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# Corporate Purpose and the Misleading Shareholder v Stakeholder Dichotomy

BEATE SJÅFJELL* AND JUKKA MÄHÖNEN+

**Abstract**

*Corporate purpose has again become a topic of discussion in company law and corporate governance. In the European Union, the tension between the societal approach to companies with its long history and the efficiency-based approach with its much shorter history (and weaker basis) is palpable in the heated debates ever since the European Commission launched its Sustainable Corporate Governance initiative in 2020. In this debate, shareholder primacy proponents have sought to frame the discussion within what we call a shareholder v stakeholder dichotomy.*

*The dichotomy is misleading and dangerous in the way it takes company law proper out of the discussion and reinforces the shareholder primacy drive. We reject the dichotomy as a meaningful framing of the debate and seek to dismantle some of the strawmen set up on the road towards sustainable corporate governance. We instead discuss corporate purpose as a matter of company law and relevant to ensuring the contribution of business to sustainability, and how such an overarching purpose could be operationalised with a redefinition of duties of the board. With this backdrop, we analyse the Sustainable Corporate Governance initiative, concentrating on company law and sustainability aspects of the proposed Corporate Sustainability Due Diligence Directive.*

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# I Introduction

After decades of being dormant, corporate purpose has become a hot topic of discussion again in company law and corporate governance in several parts of the world.[1] With 'corporate purpose' we mean the overarching aim of the company.[2] Business policy statements such as those from the US-based Business Roundtable have been given a lot of attention globally and also in Europe.[3] In European countries, and also in the European Union (EU) institutions, the discussion on how to integrate sustainability into company law and corporate governance has spearheaded the debate on corporate purpose and societal significance.[4] Corporate purpose in this sense has been brought to the forefront more or less clearly and explicitly through a variety of initiatives both in the European countries and the EU, ranging from legislative ones such as the 2019 amendments in the French Civil Code,[5] through reforms of other norm sets, notably Corporate Governance Codes in several European countries, thereunder the Netherlands (2016),[6] the UK (2018),[7] Denmark (2020),[8] France (2020),[9] Belgium (2020),[10] Austria (2021),[11] Norway (2021)[12] and

1 The Anglo-Saxon perspective has dominated the recent discussion on corporate purpose, including with terminology, as we return to below. As our focus is primarily on Europe, we use the European terminology of company law, comparable to corporate law for instance in the United States. We use company law in an expanded way covering not only the limited liability company but other incorporated limited liability business forms such as cooperatives, although we in this article concentrate on the company.

2 Accordingly, we distinguish against the objects of the company, which legislation may or may not require be set out in the law itself or in the articles of association.

3 'Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy That Serves All Americans"', *Business Roundtable* (Web Page, 19 August 2019) <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>.

4 See, eg, Holger Fleischer, 'Corporate Purpose: A Management Concept and Its Implications for Company Law' (2021) 18(2) *European Company and Financial Law Review* 161; Vanessa Knapp, 'Sustainable Corporate Governance: A Way Forward?' (2021) 18(2) *European Company and Financial Law Review* 218; Beate Sjåfjell, 'Reforming EU Company Law to Secure the Future of European Business' (2021) 18(2) *European Company and Financial Law Review* 190; Florian Möslein and Karsten Engsig Sørensen 'Sustainable Corporate Governance: A Way Forward' (2021) 18(1) *European Company Law* 7.

5 *Loi n° 2019-486 du 22 Mai 2019 relative à la croissance et la transformation des entreprises* [Law No 2019-486 of 22 May 2019 on the Growth and Transformation of Companies] (France) JO, 23 May 2019.

6 Dutch Corporate Governance Code Monitoring Committee, *Dutch Corporate Governance Code* (8 December 2016), available in English at <https://www.mccg.nl/binaries/mccg/documenten/codes/2016/12/8/corporate-governance-code-2016-en/Dutch-corporate-governance-code-2016.pdf.>

7 United Kingdom Financial Reporting Council, *UK Corporate Governance Code 2018* (July 2018).

8 Danish Committee on Corporate Governance, *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>.

9 French Association of Large Companies and Movement of the Enterprises of France, *French Corporate Governance Code of Listed Corporations* (January 2020), available in English at:

Germany (2022).[13] In the EU, the issue became especially topical with the European Commission's Sustainable Corporate Governance initiative (2020).[14]

This article contributes to the discussion of corporate purpose and sustainability from a European company law and corporate governance perspective. We position our analysis within a research-based concept of sustainability, understanding sustainability as securing *social foundations of humanity now and for the future while mitigating pressures on planetary boundaries.*[15] Our analysis draws on and is situated within developments in the EU and, more broadly, the European Economic Area,[16] which is showing, in addition to initiatives from their Member States,[17] an unprecedented willingness

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<https://ecgi.global/sites/default/files/codes/documents/200210_afep_medef_code_revision_2020_en_0.pdf>.

[10] Belgian Corporate Governance Committee, *2020 Belgian Code on Corporate Governance* (9 May 2019), available in English at: www.corporategovernancecommittee.be/sites/default/files/generated/files/page/2020_belgian_code_on_corporate_governance.pdf>.

[11] Austrian Working Group for Corporate Governance, *Austrian Code of Corporate Governance* (January 2021), available in English at: <https://ecgi.global/sites/default/files/codes/documents/austria_corporate-governance-code-012021.pdf>.

[12] Norwegian Corporate Governance Board, *Norwegian Code of Practice for Corporate Governance* (14 October 2021, available in English at: https://nues.no/wp-content/uploads/2021/10/2021-10-14-The-Norwegian-Code-of-Practice-for-Corporate-Governance.pdf>.

[13] Government Commission for the German Corporate Governance Code, *German Corporate Governance Code* (28 April 2022), available in English at: <https://www.dcgk.de//files/dcgk/usercontent/en/download/code/220627_German_Corporate_Governance_Code_2022.pdf>. See also German Council for Sustainable Development, *The Sustainability Code* (13 October 2011) available in English at: <www.nachhaltigkeitsrat.de/en/projects/the-sustainability-code/?cn-reloaded=1>.

[14] European Commission, *Communication to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, The European Green Deal* [2019] COM/2019/640, s 2.2.1; 'Sustainable Corporate Governance', *European Commission* (Web Page, 2022); see also the European Commission's public consultation on the topic at <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance>.

[15] Johan Rockström et al, 'Planetary Boundaries: Exploring the Safe Operating Space for Humanity' (2009) 14(2) *Ecology and Society* 32; Will Steffen et al, 'Planetary Boundaries: Guiding Human Development on a Changing Planet' (2015) 347(6223) *Science* 1259855:1–10; Linn Persson et al, 'Outside the Safe Operating Space of the Planetary Boundary for Novel Entities' (2022) 56(3) *Environmental Science & Technology* 1510; Melissa Leach, Kate Raworth and Johan Rockström, 'Between Social and Planetary Boundaries: Navigating Pathways in the Safe and Just Space for Humanity' in International Social Science Council and United Nations Educational, Scientific and Cultural Organization, *World Social Science Report 2013: Changing Global Environments* (2013) 84.

[16] The European Economic Area consists of the European Union and its member states and the three members of the European Free Trade Association (EFTA), Norway, Iceland and Liechtenstein, who have chosen not to be full members of the European Union.

[17] See especially *Loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre* [Law No 2017-399 of 27 March 2017 on the Corporate Duty of Vigilance for Parent and Instructing Companies] (France) JO, 28 March 2017; *Lov om virksomheters åpenhet og arbeid med grunnleggende menneskerettigheter og*

to regulate globalised business. This is a key element in the European Commission Sustainable Finance initiative (2018)[18] and the European Green Deal (2019).[19] The European Green Deal's ambition that 'sustainability should be further embedded into the corporate governance framework'[20] was followed up in the European Commission's Sustainable Corporate Governance initiative. The latter initiative was the first time that company law was publicly included in the Commission's toolbox in considering how to promote the contribution of business to sustainability.

After much pushback and several delays, the legislative proposal that the Commission presented under the Sustainable Corporate Governance initiative in February 2022 was for a Corporate Sustainability Due Diligence Directive, a narrower legislative instrument than originally envisaged in the initiative, focusing on due diligence as the name indicates, and with a limited inclusion of company law through duty of care rules.[21] The proposal has been discussed since in the European Parliament and the Council. The December 2022 Council General Approach was critical of the proposal, suggesting major deletions in its company law aspects,[22] while in its May 2023 report, the Parliament Committee on Legal Affairs required more far-reaching provisions than in the proposal.[23] The Parliament voted on the proposal in plenary on 1 June 2023, setting out its own list of amendments that the Parliament wishes to

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*anstendige arbeidsforhold (åpenhetsloven)* [Act No. 99 of 18 June 2021 Relating to Enterprises' Transparency and Work on Fundamental Human Rights and Decent Working Conditions (Transparency Act)] (Norway) 18 June 2021; *Gesetz über die unternehmerischen Sorgfaltspflichten in Lieferketten vom 16. Juli 2021 (Lieferkettensorgfaltspflichtengesetz)* [Act on Due Diligence Obligations in Supply Chains of 16 July 2021 (Supply Chain Act)] (Germany) 16 July 2021, BGBl I, 2021, 2959.

18 European Commission, *Action Plan: Financing Sustainable Growth* [2018] COM 97; 'Sustainable Finance', *European Commission* (Web Page) <https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en>.

