been achieved – similar to the way in which the disclose works in Directive 2014/95. As already stated, there is no need to invent an additional reporting regime as the existing regime can accommodate this.³⁸

Another primarily procedural measure that seems to be in the pipeline, is a requirement for human rights and environmental due diligence. At this point, we only know that the Commission is committed to making a proposal on this, but we do not know which form the proposal will take.³⁹ It is, however, likely to require companies to carry out due diligence to identify and assess human rights and environmental risks in their operations and with their suppliers. Next, they should develop a strategy to prevent and mitigate risks. An element of this should be disclosed, therefore, this proposal is likely to link up with the existing regime on disclosure of non-financial information. The effect of this exercise should be that directors are forced to identify and take steps to remedy these types of sustainability risks. The proposal may impose a duty of a general nature to address these risks, but it does so primarily by imposing a procedure that needs to be followed. A special feature of this proposal is likely to be that it imposes directors' duties not only in relation to the core business of the company, but also regarding the business conducted in subsidiaries and by

³⁴ See the Loi PACTE from 22nd May 2018, introducing a new Article 1835(2) in the Civil Code. See also Pierre-Henri Conac, *The reform of articles 1833 on social interest and 1835 on the purpose of the company of the French Civil Code: recognition or revolution?*, FS K. Schmidt 2019, Band 1, 213.

³⁵ The overall purpose is not necessarily adopted as part of the articles of association as is the case in France.

³⁶ See recommendation 2.1.1 of the Danish Recommendations on Corporate Governance, 2 December 2020, available (in English) at https://corporategovernance.dk/sites/default/files/media/anbefalinger_for_god_selskabsledelse_engelsk.pdf.

³⁷ The current regime on non-financial reporting does not require companies to adopt any policies, but only to report on those they have or alternatively report that they do not have any. Requiring directors to develop a revised strategy or corporate purpose would be a logical and probably necessary step to enhance the effect of the remedy.

³⁸ For the sake of clarity, it should be mentioned that neither the French rules nor the proposed Danish recommendation has been linked to the regime on non-financial reporting. It will be easier for the EU legislator to make this link.

³⁹ The Commission announced its intent to legislate in this area at the end of May 2020, see the webinar available at <https://responsiblebusinessconduct.eu/wp/2020/04/30/european-commission-promises-mandatory-due-diligence-legislation-in-2021/>). Prior to this, the Commission had requested a study entitled '*Study on due diligence requirements through the supply chain from BIICL, Civic Consulting and LSE*', published in January 2020 (available at <https://op.europa.eu/en/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en>).

There is also a draft report with recommendations to the Commission on corporate due diligence from the Parliament dated 11th September 2020, which includes a draft for a directive (available at https://www.europarl.europa.eu/doceo/document/JURI-PR-657191_EN.pdf). Also in November 2020 a study requested by the JURI committee entitled '*Corporate social responsibility (CSR) and its implementation into EU Company Law*' was made public (available at [https://www.europarl.europa.eu/RegData/etudes/STUD/2020/658541/IPOL_STU\(2020\)658541_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2020/658541/IPOL_STU(2020)658541_EN.pdf)).

external business partners. Expanding directors' duties to other entities and even entities governed by foreign law, will be a new feature in many Member States.⁴⁰

A slightly different way of encouraging directors to make more balanced and hopefully, sustainable decisions would be to require the directors to consult the stakeholders before making material decisions. Many listed companies already conducts such consultations but without being under an duty to do so. Instead of imposing a general duty to consult stakeholders, it is likely to be more effective if procedures are set up to establish when and how this consultation should take place. We already have this type of regulation in EU law, although its focus is on the consultation of employees.⁴¹ The EY report foresees that the duty to consult may be expanded to cover different areas but should also involve a larger group of stakeholders. One of the suggestions is to set up a stakeholder advisory council.⁴²

Trying to ensure that directors make balanced decisions could also be achieved by requiring directors to report on the implications of certain material decisions on different stakeholders. An example of such rules is found in the Takeover Directive. The directive vaguely requires the board to "act in the interests of the company as a whole", but also requires the board of the offeree company to make public "its views on the effects of implementation of the bid on all the company's interests and specifically employment, and on the offeror's strategic plans for the offeree company and their likely repercussions on employment and the locations of the company's places of business".⁴³ The latter provision compels the board to consider at least one stakeholder group's interests, *i.e.*, those of the employees; in addition, it explicitly demands a long-term perspective on that assessment.⁴⁴ In a similar vein, Article 7(1) of Directive 2005/56/EC on cross-border mergers of limited liability companies requires that the management's report explain "the implications of the cross-border merger for members, creditors and employees". The regulatory model indicated with these two examples may be expanded to include other types of decisions and a broader spectrum of stakeholder interests. This may ensure that directors make decisions that have at least taken into account the relevant implications for all stakeholders.