19 European Commission, *The European Green Deal* (n 14).

20 Ibid.

21 European Commission, *Proposal for a Parliament and Council Directive on Corporate Sustainability Due Diligence and Amending Directive EU/2019/1937* [2022] COM 71 ('*CSDDD Proposal*' or 'Proposed Directive'). See also European Commission, 'Commission Sets out Strategy to Promote Decent Work Worldwide and Prepares Instrument for Ban on Forced Labour Products' (Press Release, 23 February 2022 <https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1187>.

22 Council of the European Union, *Proposal for a Parliament and Council Directive on Corporate Sustainability Due Diligence and Amending Directive EU/2019/1937: General Approach* [2022] ST 15024/1/22 ('Council Position').

23 Committee on Legal Affairs, European Parliament, *Report on the Proposal for a Parliament and Council Directive on Corporate Sustainability Due Diligence and Amending Directive EU/2019/1937* [2023] A9-0184.

see included.[24] The proposal is in the EU 'trilogue' (interinstitutional)[25] negotiations phase at the time of writing.

As the final Directive is not adopted yet, we limit our analysis to selected company law and sustainability elements relevant to the topic of this article.[26] In our analysis of corporate purpose based on company law and corporate governance, we will also draw on developments in other relevant parts of EU regulation, showing that company law, the regulatory infrastructure for the company, has been and remains still to a great extent the missing piece.[27]

Our analysis exposes and underlines the need for a coherent approach to regulating for sustainability, which does not exclude an area of law from the regulatory toolbox based on path-dependent approaches in that area. What should be informing this discussion is that European company law, and also for instance the company law in the United States, is originally based on a strong ethos of societal purpose for companies, only granting a societal license to activities that also serve the interests of society while serving the interests of the company.[28] While company law no longer sets such explicit requirements, we see it as also underpinning current company law in the form of a legislative presumption that companies in aggregate contribute to societal welfare in the pursuit of their business. This is a logical conclusion to draw for us, based on company law's continued enabling and encouragement of the use of the legal form of the company. During the last decades, this underpinning of company law has been pushed to the sideline and even forgotten under the influence of efficiency-based, law-and-economics inspired and privatised approaches to companies.[29]

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24 *Amendments Adopted by the European Parliament on 1 June 2023 on the Proposal for a Parliament and Council Directive on Corporate Sustainability Due Diligence and Amending Directive EU/2019/1937* [2023] P9_TA 0209 <https://www.europarl.europa.eu/doceo/document/TA-9-2023-0209_EN.html> ('Parliament Position').

25 About the trilogue negotiations in the EU legislative system, see as an overview 'Interinstitutional Negotiations', *European Parliament* (Web Page) <https://www.europarl.europa.eu/olp/en/interinstitutional-negotiations>.

26 In our discussion below in Section VI, we draw on all three sources (Commission proposal, Council compromise and Parliament amendments) as relevant.

27 Together with financial accounting law, to which we will return below.

28 As a classic, see Otto von Gierke, *Die Genossenschaftstheorie und die deutsche Rechtsprechung* (Weidmann, 1887). See also Peter Muchlinski, 'The Development of German Corporate Law until 1990: An Historical Reappraisal' (2013) 14(2) *German Law Journal* 339; Leonardo Davoudi, Christopher McKenna and Rowena Olegario, 'The Historical Role of the Corporation in Society' (2018) 6(supplementary issue 1) *Journal of the British Academy* 17.

29 See especially Reinier Kraakman et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 3rd ed, 2017). We discuss the influence of this book later in somewhat more detail.

However, this societal understanding of the purpose of the company has re-emerged with Anglo-American company law and corporate governance scholars (re)discovering the also Anglo-American originated sociological concept of 'social license to operate' as a reference point in the increasing frustration with lack of corporate accountability and the extreme unsustainabilities of corporate activities.[30] The tension between the societal approach to companies with its long history and the efficiency-based approach with its much shorter history (and weaker basis) is palpable in the heated debates ever since the European Commission first launched its Sustainable Corporate Governance initiative in 2020. In this debate, shareholder primacy proponents especially have been very vocal and ideological in their contributions, seeking to frame the discussion within what we call *a shareholder v stakeholder dichotomy*.

With this backdrop, the article proceeds as follows: In Section II we outline the problem with shareholder primacy as a main barrier to sustainable corporate governance. In Section III we introduce the shareholder v stakeholder dichotomy and discuss how this is a problematic framing for the European debate in the way, amongst other reasons, that it serves to sideline company law. We turn in Section IV to a discussion of corporate purpose as a matter of company law and the role of company law in ensuring business's contribution to sustainability. In Section V, we discuss how such an overarching purpose could be operationalised together with a redefinition of duties of the board. Drawing on our research-based reform proposals, we analyse, in Section VI, elements of the proposed Corporate Sustainability Due Diligence Directive as the European Commission's first explicit attempt at integrating sustainability into company law and corporate governance. In Section VII we discuss the counterproductive resistance against change in the context of the EU's Sustainable Corporate Governance initiative. Section VIII concludes by positioning the analysis in this article in the broader context of policy coherence for sustainability in the EU.

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[30] For an analysis from a corporate governance perspective, see Hillary A Sale, 'The Corporate Purpose of Social License' (2021) 94(4) *Southern California Law Review* 785. For an analysis of the various origins of the concept of social license to operate, see Joel Gehman, Lianne M Lefsrud and Stewart Fast, 'Social License to Operate: Legitimacy by Another Name?' (2017) 60(2) *Canadian Public Administration* 293. See also Elizabeth Pollman, 'Here's the Term You've Been Looking for: Social License', *Journal of Things We Like (Lots)* (Web Article, 16 September 2019) <https://corp.jotwell.com/heres-the-term-youve-been-looking-for-social-license/>.

## II The Rise of Agency Theory and Shareholder Primacy

Due to the convergence of company law discourse globally, the debate in Europe on corporate purpose has also been influenced by the Anglo-American economics-based ideas of *shareholder primacy*.[31] Shareholder primacy is a social norm, not a legal one. In stating this, we distinguish between the legal norm of shareholder *value* and the social norm of shareholder *primacy*,[32] drawing on multijurisdictional comparative company law analysis.[33]

We use 'shareholder primacy' as a short form for a complex mix of perceived market signals and economic incentives, informed by path-dependent corporate governance assumptions and postulates from legal-economic theories.[34] Originating from the United States, it is based on US economic theory, and it has developed as such a strong social norm that it also has become a legal myth.[35] Shareholder primacy equates corporate purpose with maximising returns to shareholders. Under the shareholder primacy view, maximising returns to shareholders is the duty of corporate boards and senior executive management.[36]

The US economic theory behind shareholder primacy borrows the idea of a company as a legal person from company law but employs it primarily to serve as a 'nexus' for a set of contracting relationships

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31 David Millon and Lyman Johnson coined the term in 1989: see David Millon, 'Radical Shareholder Primacy' (2013) 10(4) *University of St Thomas Law Journal* 1013, 1015.

32 In his 2013 article, David Millon distinguishes between traditional and radical shareholder primacy in the same way: Millon (n 31).

33 Where the Anglo-Saxon legal norm of shareholder value can be found at the one end of the spectrum (we return to this below). See Beate Sjåfjell et al, 'Shareholder Primacy: The Main Barrier to Sustainable Companies' in Beate Sjåfjell and Benjamin J Richardson (eds), *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press, 2015) 79. See also Judd F Sneirson, 'The History of Shareholder Primacy, from Adam Smith through the Rise of Financialism' in Beate Sjåfjell and Christopher M Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press, 2019) 73, 73.

34 Beate Sjåfjell, 'Realising the Potential of the Board for Corporate Sustainability' in Beate Sjåfjell and Christopher M Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press, 2019) ch 49.

35 See, eg, Lynn Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (Berrett-Koehler Publishers, 2012); Judd F Sneirson, 'Green Is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance' (2009) 94(3) *Iowa Law Review* 987, 995–1007; Stephen M Bainbridge, *Corporate Law* (Foundation Press, 3rd ed, 2015) s 9.2; Leo E Strine Jr, 'The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law' (2015) 50(3) *Wake Forest Law Review* 761; Sneirson, 'The History of Shareholder Primacy, from Adam Smith through the Rise of Financialism' (n 33).

36 Sneirson, 'The History of Shareholder Primacy, from Adam Smith through the Rise of Financialism' (n 33); D Gordon Smith, 'The Shareholder Primacy Norm' (1998) 23(2) *Journal of Corporation Law* 277, 290–1.

among individuals,[37] which does not fully recognise the real transactions that constitute it.[38] There is a presumed conflict between 'control' by corporate boards and management, and shareholders as 'owners' of the corporate property. The economic theory originates from the 1930s, with Adolf Berle's and Gardiner Means' book *The Modern Corporation and Private Property*,[39] and Ronald Coase's article 'The Nature of the Firm'.[40] In their book *The Economic Structure of Corporate Law*, Frank Easterbrook and Daniel Fischel took from financial economists Michael Jensen's and William Meckling's 1976 article, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure',[41] the idea of 'nexus' and made it into a company law theory, articulating in legal discourse for the first time the idea that the corporate board and by extension senior management are the agents of the shareholders,[42] and then assumed its foundational relevance for their analysis of the entire field of corporate law.[43]

Since then, the agency idea and the focus on agency costs as corporate law's central problem have been taken for granted by most economically-oriented corporate law scholars despite the absence of an actual legal mandate.[44] In Europe, it was promoted especially by Klaus Hopt[45] and made famous globally through the several editions of the volume *The Anatomy of Corporate Law* by Reinier Kraakman et al, including scholars from the United States, Asia, Europe and, in

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37 The concept originated from Michael C Jensen and William H Meckling's 1976 article: Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3(4) *Journal of Financial Economics* 305, 310. However, there is a difference between what Jensen and Meckling originally wrote and how their article has been used by others: see, eg, Brian R Cheffins, 'What Jensen and Meckling Really Said about the Public Company' in Elizabeth Pollman and Robert B Thompson, *Research Handbook on Corporate Purpose and Personhood* (Edward Elgar, 2021) 2.

38 Frank H Easterbrook and Daniel R Fischel, 'The Corporate Contract' (1989) 89(7) *Columbia Law Review* 1416, 1426.

39 Adolf A Berle Jr and Gardiner C Means, *The Modern Corporation and Private Property* (Macmillan, 1933).

40 RH Coase, 'The Nature of the Firm' (1937) 4(16) *Economica* 386.

41 Jensen and Meckling (n 37).

42 While Easterbrook and Fischel in the Anglo-American terminology use 'management' to reference also the board, in Continental European terminology, it needs to be specified that we are speaking about the board and management, as opposed to just referencing the management level beneath the board.

43 Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991). See also Daniel R Fischel, 'Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers' (1978) 57(1) *Texas Law Review* 1.

44 Millon (n 31) 1026.

45 Klaus J Hopt, 'Gestaltungsfreiheit im Gesellschaftsrecht in Europa: Generalbericht' in Marcus Lutter and Herbert Wiedemann (eds), *Gestaltungsfreiheit im Gesellschaftsrecht* (De Gruyter, 1998) 123.

the latest 2017 edition, also one scholar (and the only woman) from Latin America.[46]

In corporate governance, this law and economics theory has reduced the role of law to a mere application of agency theory to corporate relationships,[47] not matching the legal reality even in the United States.[48] The theory has, however, functioned as a powerful tool to change social norms concerning companies, notably informing and reinforcing the social norm of shareholder primacy.[49] According to the economic agency theory of 'nexus of contracts',[50] company law is a set of default rules hypothetically accepted by a majority of shareholders in all companies, designed to reduce their costs of contracting with each other and other corporate constituencies, protected only through their contracts with the company or, if not feasible from a transaction costs point of view, 'extracorporate' regulation such as environmental or labour law.[51]

Since the 1980s, when Easterbrook and Fischel introduced it into company law, this law and economics theory has not only dominated the conceptualisation of what a company is, but even directly been used as an argument for a legal (dogmatic) understanding of company law — limiting its scope, as Kraakman et al do from a comparative perspective,[52] by explicitly seeking to make their application of agency theory the basis for company law.[53] The economic identification of agency issues (or 'problems', as they are called in Kraakman et al) is used as a normative basis to define certain societal interests as external and therefore something that should be regulated by other areas of law, ignoring then, it seems, the vast breadth of

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46 See Kraakman et al (n 29).

47 Katsuhito Iwai, 'Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance' (1999) 47(4) *American Journal of Comparative Law* 583, 619.

48 Stout (n 35); Sneirson, 'Green Is Good' (n 35); Bainbridge (n 35); Strine (n 35); Sneirson, 'The History of Shareholder Primacy, from Adam Smith through the Rise of Financialism' (n 33). See also Robert C Clark, 'Agency Costs versus Fiduciary Duties' in John W Pratt and Richard J Zeckhauser (eds), *Principals and Agents: The Structure of Business* (Harvard Business School Press, 1985) 55, 57; Robert C Clark, *Corporate Law* (Aspen Publishers, 1986) 114; Melvin A Eisenberg, *The Structure of Corporate Law: A Legal Analysis* (Little, Brown, 1976).

49 Christopher M Bruner and Beate Sjåfjell, 'Corporate Law, Corporate Governance and the Pursuit of Sustainability' in Beate Sjåfjell and Christopher M Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press, 2019) 713.

50 Eugene F Fama, 'Agency Problems and the Theory of the Firm' (1980) 88(2) *Journal of Political Economy* 288, 290. Jensen and Meckling themselves wrote on the nexus *for* contracts: Jensen and Meckling (n 37) 310.

51 See Christopher M Bruner, 'Distributed Ledgers, Artificial Intelligence and the Purpose of the Corporation' (2020) 79(3) *Cambridge Law Journal* 431, 447–8.

52 Kraakman et al (n 29) 29.

53 Susan Mary Watson, 'The Corporate Legal Person' (2019) 19(1) *Journal of Corporate Law Studies* 137, 138–9.

research explaining the limits of, for example, environmental law, labour law, consumer law or human rights law.[54]

An element of the economic theory underpinning current corporate governance debates is the idea of companies as a 'nexus of contracts' between various interest groups that later came to be called 'stakeholders', and how shareholders should be given primacy among them due to their presumed residual interest in the company.[55] This shareholder v stakeholder discussion is, as we will return to below, from a company law perspective, a misleading discussion. Both sides of the discussion take the social norm of 'shareholder primacy' as their starting point.[56]

Originally unfamiliar to European company law and corporate governance, shareholder primacy has affected the discourse on how the duties of corporate boards are perceived.[57] This is most clearly seen in the shift from a discussion of whether corporate boards ensure the fulfilment of the (implicit) societal purpose of the company to an overly simplistic assessment where corporate boards are seen as the 'agents' (using the US law-and-economics vocabulary of agency theory) of shareholders. The also mostly US-originated critique of shareholder primacy is then limited to discussion of other stakeholders' equal setting as claimants to the corporate assets.[58]

Shareholder primacy is manifested in corporate governance codes and business practices. In the face of law, it should, as touched upon above, be distinguished from the legal norm denoted *shareholder value*. In Europe, the UK is a notable example of a shareholder value jurisdiction, which has sought to mitigate negative effects of shareholder primacy through the addition of the adjective 'enlightened' in front of shareholder value, as we see reflected in section 172 of the UK Companies Act.[59]

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54 For further critical analysis and an alternative approach to agency theory, see Beate Sjåfjell, 'Sustainability and Law and Economics: An Interdisciplinary Redefinition of Agency Theory' in Beate Sjåfjell, Roseanne Russell and Maja van der Velden (eds), *Interdisciplinary Research for Sustainable Business: Perspectives of Women Business Scholars* (Springer, 2023) ch. 5.

55 Jensen and Meckling (n 37); Michael C Jensen, 'Value Maximization, Stakeholder Theory, and the Corporate Objective Function' (2001) 14(3) *Journal of Applied Corporate Finance* 8.

56 Or 'radical shareholder primacy' in the 2013 terminology of David Millon: see Millon (n 31).

57 See Stefan Grundmann, 'Actors in Organizations' in Stefan Grundmann, Hans-W Micklitz and Moritz Renner, *New Private Law Theory: A Pluralist Approach* (Cambridge University Press, 2021) 369.

58 Margaret M Blair and Lynn A Stout, 'A Team Production Theory of Corporate Law' (1999) 85(2) *Virginia Law Review* 247; Margaret M Blair, 'Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century' (2003) 51(2) *University of California Los Angeles Law Review* 387, 433. See also Paddy Ireland, 'Company Law and the Myth of Shareholder Ownership' (1999) 62(1) *Modern Law Review* 32, 53.

59 Andrew Johnston, 'Market-Led Sustainability through Information Disclosure: The UK Approach' in Beate Sjåfjell and Christopher M Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press,

That this distinction between shareholder primacy and shareholder value is often not made clearly is symptomatic of the dominance of shareholder primacy thinking even in corporate law doctrine. Shareholder value is on the one end of the spectrum, with a pluralistic approach to the interests of the company on the other, as we have found in multi-jurisdictional comparative analyses.[60] The UK discussion is an example, with section 172 mixing elements of stakeholder thinking in shareholder value thinking, denoted 'enlightened shareholder value',[61] or even (maybe ironically) 'enlightened stakeholder value'.[62] The thinking is also echoed, for instance, in the United Nations Principles for Responsible Investment.[63]

By conflating shareholder value with shareholder primacy, and seeing section 172 of the UK Companies Act, with its listing of interests to be taken into account while promoting the interests of shareholders, as an innovative and modern 'stakeholder' approach,[64] the discussion is based on at least three faulty assumptions: Firstly, that shareholder primacy is reflected in company law; secondly, that the Anglo-American discussion is representative for all jurisdictions in the world; and thirdly, that there are only two choices: shareholder primacy or some kind of shift to 'stakeholderism'.[65] This ignores company laws across the spectrum, where shareholder value is at one end and with multi-value pluralistic jurisdictions such as Germany and Norway at the other end.[66] Most of all, it ignores the theoretical basis

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2019) 204; Virginia Harper Ho, 'Enlightened Shareholder Value: Corporate Governance beyond the Shareholder-Stakeholder Divide' (2010) 36(1) *Journal of Corporation Law* 59. On the economic origins of 'enlightened value maximization', see Jensen (n 55).

60 Sjåfjell et al (n 33); Bruner and Sjåfjell (n 49).

61 Ho (n 59).

62 Ibid 62, 99 citing Jensen (n 55) 8, 12–13: he uses the concept 'enlightened stakeholder theory'.

63 PRI Association, 'Principles for Responsible Investment', *Principles for Responsible Investment* (Web Page) <https://www.unpri.org>. See Ho (n 59) 62.