Another solution could be to promote the certification of sustainable companies. Certification schemes provide a means for sustainable corporations to signal their good behaviour to the market.⁴⁵ The respective information is similar to non-financial reporting, but certification makes that information not only more condensed but also more trustworthy as it is assessed by a third party, the certifier.⁴⁶ While certificates for products (fair-trade coffee, for instance) are widespread and thoroughly researched,⁴⁷ certificates for 'good'

⁴⁰ One of the few examples where such procedurals are extended to other (including foreign) entities is the French vigilance law, see Loi, No. 2017-399, of 27th March 2017.

⁴¹ A consultation of employees is required in the Directive supplementing the SE statute, Directive 2001/86/EC. There are many additional consultation regimes outside the company law directives, see *e.g.*, the general framework of Directive 2002/14/EC and the European Work Council Directive, Directive 2009/38.

⁴² EY report, p. 163.

⁴³ See Articles 3(1)(c) and 9(5) of Directive 2004/25/EC.

⁴⁴ See, *e.g.*, B. Clarke, *The Takeover Directive: Is a Little Regulation Better than No Regulation?* 15 Eur. L.J. 174, 184 (2009).

⁴⁵ Cf., more extensively: Florian Möslein, *Certifying "Good" Companies: Regulatory Schemes for Corporate Sustainability in a Comparative Perspective* in Christopher Bruner and Beate Sjøfjell (eds.), *Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, Cambridge University Press, Cambridge 2020, p. 669.

⁴⁶ For more detail, see Florian Möslein, *Offenlegung nichtfinanzieller Unternehmensinformationen*, in: Martin Burgi and Florian Möslein's (eds.), *Zertifizierung nachhaltiger Kapitalgesellschaften*, Mohr Siebeck 2020 (in print), p. 344.

⁴⁷ Regarding certification regimes like *Fair Trade* or *Forest Stewardship*, see S. Guéneau, *Certification as a new Private Global Forest Governance System*, in: A. Peters, L. Koehlin, T. Forster and G. Zinkernagel (eds.), *Non-State Actors as Standard-Setters* (Cambridge: Cambridge University Press, 2009), p. 379; L. Gulbrandsen, *Transnational Environmental*

companies have not captured significant academic attention until very recently.⁴⁸ In business and legal practice, however, various certification schemes have evolved in different jurisdictions. A case in point is the B Corporation certification, a private certification issued by B Lab, a non-profit US organization that now operates worldwide. To be granted certification, companies must receive a minimum score in an assessment of social and environmental performance, they must integrate B Lab commitments to stakeholders in their governing documents and pay a substantial annual fee.⁴⁹ While that certification scheme is entirely private, the question remains as to whether public – or hybrid – certification schemes would provide a better, European alternative.⁵⁰ They promise to provide more trustworthy signals. Moreover, Europe is well-equipped in this regard since it already has a wealth of experience of hybrid certification schemes in relation to product certification.⁵¹ Implementing a similar system for the certification of companies would not only give a message of credibility to investors and consumers, but would also constitute an important incentive for directors to act in a sustainable manner. From this perspective, certification operates much like disclosure – and can, therefore, qualify as a procedural instrument. However, given that its information is more condensed, certification might prove to be an even more powerful trigger for sustainable corporate behaviour.

Should the indicated procedural measures be adopted, it should be considered how these might best be enforced. Whereas a revised general duty will be difficult to enforce, the procedural rules outlined can be enforced more easily, given that they set out the specific duties of the board. Thus, if the board fails to perform the procedure or performs it in an insufficient way, this may be challenged. The same is the case if the result of the effort is misrepresented, *e.g.*, if false claims are made in non-financial reporting or in the report on the due diligence strategy or if a certified company does not adhere to the certification conditions. Even though enforcement is possible, it may not be feasible (only) to rely on the existing system of enforcing directors' duties. One of the driving forces has usually been claims for damages, but most often, it will not be possible to prove that a breach of procedure has resulted in a loss for the company or for specific stakeholders. Therefore, additional enforcement remedies should be contemplated, and most likely, these must involve stakeholders other than shareholders, since the procedural rules outlined above are also (even primarily) designed to ensure non-shareholder interests. Consequently, a system which is not based on damages and is open to more stakeholders must be designed.