64 Lynn Stout, 'The Troubling Question of Corporate Purpose' (2013) 3(1) *Accounting, Economics, and Law* 61; Thomas Clarke, 'Deconstructing the Mythology of Shareholder Value: A Comment on Lynn Stout's "The Shareholder Value Myth"' (2013) 3(1) *Accounting, Economics, and Law* 15; Thomas Clarke, 'The Contest on Corporate Purpose: Why Lynn Stout Was Right and Milton Friedman Was Wrong' (2020) 10(3) *Accounting, Economics, and Law* 1; Thomas Clarke, 'The Impact of Financialisation on International Corporate Governance: The Role of Agency Theory and Maximising Shareholder Value' (2014) 8(1) *Law and Financial Markets Review* 39.

65 See Lucian A Bebchuk and Roberto Tallarita, *The Illusory Promise of Stakeholder Governance* (2020) 106(1) *Cornell Law Review* 91 and the rebuttal in Colin Mayer, 'Shareholderism versus Stakeholderism: A Misconceived Contradiction' (2001) 106(7) *Cornell Law Review* 1859.

66 Andreas Rühmkorf, 'Stakeholder Value versus Corporate Sustainability: Company Law and Corporate Governance in Germany' in Beate Sjåfjell and Christopher M Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press, 2019) ch 17; Jukka Mähönen and Guðrún Johnsen, 'Law, Culture and Sustainability: Corporate Governance in the Nordic Countries' in Beate Sjåfjell

and the main purposes of company law, and the law-based rights and duties of shareholders, creditors, employees and other contractual parties to the company.

As we have discussed elsewhere, the economics-based social norm of shareholder primacy is at the heart of the unsustainability of business.[67] It also informs the attempted derailing of the academic and political discussions in Europe on the role of company law in ensuring that business has a sustainable corporate purpose and is based on corporate governance that contributes to a sustainable future.

## III The Misleading Shareholder v Stakeholder Dichotomy

As we touched upon above, in challenging Anglo-American economic theory on its own narrow terms, a dichotomy between shareholders and stakeholders is established with no or very limited room for any changes in company law. We see this illustrated in Kraakman et al where they concede that 'non-contractual stakeholders' of a company deserve legal protection, but argue that protection of interests extraneous to the firm should come (only) from other areas of law, such as environmental law, human rights law, antitrust law or financial regulation.[68] The basis for their reluctance to include company law properly into the regulatory toolbox is that company law should not be employed to 'tackle concerns which reach far beyond the agency problems that form its core competency',[69] using thereby the agency issues they themselves emphasise as of interest as a basis for excluding company law from the discussion.

Isolating and insulating company law from the broader societal discussion of the impact companies have on society and narrowing their thinking in enforcement of company law obligations[70] jar with

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and Christopher M Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press, 2019) ch 16.

67 Sjåfjell et al (n 33); Bruner and Sjåfjell (n 49). Criticism of the prevailing shareholder primacy theory has long roots, including progressive company law scholarship from the 1990s onwards: Lawrence E Mitchell (ed), *Progressive Corporate Law* (Westview Press, 1995); Irene Lynch-Fannon, *Working within Two Kinds of Capitalism* (Hart Publishing, 2003); Kent Greenfield, *The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities* (University of Chicago Press, 2006). There are more recent contributions: see Lorraine Talbot 'Why Shareholders Shouldn't Vote: A Marxist-Progressive Critique of Shareholder Empowerment' (2013) 76(5) *Modern Law Review* 791; Colin Mayer, *Firm Commitment: Why the Corporation Is Failing Us and How to Restore Trust in It* (Oxford University Press, 2013); Stout, *The Shareholder Value Myth* (n 35); Christopher M Bruner, *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* (Cambridge University Press, 2013); John Gerard Ruggie, 'Multinationals as Global Institution: Power, Authority and Relative Autonomy' (2018) 12(3) *Regulation & Governance* 317, 325–6 [3.3].

68 Kraakman et al (n 29) 93.

69 Ibid 108.

70 Ibid 107.

Kraakman et al's own identification of a range of legal strategies that can be employed where needed.[71]

Nevertheless, there have been some attempts toward employing company law legal strategies to tackle broad social problems and to enlarge the agency approach to cover constituencies other than shareholders without challenging the theory itself. For instance, according to Margaret Blair and Lynn Stout's 'team production' theory,[72] a variant of the economic nexus of contracts agency theory,[73] a company is a vehicle through which all potential corporate stakeholders can jointly relinquish control over their firm-specific resources to the corporate board as a 'mediating hierarchy'.[74] It gives little guidance on what should be done and how as there is a long list of potential contributors of firm-specific resources. The theory is silent on how the contributors of firm-specific resources should be chosen and whether there is a way to measure their joint welfare in any reasonable way,[75] making it vulnerable to criticisms from the shareholder primacy perspective. Other — and older — stakeholder theorisations, notably Freeman's, posit, mainly on non-legal ethical grounds, that businesses should attempt to maximise the positive impact not only for shareholders but also for other 'stakeholders', including notably employees and customers.[76]

These stakeholder approaches, including team production theory, do not represent a fundamentally different way of conceptualising business, but rather, a reaction to the mainstream shareholder primacy thinking of the theory of the firm, attempting to bring more people into the group beside shareholders prioritised by the board and management as decision-makers in companies. As a reactive approach, stakeholder theories also fail to provide a credible alternative corporate purpose or corporate objective to maximising returns for shareholders.[77]

As we saw in Section II above, the shareholder primacy norm and the shareholder v stakeholder dichotomy are not merely questions of theory as an academic exercise, as this infects the whole company *law* discourse, with shareholder primacy firmly positioned at the heart of

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71 Ibid 31.

72 Blair and Stout (n 58); Blair (n 58). See also Ireland (n 58).

73 Bruner, 'Distributed Ledgers, Artificial Intelligence and the Purpose of the Corporation' (n 51) 448.

74 Blair and Stout (n 58).

75 Petri Mäntysaari, 'Theories of Corporate Law and Corporations: Past Approaches' in Petri Mäntysaari (ed), *Organising the Firm: Theories of Commercial Law, Corporate Governance and Corporate Law* (Springer, 2012) 57, 74.

76 R Edward Freeman, *Strategic Management: A Stakeholder Approach* (Pitman, 1984); R Edward Freeman, Jeffrey S Harrison and Stelios Zyglidopoulos, *Stakeholder Theory: Concepts and Strategies* (Cambridge University Press, 2018).

77 Jensen (n 55).

the unsustainability of business and constituting a systemically entrenched barrier to the contribution of business to sustainability. The discussion on section 172 of the UK Companies Act and its 'enlightened shareholder value' is an example of this. Instead of discussing the role of company law in ensuring that corporate governance contributes to a sustainable future, the academic and political discussion is attempted to be derailed through this misleading shareholder v stakeholder dichotomy, for instance in the US Business Roundtable's 'Purpose of the Corporation' statement.[78] Shareholder primacy advocates claim that the only alternative to shareholder primacy is a (by definition faulty) stakeholder model, and then go on to outline the (perceived) problems of a stakeholder reign.[79]

One main reason for the narrowness and binary nature of the debate, limiting it to these two choices only, is that both critics and proponents are constrained by the US law-based economic agency theory mindset. This mindset is partly a matter of the dominance of US economics, partly also of US legal-economic doctrine in international debates, and partly the English language, all drawing on Anglo-Saxon terminology even to the extent of conflicting with non-US and non-UK law. For example, we can mention the use of 'directors' referring to members of the corporate board, which is unfamiliar to Continental company law proper, as well as 'agency', based on Anglo-American common law. In spite of that, many company law scholars in Continental and Nordic countries describe a board in a Continental company as a 'board of directors' and perceive the board members as 'agents'.[80] Unfortunately, the European Commission also employs this misleading Anglo-Saxon vocabulary, calling, in its Corporate Sustainability Due Diligence Directive proposal, a member of the administrative, management or supervisory body of a company a 'director'.[81] This is not only inaccurate language; words convey meaning. Despite the pluralistic nature of their company law, Continental European academics use the shareholder v stakeholder language to explain their company law and corporate

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78 'Business Roundtable: Opportunity Agenda', *Business Roundtable* (Web Page) <https://opportunity.businessroundtable.org/ourcommitment/>.

79 See Jensen (n 55); Bebchuk and Tallarita (n 65).

80 See, eg, Kraakman (n 29); Per Lekvall (ed), *The Nordic Corporate Governance Model* (SNS Förlag, 2014).

81 *CSDDD Proposal* (n 21) art 3(o)(i). Here the Commission follows a similar definition in art 3(i) of *Parliament and Council Directive 2007/36/EC of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies* (2007) OJ L 184/17 as amended by *Parliament and Council Directive EU/2017/828 of 17 May 2017 Amending Directive 2007/36/EC as Regards the Encouragement of Long-Term Shareholder Engagement* [2017] OJ L 132/1.

governance regime, forgetting, it seems, the core rules in their own company law.[82]

The shareholder v stakeholder dichotomy is not only misleading, it is dangerous. It is time to wake up to the danger of allowing the debate to be framed by this dichotomy. We will outline three main reasons for our statements.

Firstly, the dichotomy is dangerous because it tends to take company law proper out of the legal discussion and thereby reinforces the shareholder primacy drive. As shown in the US debate, the legal arguments against shareholder primacy easily remain in the shadow of more vocal economic arguments,[83] or lure legal scholars to the economic debate on their terms.

Secondly, it is dangerous because we may, following the Anglo-Saxon thinking, risk moving over from shareholder primacy to 'stakeholder primacy', without considering other options that suit better our company law regimes. The shareholder primacy drive continues to constrain — in Christopher Bruner's pen — 'our collective sense of the possible — even for many who favour pursuing corporate sustainability in the abstract'.[84] Opting for what would be *stakeholder* primacy brings with it its own set of problems as the US team production theory and stakeholder theories may serve to indicate. The challenges global society faces today — and which business contributes to — will not be resolved through identifying possible stakeholders and their private preferences. Balancing of interests risks quickly becoming a utopia; in a stakeholder primacy model, the strongest, most strategic or most vocal of stakeholders may get to set business strategies and make decisions for private benefits. The result of stakeholder primacy may accordingly be power-grabbing and entrenching of inequalities and continued unsustainability. Privileged stakeholders may then reap private benefits to the detriment of those with less or no power. This leaves little or no room for vulnerable groups, such as invisible workers down in global value chains, Indigenous communities, future generations, and the environment that we all depend on. We risk people and the environment being

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82 As explicitly rejected in Rühmkorf's analysis of German law: Rühmkorf (n 66). See also Anne-Christin Mittwoch, 'The Interest of the Company as Key to the Corporate Purpose Discussion: Historic Concepts in German Company Law Revisited', *University of Oslo: The Faculty of Law* (Blog post, 24 August 2022) <https://www.jus.uio.no/english/research/areas/companies/blog/companies-markets-and-sustainability/2021/the-interest-of-the-company--mittwoch.html>.

83 See, eg, Clarke, 'The Contest on Corporate Purpose' (n 64).

84 See Bruner and Sjåfjell (n 49) 716 citing Christopher M Bruner, 'Conceptions of Corporate Purpose in Post-Crisis Financial Firms' (2013) 36(2) *Seattle University Law Review* 527, 560–1.

subjugated to providers of 'capitals' in stakeholder theorisations and reporting schemes.[85]

Thirdly, through well-intended efforts at dismantling *shareholder* primacy, within a constraining shareholder v stakeholder framing, we risk giving shareholder primacy proponents a big win by diluting a core company law principle, namely that the board is responsible to the company. Shareholder primacy proponents argue that their way of seeing the boards as solely agents of shareholders is the only way to ensure that companies are run efficiently and well — through the faulty logic of the legal-economic thinking underpinning the still prevailing paradigm. By attempting to mitigate shareholder primacy through the perceived only alternative: stakeholderism, leading to stakeholder primacy, we risk that boards would be responsible for the private interests of various interest groups, instead of the interests of the company as the law stipulates. Boards should never in practice (and contrary to law) have abdicated to shareholder primacy and they cannot abdicate to stakeholder primacy either.

## IV Taking Company Law Seriously: Corporate Purpose

We therefore reject the shareholder v stakeholder dichotomy and rather discuss corporate purpose as a matter of modern company law, in the light of the role company law can have to set out an overarching purpose that resonates with a research-based concept of sustainability.[86] We see a sustainable company law as based on integrating sustainability into corporate governance, and corporate purpose is at the heart of this.[87] Setting out a sustainable corporate purpose (which we introduce below) is about taking back the company law space that now is filled with non-legal arguments and explicitly defining what companies should have as their overarching aim. Although corporate purpose is such an important element of the societal basis on which company law's acceptance and promotion of the company form is based, statutory law does not generally set overarching purposes for companies in company law. Company law has, together with the historically understandable emphasis on the relationship between shareholders and companies in company legislation, thereby given ample space for the development of the law-

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85 Jukka Mähönen, 'Integrated Reporting and Sustainable Corporate Governance from European Perspective' (2020) 10(2) *Accounting, Economics, and Law* 20180048:1–40.

86 See Beate Sjåfjell, Sarah Cornell and Tiina Häyhä, 'Business, Sustainability and Agenda 2030' (Research Paper No 5/2023, Faculty of Law, University of Oslo, 7 August 2023) <https://ssrn.com/abstract=4533509>: preprint of this article submitted to the Earth System Governance Journal in March 2023.

87 Beate Sjåfjell and Mark B Taylor, 'A Clash of Norms: Shareholder Primacy vs Sustainable Corporate Purpose' (2019) 13(3) *International and Comparative Corporate Law Journal* 40; Sjåfjell, 'Reforming EU Company Law to Secure the Future of European Business' (n 4).

and-economics-based conceptualisation of the purpose as maximisation of returns to shareholders.[88] We suggest that company law should take back the power of defining why companies exist — to push against shareholder primacy — and more than that: set companies on the path towards a sustainable future.

We have proposed a legislative and explicit redefinition of corporate purpose for European undertakings — broadly understood to include all business forms (both public and private) — to dismantle the legal-economic myth of shareholder primacy that has dominated so much of the corporate governance discussion over the last decades, and to redirect companies towards sustainability.[89] The corporate purpose we have suggested will not alter or replace the possibility of expressing an individual and more detailed purpose or objects for businesses, legally to be separated from the purpose, which can be set in law governing different business forms and in the firm-specific instruments of the constitution or memorandum and articles of association.

The aim of our proposal is not to dramatically change the nature of European businesses or their specific purposes. Rather, it is to put the overarching societal purpose again in the centre of company law. It does not take away profit as an intrinsic element of the nature of for-profit companies or of their value creation and how profit is used and distributed in them. What we do is to return to an overarching societal purpose for all undertakings, following thereby the tradition of European company law, and reformulating it as a corporate purpose fit for our time. We suggest that it should be formulated employing the concepts of *sustainable value creation* and *planetary boundaries*.[90]

Positioning sustainable value creation within the planetary boundaries framework is a crucial step in integrating a research-based concept of sustainability into proposals for legislative reform. Ensuring that companies contribute to the overarching societal goal of mitigating pressures on planetary boundaries is necessary if we are going to have a chance to achieve crucial environmental goals, including those of mitigating climate change and reversing biodiversity loss. When the planetary boundaries framework was first presented in 2009, three of the identified nine planetary boundaries were highlighted as boundaries that human activity on a global scale has transgressed.[91] In 2015, the number of transgressed boundaries

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88 Sjåfjell, 'Reforming EU Company Law to Secure the Future of European Business' (n 4) 209.

89 Ibid 209–16.

90 Ibid 210–11: this builds on Beate Sjåfjell et al, 'Securing the Future of European Business: SMART Reform Proposals' (Research Paper No 11/2020, Faculty of Law, University of Oslo, 7 May 2020) 57–61 [6.2.1] <https://ssrn.com/abstract=3595048>.

91 Rockström et al (n 15).

had increased to four,[92] and in 2022, research showed that a fifth boundary has been transgressed.[93]

While the IPCC report on climate change of 2021 has been referred to as signalling a 'code red for humanity', planetary boundaries research shows that reality is even more grim — we have a whole set of code reds for humanity and they must all be dealt with simultaneously. The sustainability challenges of our time are complex, interconnected and messy, and attempting to silo sustainability work into dealing piecemeal with isolated elements will not work.

Working towards sustainability also entails questions of social justice — just as we cannot silo environmental issues into various categories to be dealt with separately, we cannot separate environmental and social issues. These are all interconnected elements. Sustainable value creation is already an emerging concept in company law discussions and corporate governance codes in a range of countries.[94] Creating sustainable value, as we see it, encompasses issues such as fair treatment of employees as well as of workers and local communities across global value chains, with respect for international human rights and core International Labour Organization conventions as a minimum, ensuring a 'living wage' and safe working conditions. Further, sustainable value encompasses participatory aspects of social foundations of sustainability, including all workers regardless of their labour law status, without taking a stand on how participation should be arranged. It includes honouring Indigenous Peoples' rights, including in the use of natural resources. A topical example is energy production in violation of the International Covenant on Civil and Political Rights, as stipulated in the Norwegian Supreme Court *Fosen* case against wind energy producers.[95]

An overarching corporate purpose for all corporate forms can be formulated simply in the following manner:

> The overarching purpose of the undertaking is to create sustainable value in a manner that contributes to mitigating pressures on planetary boundaries.[96]

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92 Steffen et al (n 15).

93 Persson et al (n 15).

94 Beate Sjåfjell and Georgina Tsagas, 'Integrating Sustainable Value Creation in Corporate Governance: Company Law, Corporate Governance Codes and the Constitution of the Company' in Beate Sjåfjell, Georgina Tsagas and Charlotte Villiers (eds), *Sustainable Value Creation in the European Union: Towards Pathways to a Sustainable Future through Crises* (Cambridge University Press, 2023) 209.

95 *Statnett SF v Sør-Fosen sijte* [2021] HR S 1975. For the English-language comment, see 'Norway: Climate and Human Rights Litigation Database', *Climate Rights Database* (Web Page, 16 August 2022) <https://climaterightsdatabase.com/category/state-concerned/norway/>.