The EY report is already outlining certain options as to how this may be achieved.⁵² The report seems to favour a judicial mechanism.⁵³ Given that the issue here is to enforce procedural rules and disclosure requirements, and given that several stakeholders should be involved in the enforcement, (see section 2.3 below), it may not be the best solution to involve national courts. Instead, consideration could be given to involve a public body, such as the consumer ombudsman (if it exists) or another state institution.⁵⁴ A softer

Governance – The Emergence and Effects of the Certification of Forests and Fisheries (Cheltenham: Edward Elgar, 2010); A. Nicholls and C. Opal, *Fair Trade: Market-Driven Ethical Consumption* (London: Sage, 2005).

⁴⁸ For an extensive overview, however, cf. the recent contributions in Martin Burgi and Florian Mösllein's (eds.), *Zertifizierung nachhaltiger Kapitalgesellschaften*, Mohr Siebeck 2020 (in print).

⁴⁹ For more detail: R. Honeyman, *The B Corp Handbook* (San Francisco: Berrett-Koehler Publishers, 2014).

⁵⁰ See the policy recommendations in Martin Burgi and Florian Mösllein's (eds.), *Zertifizierung nachhaltiger Kapitalgesellschaften*, Mohr Siebeck 2020 (in print), in particular in §§ 17-19.

⁵¹ Cf. in particular the regime introduced by Regulation (EC) 765/2008, setting out the requirements for accreditation and market surveillance relating to the marketing of products.

⁵² See pp. 163-165.

⁵³ A judicial mechanism is also the option chosen in the Vigilance Law in France, see *supra* 40.

⁵⁴ There are examples of this, *e.g.*, in the UK, a public authority (CIC Regulator) has the duty to monitor whether Community Interests Companies (CICs) comply with the relevant law. Any stakeholder can make a complaint about the

enforcement could also be considered by opting to expand the competences of the OECD National Contact Point.⁵⁵

2.2. ...then shareholders

The board of directors is likely to have a preference for the shareholders' aspirations. Usually, the board is appointed by the shareholders and can potentially be dismissed by them. As for listed companies in the EU, this inclination towards the shareholders has been strengthened by the two Shareholder Rights Directives that have increased the influence of shareholders.⁵⁶

The question is whether it is a problem that directors consider the interests of the shareholders as a high priority. This could be the case if the consequence were that directors would not adequately consider the interests of other stakeholders. This seems to be the assumption in the EY report.⁵⁷ However, shareholders are a diverse group and not all shareholders are likely to induce directors to disregard other stakeholders. Certain shareholders favour sustainable corporate governance or are inclined to move in this direction. Therefore, this would support the move to sustainable corporate governance should those shareholders inclined to be sustainable, be empowered.

The EY report makes several suggestions aiming either to give more influence to long-term shareholders (additional voting rights), inducing shareholders to become long-term investors (enhanced dividend, favourable tax treatment, etc.) or removing the incentive to make short-term decisions (quarterly reporting on financial results).⁵⁸ All of these options are substantive company law. Instead, perhaps a different approach could be considered, see section 1.

It seems that there is a drive among investors for responsible investments. This development may be enhanced through different initiatives, preferably of a procedural nature. There are different ways of doing this.

possible misconduct of a CIC to the CIC Regulator who can take further steps to examine the complaint or demand further information, evidence, etc., from the company being investigated. The CIC Regulator has the authority to appoint an auditor to carry out an audit and impose a number of special sanctions, e.g., the CIC Regulator can appoint, suspend or dismiss members of the board of directors if there is: (a) misconduct or mismanagement, (b) a necessity to protect the assets of the company, (c) a failure on the company's part to meet the 'community interest' test or (d) evidence that the company is not carrying out any activities in pursuit of its social purpose. On the CIC enforcement system, see Office of the Regulator of Community Interest Companies, Information and Guidance Notes, Chapter 11 <http://www.bis.gov.uk/assets/cicregulator/docs/guidance/13-714-community-interest-companies-guidance-chapter-11-the-regulator.pdf>).

⁵⁵ Regarding the working of the OECD National Contact Points, see, e.g., L. Davarnejad, *In the Shadow of Soft Law: The Handling of Corporate Social Responsibility Disputes under the OECD Guidelines for Multinational Enterprises*, J. Disp. Resol. 351 (2011); Juan Carlos Ochoa Sanchez, *The Roles and Powers of the OECD National Contact Points Regarding Complaints on an Alleged Breach of the OECD Guidelines for Multinational Enterprises by a Transnational Corporate*, Nordic Journal of International Law 89 (2015) and B. Egelund Olsen/K. Engsig Sørensen, *Strengthening the Enforcement of CSR Guidelines: Finding a New Balance Between Hard Law and Soft Law*, Legal Issues of Econ. Integration 9 (2014).

⁵⁶ See Directive 2007/36/EC, recital 2 and Directive (EU) 2017/823, recital 14.

⁵⁷ See the EY report, pp. 103-110.

⁵⁸ See the EY report, pp. 151-154.

Again, the regime on non-financial reporting is a good example. The idea is that if investors are presented with information relating to the non-financial performance of the company, they are likely to consider this when they make their investment decisions.⁵⁹

It could be considered whether presenting the shareholders with more stakeholder-related information, *e.g.*, when making important decisions about the business of the company, could help promote other stakeholder interests. For instance, when the shareholders have to decide on a takeover bid, they will be presented with information as to what impact the takeover will have for the employees of the company. The assumption is that this information may be of importance to certain shareholders and these shareholders are thus empowered to act. There may be other decisions (remuneration, expansion of business, new business strategy, formulation of a corporate purpose, *etc.*) which a general meeting could benefit from being informed of, in relation to the broader impact of different decisions on stakeholders. This would allow the shareholders to make more informed decisions and, in particular, make it easier for shareholders inclined to sustainable business conduct, to act upon it. One could argue that giving the shareholder the power to decide on these issues renders it more likely that only shareholder-oriented solutions will be accepted. However, if it is accepted that shareholders in many companies have influence over management that extends beyond the proceedings of a general meeting, putting the issues before the shareholder will only make the process more transparent, and will hopefully make it easier for shareholders to make sustainable decisions.

In addition, it may be possible to nudge certain shareholders more directly towards sustainable governance. The obvious candidates are institutional investors and pension funds, *etc.* The Commission has suggested that the managers of such institutions should have a general duty to make sustainable investments.⁶⁰ However, for the same reasons as outlined above, such a substantial approach may prove not to be effective. Instead, procedural rules may be preferable.⁶¹ Such institutional investors are already required to make non-financial reports, and the SRD II also requires them to report on their investments and engagement policies.⁶² There are elements of sustainability in the requirements for the latter reports, but these elements may be enhanced to ensure that the nudging effect is more likely. Several of the actions, outlined in the Action Plan for Financing Sustainable Growth, also aim to make different investors more sustainable and this will work towards the same end.⁶³ Even though these initiatives are not company law measures, they have the potential to affect the companies in which these investors invest.

2.3....and not forgetting the rest

It may also be contemplated whether stakeholders other than the shareholders may be engaged. As mentioned, this could be achieved through consultation, including a stakeholder advisory board. Another

⁵⁹ Regarding the educational effect of such reporting, see Howard Beales et al., *The Efficient Regulation of Consumer Information*, XXIV J.L. & ECON. 491, 531 (1981) (in relation to consumers); Niamh Moloney, *Confidence and Competence the Conundrum of EC Capital Markets Law*, 4 Journal of Corporate Law Studies 1, 33 (2004) (in relation to investors).

⁶⁰ See the Action Plan for Financing Sustainable Growth, Action 7, COM(2018) 97. So far the Commission has not acted on this intention, but it appears from the ongoing consultation on the renewed sustainable finance strategy that the idea is still on the table, see Consultation Document pp. 17-18.

⁶¹ It can be argued that the duty of asset managers to invest in a sustainable way is easier to regulate via the general duties of such managers, given that we are dealing with a specific type of activity: investment, *e.g.*, requirements as to what type of investment manager should prioritize may be enforceable. However, this type of regulation would set narrow bounds on which investment strategy a manager can adopt, and there is a risk that at least for some investors the law will get it wrong.

⁶² See the revised Shareholder Rights Directive, Directive 2017/828, Articles 3(g) and 3(h). See also Möslein and Engsig Sørensen, *supra* 7, pp. 423-424.