96 Beate Sjåfjell, 'A General Corporate Law Duty to Act Sustainably' in Hanne S Birkmose, Mette Neville and Karsten Engsig Sørensen (eds), *Instruments of EU Corporate Governance:*

The formulation 'contributes to' as regards planetary boundaries is a carefully chosen formulation as mitigating pressures on planetary boundaries is clearly not something that easily can be operationalised on the level of the individual company.[97] Concerning both key concepts, the boundary of the company's responsibility is envisaged to be drawn up in a way that encompasses the operations and activities of the business, including the full life of the products, processes and services of the business.[98]

We envisage 'sustainable value' and 'planetary boundaries' as general clauses in company law, the content of which gradually can be firmed up as practice develops. This doesn't mean we don't think there should be any guidance in the law — quite the opposite, as we see the need to ensure that business does not take these two concepts and turn them into opportunities for greenwashing, bluewashing or 'sustainability washing'. We have suggested 'planetary boundaries' to be defined as:

> the scientifically recognised processes that regulate the stability and resilience of the Earth system within which humanity can continue to develop and thrive for generations to come

and that 'sustainable value' be defined as:

> creating value for the undertaking, while respecting the rights of its members, investors, employees, and other contractual parties, and promoting good governance, decent work and equality, and the human rights of its workers and affected communities and peoples.[99]

Avoiding the shareholder v stakeholder trap does not mean that we do not in our proposal encompass a wide variety of interests affected by the company's business. However, while involving affected communities, trade unions and civil society is crucial, a mere canvassing of 'stakeholder interests' and giving priority to the ones that make themselves heard the most is insufficient, misleading and potentially destructive for the overarching purpose of sustainable value creation. The backdrop must always be the interconnected complexities and the vulnerability of the often unrepresented groups (whether invisibilised workers deep in the global value chains,

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*Effecting Changes in the Management of Companies in a Changing World* (Kluwer Law International, 2023) 67. This section draws on the analysis in that chapter, as the latest publication presenting our research-based reform proposals.

97 Roland Clift et al, 'The Challenges of Applying Planetary Boundaries as a Basis for Strategic Decision-Making in Companies with Global Supply Chains' (2017) 9(2) *Sustainability* 279.

98 See also Sjåfjell, 'A General Corporate Law Duty to Act Sustainably' (n 96).

99 Sjåfjell et al, 'Securing the Future of European Business: SMART Reform Proposals' (n 90) s 6.2.1.

Indigenous communities or future generations),[100] and the aim of a sustainable future, which depends on mitigating pressures on planetary boundaries.[101]

## V Operationalising a Sustainable Corporate Purpose: The Duties of the Board

The board is the governing body of a company. Although the competence of the board varies in different jurisdictions, its role is crucial in fulfilling the corporate purpose. In most jurisdictions the board is compulsory, even where the board duties have been divided between several management and supervisory organs, such as the management board, consisting of one or several members, and the supervisory board. The board is also central in EU company legislation, described as the 'administrative or management body' of the undertaking.[102] Although there are attempts to at least partially replace boards with artificial intelligence, they still consist mainly of human decision-makers.[103] Taking into consideration the central role of boards in companies, integrating our proposal for the overarching purpose into the duties of the board is paramount, outlining these in a way that provides legal certainty for undertakings and clarifies the board's relationship to the company, its shareholders and other involved and affected parties. In this section we explain why and briefly how, drawing on extensive presentations and discussions of this in previous works.

During the nineteenth century, companies were generally, in most jurisdictions, granted a legal personality, allowing them to own property and contract in their own name.[104] As a company (a legal person) does not have physical personality, it must be coordinated by humans (or human-made technology such as artificial intelligence). Companies need organs to operationalise their activities. The position, competence and duties of the organs are therefore core company law issues. In European companies, the boards have overarching competence to run the company — with the shareholders through the

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[100] Louis J Kotzé, 'The Anthropocene, Earth System Vulnerability and Socio-Ecological Injustice in an Age of Human Rights' (2019) 10(1) *Journal of Human Rights and the Environment* 62.

[101] Sjåfjell, 'Reforming EU Company Law to Secure the Future of European Business' (n 4) 213.

[102] See, eg, *Parliament and Council Directive EU/2017/1132 of 14 June 2017 Relating to Certain Aspects of Company Law* [2017] OJ L 169/46, arts 13f, 50, 60, 61, 64, 65, 72, 86d, 86e, 86j, 124, 126b, 160d, 160e, 160j.

[103] Bruner, 'Distributed Ledgers, Artificial Intelligence and the Purpose of the Corporation' (n 51).

[104] Of the history of corporate legal personality, see, eg, Nicholas HD Foster, 'Company Law Theory in Comparative Perspective: England and France' (2000) 48(4) *American Journal of Comparative Law* 573; Watson (n 53); Iwai (n 47).

general meeting normally having various forms of control over the composition of the board and certain major corporate decisions. The board powers can be defined in national company law and the firm-specific corporate instruments; the powers of the board can be divided, for instance, between a management board and a supervisory board.

What is crucial is the board's company law duty to promote the interests of the company, or the 'company interest' as it is often referred to in Continental Europe. To clarify the board's role in a company, which has been clouded through the influence of the shareholder primacy drive, the basic company law rule, that the core duty of the board is to promote the interests of the company, needs to be explicitly stated. In line with what we have proposed, this will not entail a harmonisation of the definition of the interests of the company in European company law. Developing the understanding of what the interests of the specific company entail in a concrete instance should remain for the board to define, within the scope of national legislation, articles of association and existing contracts and commitments. The duty of the board to promote the interests of the company should — and can — be positioned within the overarching purpose. This can be set out as

> promoting the interests of the company in such a way as to create sustainable value that also contributes to mitigating pressures on planetary boundaries.[105]

It would entail a duty to assess and as necessary change the corporate business model and strategy, and encompass changes in risk management, with mandatory sustainability due diligence as a key tool for boards to fulfil this duty.[106]

The board has a crucial role in the company. The company is bound by contracts made by the board on the company's behalf, and the harm caused by the board through its actions or inactions falls under the liability of the company as a legal person. To enforce board duties, national company laws may include provisions on the board's and its members' direct liability to the company, its shareholders and other parties negatively affected by the corporate actions caused by the board violating its duties. When concerning the effectiveness of board duties, it must be taken into consideration how the duties are enforced through company law rules, including rules on board liability.

We now turn to the emphasis on due diligence in the EU law context, and our analysis of the proposed Corporate Sustainability Due Diligence Directive within the context of our research-based proposal

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[105] Sjåfjell, 'A General Corporate Law Duty to Act Sustainably' (n 96).

[106] Ibid: this is building on Sjåfjell et al, 'Securing the Future of European Business: SMART Reform Proposals' (n 90) 57–61 [6.2.1].

for corporate purpose and board duties — which include specifications of corporate sustainability due diligence — and their enforcement.

## VI The EU Corporate Sustainability Due Diligence Directive Proposal

Due diligence has increasingly become a hot topic in corporate governance and corporate accountability debates since the adoption of the UN Guiding Principles for Business and Human Rights (UNGPs) in 2011.[107] Several jurisdictions, such as France, Germany and Norway, have introduced due diligence provisions in their legislation and others are considering doing it.[108] In March 2021, the European Parliament proposed that the Commission develop harmonised due diligence rules on environmental and human rights.[109] This appears to be inspired in part by the human rights due diligence flowing from the UNGPs and in part by the European Commission's Action Plan for Financing Sustainable Growth, with its emphasis on the environment and especially climate change.[110] Due diligence is what has remained of the European Commission's originally more ambitious Sustainable Corporate Governance initiative, as is clear from the Commission's proposal of February 2022 for a Corporate Sustainability Due Diligence Directive. The pre-existing EU legislation already has reporting rules that refer to due diligence.[111] These are strengthened in the new Corporate Sustainability Reporting Directive, applicable from 1 January 2024 for financial years starting on or after 1 January 2024.[112]

The European Commission's Corporate Sustainability Due Diligence Directive proposal, presented on 23 February 2022, is at the time of writing in trilogue (interinstitutional) negotiations, after the Council put forward its general approach, a critical consensus

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[107] Office of the High Commissioner, *Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework*, UN Doc HR/PUB/11/04 (16 June 2011).

[108] See, eg, 'Human Rights Due Diligence: The State of Play in Europe', *Shift* (Web Page, 10 May 2023) <https://shiftproject.org/resource/mhrdd-europe-map/>.

[109] *Parliament Resolution of 10 March 2021 with Recommendations to the Commission on Corporate Due Diligence and Corporate Accountability (2020/2129(INL))* [2021] OJ C 474/11; 'Sustainable Corporate Governance' (n 14).

[110] European Commission, *Action Plan: Financing Sustainable Growth* (n 18) 11.

[111] *Parliament and Council Directive 2013/34/EU of 26 June 2013 on the Annual Financial Statements, Consolidated Financial Statements and Related Reports of Certain Types of Undertakings, Amending Parliament and Council Directive 2006/43/EC and Repealing Council Directives 78/660/EEC and 83/349/EEC* [2013] OJ L 182/19, art 19a.

[112] *Parliament and Council Directive EU/2022/2464 of 14 December 2022 Amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as Regards Corporate Sustainability Reporting* [2013] OJ L 322/15 ('*Corporate Sustainability Reporting Directive*').

proposal in December 2022,[113] and the Parliament voted in plenary on the proposal in June 2023, setting out its own list of amendments.[114]

The proposed Directive aims to put into place mandatory and harmonised sustainability due diligence rules in the European Economic Area, in recognition of the insufficiency of voluntary action by business and the regulatory chaos that business faces in its cross-border activities.[115]

We give here first some background on the EU regulatory framework for due diligence, drawing also here on our reform proposals and most recent publications,[116] before turning to core elements of the proposed Directive.