⁶³ See for instance Regulation 2019/2088, on sustainability-related disclosures in the financial services.

regulatory option could be to give stakeholders a role in the enforcement of the procedural rules, outlined above in section 2.1. Given that these measures are designed, *i.a.*, to ensure that non-shareholder interests are considered, it makes sense to give these stakeholders a voice in enforcing them. This would initially require that they are granted status to bring cases against the director.⁶⁴ However, if enforcement imposes costs on the stakeholders or is complicated, it is less likely that stakeholders such as creditors, employees, NGOs and others will pursue such cases. Most likely, the outcome will not be the payment of damages, so the incentive to free ride will be great. Apart from making enforcement cheap and easy, it may also be contemplated to allow for public enforcement of these rules. This would partly overcome the risk of free riding but would also ensure that relevant interests that do not necessarily have a voice – such as environmental groups – may be given one. There are examples where public authorities have been given a role in the enforcement of directors' duties and these experiences should be included in the Commission's considerations.⁶⁵

It has, on occasions, been pointed out that allowing stakeholders easy access to enforcement may trigger too many cases or may cause directors to be too careful or even reluctant to take up the position of director.⁶⁶ Given that we are only dealing with the possible enforcement of procedural rules and disclosure requirements, such an effect seems less likely.⁶⁷

Finally, it should be mentioned that there is an important stakeholder that may be given a more important role in this: the banks. If banks and other financial intermediaries are encouraged to provide more (favourable) loans to sustainable businesses, this in itself will be an inducement for companies to do more in this direction.⁶⁸ Such an approach has been considered as part of the sustainable finance initiative and even though it is not a company law initiative, it is an initiative that may fit perfectly into the sustainable corporate governance agenda.

⁶⁴ As stakeholders will usually not have a standing, with the exception of Germany, where the employee has a standing in some cases, see EY report p. 138.

⁶⁵ Regarding the public enforcement of directors' duties in financial institutions, see H.-J. Kim, *Financial Regulation and Supervision in Corporate Governance of Banks*, 41 *Journal of Corporate Law* 707 *et seqs.* (2016); P.C. Leyens/F. Schmidt, *Corporate Governance durch Aktien-, Bankaufsichts- und Versicherungsaufsichtsrecht*, Die Aktiengesellschaft 533 (2013); Another example is the Australian public enforcement of directors' duties. On the workings of the latter, see I. Ramsay, *An Empirical Analysis of Public Enforcement of Directors' Duties in Australia: Preliminary Findings* (19/04/2016) (https://papers.ssrn.com/sol3/papers.Cfm?abstract_id=2766132) and J. Hedges, H. Bird, G. Gillian, A. Godwin and I. Ramsay, *The Policy and Practice of Enforcement of Directors' Duties by Statutory Agencies in Australia: An Empirical Analysis*, 40 *Melbourne University L. Rev.* 905 (2017). For a discussion of the advantages and disadvantages of copying this system, see Thilo Kuntz, *Regulierungsstrategien zur Durchsetzung von Gemeinwohlintereessen im Aktienrecht*, FS K. Hopt, 2019, pp. 664-672; more extensively Felix Abetz, *Die Sanktionierung gesellschaftsinterner Vorstandspflichten – Eine rechtsvergleichende Analyse zum australischen Recht unter der besonderen Berücksichtigung der Australian Securities and Investment Commission (ASIC)*, Mohr Siebeck, forthcoming early 2021.

⁶⁶ Regarding this risk in the context of benefit corporations, see J. William Callison, *Putting New Sheets on a Procrustean Bed: How Benefit Corporations Address Fiduciary Duties, the Dangers Created, and Suggestions for Change*, 2 *AM. U. Bus. L. REV.* 85, 111 (2012). A similar risk has been pointed out in case of too rigorous an enforcement of directors' duties in ordinary companies, see Bernard Black, Brian Cheffins and Michael Klausner, *Outside Director Liability*, 58 *STAN. L. REV.* 1055, 1140 (2006).

⁶⁷ Usually, enforcement is left for the Member State and this could indicate that the EU should require an enforcement regime but not dictate the details. However, since listed companies are likely to be at the centre of the regulation, there is a case for ensuring that the Member State adopts comparable enforcement mechanisms to make it more likely that stakeholders may engage in cross-border enforcement.

⁶⁸ See the Action Plan for Financing Sustainable Growth, Action 8, COM(2018) 97.

3. Conclusion

In the face of climate change, sustainability matters and company law is able to provide suitable regulatory instruments in order to create incentives for managers, shareholders and other stakeholders to take sustainability into account. Despite all the justified criticism of the EY report, the potential of company law to make companies more sustainable, should not be overlooked. Otherwise, that criticism risks 'throwing the baby out with the bathwater'. Instead, we advocate the use of procedural regulatory instruments, such as disclosure or consultation requirements. Since the impact of procedural rules on sustainable governance is hard to predict, we also advocate a regulatory mix that may have a combined positive impact. As has been shown, different procedures may affect different areas of the business of a company. Even if it is challenging to calibrate the variety of potential regulatory instruments, such a mix seems to be the best way forward at this point in time.

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