### A *Due Diligence in EU Financial and Reporting Rules*

In addition to specific due diligence rules such as on conflict minerals,[117] recent developments in the EU provide examples of the inclusion of what we denote financial 'risks of unsustainability' in due diligence considerations.[118] These concern the duty of financial market participants and financial advisers to conduct adequate due diligence prior to making investments. This duty encompasses not only financial risks in the traditional sense but also all sustainability risks — as such inseparable — that might have a relevant material negative impact on the financial return of an investment or advice. The policies have to be specified and disclosed, including on how the management of those risks is integrated into the activity of the financial actor.[119] In April 2021, the European Commission put forward its proposal for a reform of the in 2014 unfortunately named 'Non-Financial' Reporting Directive, which reform was suggested to

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113 Council Position (n 22).

114 Parliament Position (n 24).

115 As explained in the explanatory text of the Directive proposal: *CSDDD Proposal* (n 21) 1–3.

116 Sjåfjell, 'A General Corporate Law Duty to Act Sustainably' (n 96); Jukka Mähönen, 'Auditors' Role in Corporate Governance' in Hanne S Birkmose, Mette Neville and Karsten Engsig Sørensen (eds), *Instruments of EU Corporate Governance: Effecting Changes in the Management of Companies in a Changing World* (Kluwer Law International, 2023) 477. This section draws on the analysis in these chapters, as the latest publication presenting our research-based reform proposals.

117 *Regulation (EU) No 2017/821 of the European Parliament and of the Council of 17 May 2017 Laying down Supply Chain Due Diligence Obligations for Union Importers of Tin, Tantalum and Tungsten, Their Ores, and Gold Originating from Conflict-Affected and High-Risk Areas* [2017] OJ L 130/1.

118 On the concept of 'risks of unsustainability', see Beate Sjåfjell, 'Taking Finance Seriously: Understanding the Financial Risks of Unsustainability' in Kern Alexander, Matteo Gargantini and Michele Siri (eds), *The Cambridge Handbook of EU Sustainable Finance: Regulation, Supervision and Governance* (Cambridge University Press, forthcoming) ch 2, preprint available at SSRN: https://ssrn.com/abstract=4294693.

119 *Regulation (EU) No 2019/2088 of the European Parliament and of the Council of 27 November 2019 on Sustainability-Related Disclosures in the Financial Services Sector* [2019] OJ L 317/1, Preamble paras 12, 14, 18, arts 2(22), 4.

be named the Corporate Sustainability Reporting Directive,[120] to amend the Accounting Directive[121] and the Audit Directive.[122] The new Directive, adopted in December 2022, includes disclosure rules on the due diligence processes implemented with regard to sustainability matters.[123] The Directive also includes rules for European Sustainability Reporting Standards,[124] the first set of which was published by the European Commission in July 2023,[125] as well as rules for the assurance of sustainability reports, including assurance standards to be given by the Commission.[126]

The new EU reporting rules, including the duty for companies to disclose and verify their due diligence processes,[127] are a step in the right direction but not enough. Although the Corporate Sustainability Reporting Directive requires that the undertaking include in its management report a description of the due diligence process implemented regarding all sustainability matters, and this description falls under auditing according to detailed European Sustainability Reporting Standards[128] and the assurance standards to be given by the Commission, there are no detailed material rules on the due diligence duty itself.

Secondly, while the new reporting duties in the verified management report are stronger than the present non-verified and decoupled 'non-financial statements', the hard core of reporting, financial statements, remains intact and untouched by sustainability

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120 See European Commission, *Proposal for a Parliament and Council Directive Amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as Regards Corporate Sustainability Reporting* [2021] COM 189, Preamble para 27.

121 *Parliament and Council Directive 2013/34/EU of 26 June 2013 on the Annual Financial Statements, Consolidated Financial Statements and Related Reports of Certain Types of Undertakings, Amending Parliament and Council Directive 2006/43/EC and Repealing Council Directives 78/660/EEC and 83/349/EEC* [2013] OJ L 182/19 ('*Accounting Directive*').

122 *Parliament and Council Directive 2006/43/EC of 17 May 2006 on Statutory Audits of Annual Accounts and Consolidated Accounts, Amending Council Directives 78/660/EEC and 83/349/EEC and Repealing Council Directive 84/253/EEC* [2006] OJ L 157/87 ('*Audit Directive*').

123 *Accounting Directive* (n 121) as amended by *Corporate Sustainability Reporting Directive* (n 112) arts 19a(2)(f), 29a(2)(f).

124 *Accounting Directive* (n 121) as amended by *Corporate Sustainability Reporting Directive* (n 112) arts 29b, 29c.

125 *Commission Delegated Regulation EU/…/… of 31.7.2023 Supplementing Parliament and Council Directive 2013/34/EU as Regards Sustainability Reporting Standards* [2023] C 5303 ('*Regulation Regarding Sustainability Reporting Standards*'): not in force until it is published in the Official Journal.

126 *Audit Directive* (n 122) as amended by *Corporate Sustainability Reporting Directive* (n 112) arts 26a–28.

127 *Accounting Directive* (n 121) as amended by *Corporate Sustainability Reporting Directive* (n 112) arts 19a(2)(f), 29a(2)(f), 34(1)(a)(ii), 34(1)(aa), 34(3).

128 The first set of standards was published in July 2023: *Regulation Regarding Sustainability Reporting Standards* (n 125) annex.

concerns. Financial accounting is the cornerstone of corporate infrastructure. Corporate reporting, company law and corporate governance are interlinked: Modern accounting and through that corporate reporting are prerequisites for the modern company, and without the modern company there would have been no entity on which to report. The purpose of both accounting and company regulation has been to protect the entity and those involved with it.

However, as with the change in the 1970s in corporate thinking, based on agency and shareholder primacy, there has been a similar change in financial accounting. Instead of emphasis on precaution, more and more demands were concentrated on shareholder value and its measurement and distribution. Companies were obligated to follow this practice to have access to capital markets, with a vast social infrastructure of securities markets regulators, accounting and auditing standard setting bodies, and auditing firms and their oversight bodies.[129] In the early 2000s, this change reached the EU. Since then, European accounting regulation has been both directly[130] and indirectly[131] based on the International Financial Reporting Standards, a framework based solely on shareholder primacy.[132]

Financial accounting based on shareholder value maximisation, shown for instance in the fair value measurement and ignorance of risks of unsustainability, reinforces the corporate shareholder primacy norm. This also helps explain the limited success of the EU's 2014 'non-financial' reporting rules and other sustainability reporting initiatives on the national level.[133] With the shareholder primacy drive dictating (contrary to company law) that boards must maximise returns to shareholders, and with accounting law supporting this kind of corporate purpose, reporting rules on sustainability issues were not able to bridge the gap between what the board perceives as its core duty and what it is asked to report on. It is open for question whether

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[129] Jukka Mähönen, 'Comprehensive Approach to Relevant and Reliable Reporting in Europe: A Dream Impossible?' (2020) 12(13) *Sustainability* 5277.

[130] *Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the Application of International Accounting Standards* [2002] OJ L 243/1: This makes it compulsory for listed undertakings to prepare their consolidated (group) accounts according to International Financial Reporting Standards.

[131] Through the provisions of *Accounting Directive* (n 121), heavily influenced by the International Financial Reporting Standards.

[132] Vera Palea, 'Financial Reporting for Sustainable Development: Critical Insights into IFRS Implementation in the European Union' (2018) 42(3) *Accounting Forum* 248; Vera Palea, 'Accounting for Sustainable Finance: Does Fair Value Measurement Fit for Long-Term Equity Investments?' (2022) 30(1) *Meditari Accountancy Research* 22.

[133] See Charlotte Villiers and Jukka Mähönen, 'Article 11: Integrated Reporting or Non-Financial Reporting?' in Beate Sjåfjell and Anja Wiesbrock (eds), *The Greening of European Business under EU Law: Taking Article 11 TFEU Seriously* (Routledge, 2015) 118; Mähönen, 'Integrated Reporting and Sustainable Corporate Governance from European Perspective' (n 85).

we can say that the EU in its proposed Corporate Sustainability Due Diligence Directive has learned from the failure of the non-financial reporting regime.

### B *The Sustainability Concept of the Due Diligence Directive*

The proposed Directive is appropriately named the Corporate Sustainability Due Diligence Directive, resonating in title with the Corporate Sustainability Reporting Directive. It is positive that the Corporate Sustainability Due Diligence Directive proposal clarifies which environmental and human rights issues are intended to be included.[134] However, the Commission's proposal neither defines what it means by 'corporate sustainability', or 'sustainability' for that matter, nor is its clarification of which issues are intended to be included comprehensive or consistent. The Parliament's and the Council's respective positions also do not include any definition of sustainability, although the Parliament's position goes further in suggesting amendments that more broadly reference sustainability aspects. None of the EU institutions mentions 'planetary boundaries' or, in other language, the ecological limits of our planet.

The proposed rules give little guidance to corporate decision-makers. For instance, to get an overview of the environmental issues included in the Commission proposal, a reading of the proposed Annex with its (somewhat limited) listing of environmental conventions is required,[135] which then easily lends itself to the understanding that companies can rely on legislators to set the limits for what they can and cannot do through environmental law, which may undermine the impact of the proposed Directive. We would have preferred, as outlined above, that the concept of planetary boundaries were included and defined in a way that gives explicit guidance to the corporate decision-makers and gives room for new legislation as well as further scientific developments irrespective of the extent to which certain environmental issues are included in international environmental laws.[136]

Climate change is not included in the due diligence obligations in the Commission proposal but rather given a different emphasis

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[134] Including its proposed Annex listing the bases for human rights and environmental violations: *CSDDD Proposal* (n 21) annex.

[135] Ibid.

[136] We suggest, in our proposal for a redefined corporate purpose and duties of the board, that 'planetary boundaries' to be defined as 'the scientifically recognised processes that regulate the stability and resilience of the Earth system within which humanity can continue to develop and thrive for generations to come', and we suggest in simple language explaining what this entails for the duty of the corporate board including for the due diligence process: Sjåfjell et al, 'Securing the Future of European Business: SMART Reform Proposals' (n 90) 57–61 [6.2.1].

through the proposed more specific duties in Article 15, with reference to the Paris Agreement 1.5°C global warming threshold. This approach is supported by the Council position, although it includes a few more environmental conventions (while deleting some of the human rights conventions). The Parliament position, which both adds and removes conventions, includes climate change in the due diligence obligations.[137]

The peculiar approach to climate change illustrates both its topicality and the issue's political sensitivity. Climate change, which the Financial Stability Board's Task Force on Climate-Related Financial Disclosure[138] has done much to raise awareness about, was also given special attention in the European Commission 2019 Guidelines on implementation of the Non-Financial Reporting Directive,[139] and is now included in the Corporate Sustainability Reporting Directive,[140] as it is under the Taxonomy Regulation,[141] one of the key legal instruments of the EU's Sustainable Finance Initiative.[142] Climate change needs to be included fully and properly. At the same time, it is *one* of the hitherto identified *nine* planetary boundaries, all of which are Earth system processes fundamental to maintaining this planet as a relatively stable and safe space for humanity. Biodiversity loss, land use, freshwater use and the release of novel entities are examples of other environmental issues that should be given equal emphasis.[143]

Social aspects should be fully encompassed, including human rights violations, lack of decent work, corruption and tax evasion, reflecting the sustainability goal of securing social foundations for humanity now and for the future. The Commission's proposal follows

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137 See generally Marian G Ingrams, Joseph Wilde-Ramsing and Ben Vanpeperstraete, 'Achieving Alignment: Synching EU Due Diligence Legislation with the Updated OECD Guidelines', *OECD Watch* (Web Article, 6 July 2023) <https://www.oecdwatch.org/achieving-alignment-synching-eu-due-diligence-legislation-with-the-updated-oecd-guidelines/>: This is a helpful overview comparing the Commission's Proposed Directive, Council Position and Parliament Position.

138 'Task Force on Climate-Related Financial Disclosures', *Financial Stability Board: Task Force on Climate-Related Financial Disclosures* (Web Page) <https://www.fsb-tcfd.org>.

139 *Communication from the Commission — Guidelines on Non-Financial Reporting: Supplement on Reporting Climate-Related Information* [2019] OJ C 209/1.

140 *Accounting Directive* (n 121) as amended by *Corporate Sustainability Reporting Directive* (n 112) arts 19a(2)(a)(iii), 29a(2)(a)(iii).

141 *Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the Establishment of a Framework to Facilitate Sustainable Investment, and Amending Regulation (EU) 2019/2088* [2020] OJ L 198/13.

142 'EU Taxonomy for Sustainable Activities', *European Commission* (Web Page) <https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en>.

143 Based on the revised OECD Guidelines of 2023, the Parliament position does more explicitly include some more environmental categories: Ingrams, Wilde-Ramsing and Vanpeperstraete (n 137).

up on the trend from the UNGPs of concentrating on human rights,[144] which is laudable, but not enough. And its listing of conventions is limited. The listing of conventions is limited further in the Council position, while the Parliament position broadens the conventions and issues included, notably with an emphasis on Indigenous Peoples' issues as well as fundamental ILO conventions.[145]

As is done in the OECD Due Diligence Guidance for Responsible Business,[146] it is crucial that a full range of social issues is included, encompassing also economic and governance issues.[147] Mandatory sustainability due diligence should include, of course, compliance with applicable regulatory frameworks on human rights, workers' rights, Indigenous People's rights, health and environment (including those listed in the proposed Annex), and also governance issues such as anti-corruption and taxation (which are not listed in the Annex). However, legal compliance is not enough. The standards for due diligence should be set higher, encompassing business activities' global impacts and promoting sustainable value creation that also contributes to mitigating pressures on planetary boundaries. In its Communication on the European Green Deal, the Commission writes, appropriately: 'As the world's largest single market, the EU can set standards that apply across global value chains.'[148] Mandatory sustainability due diligence is crucial to achieving this, and it should be shaped in a way as to strike an appropriate balance between being principles-based enough to allow for individual assessments across various types of undertakings and sectors and across time, while being firm and specific enough on the environmental, social and governance issues that must be encompassed in the due diligence.

For an EU law reform to have the intended effect, the due diligence duty should not only be denoted as *corporate sustainability* due diligence, it should actually encompass in a comprehensive way all environmental, social and governance aspects of a research-based

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144 See also here the proposed Annex listing of the bases for human rights violations: *CSDDD Proposal* (n 21) annex.

145 Parliament Position (n 24). See also Ingrams, Wilde-Ramsing and Vanpeperstraete (n 137).

146 The OECD Guidelines were originally adopted in 1976 and most recently revised in 2023: Organisation for Economic Co-Operation and Development, *OECD Guidelines for Multinational Enterprises on Responsible Business Conduct* (OECD Publishing, 2023). There is precedence for incorporating reference to the OECD Guidelines and other key elements of the international norm sets promoting sustainability in the EU's Sustainable Finance work, including the Taxonomy Regulation Article 18, the *Corporate Sustainability Reporting Directive* (n 112), see Preamble Recitals 31, 45 and 50, and, eg, the Norwegian Transparency Act. On the latter, see Mark Taylor, 'Mandatory Human Rights Due Diligence in Norway: A Right to Know', *University of Oslo: The Faculty of Law* (Web Article, 21 August 2022) <https://www.jus.uio.no/english/research/areas/companies/blog/companies-markets-and-sustainability/2021/mandatory-human-rights--taylor.html>.

147 See also Sjåfjell, 'A General Corporate Law Duty to Act Sustainably' (n 96) s 4.

148 European Commission, *The European Green Deal* (n 14) 22.

approach to sustainability. The individual aspects should be defined drawing on international and EU law, on interdisciplinary sustainability research and on widely accepted due diligence guidance,[149] including the UNGPs, the OECD Guidelines and the OECD Due Diligence Guidance for Responsible Business.[150]

### C *The Limited Company Law Element in the Directive: The Role of the Board*

The connection of the proposed Corporate Sustainability Due Diligence Directive with company law proper is very much on the defensive, although the proposal has some positive aspects. It has become evident that the Commission's Directorate-General for Justice and Consumers was forced to tone down its originally more ambitious ideas, due to lobbying of the Commission's own Regulatory Scrutiny Board, which twice sent the proposal back to the Directorate-General for amendments before it finally let it through.[151]

We see the Commission's defensiveness reflected in the way core company law issues are relegated to the end of the proposal. The logical approach would have been to set out clearly the core duties of the board and how to enforce them in the beginning of the proposed Directive, to ensure that sustainability due diligence is used as a key tool for integrating sustainability into the entire business of the company.

In spite of its limitations and defensiveness, one of the main positive aspects in the proposal is a duty of care for 'directors'. In the remaining company law element in the proposed Directive, the important clarification of the duty of the board to promote the interests of the company is included in Article 25(1), setting out the language of 'when fulfilling their duty to act in the best interest of the company' concerning the corporate board (and, more broadly, 'directors').[152]

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149 See the *Corporate Sustainability Reporting Directive* (n 112), Preamble para 31.

150 See also Sjåfjell, 'A General Corporate Law Duty to Act Sustainably' (n 96). This is building on Sjåfjell et al, 'Securing the Future of European Business: SMART Reform Proposals' (n 90) 57–61 [6.2.1]. See also Ingrams, Wilde-Ramsing and Vanpeperstraete (n 137).

151 Corporate Europe Observatory sets out this lobbying of the Regulatory Scrutiny Board and how it weakened the proposal in its 2022 report: 'Inside Job: How Business Lobbyists Used the Commission's Scrutiny Procedures to Weaken Human Rights and Environmental Legislation', *Corporate Europe Observatory* (Web Page, 8 June 2022) <https://corporateeurope.org/en/inside-job>. This had the result that the European Ombudsman now has opened up an enquiry into the functioning of the Regulatory Scrutiny Board: Emily O'Reilly, 'The Composition of the European Commission's Regulatory Scrutiny Board and How It Interacts with Interest Representatives', *European Ombudsman* (Web Page, 4 April 2023) <https://www.ombudsman.europa.eu/en/opening-summary/en/168093>.

152 The Anglo-Saxon concept of 'directors' that the Proposed Directive (n 21) uses is defined in the Article 3(o) as '(i) any member of the administrative, management or supervisory bodies

As outlined above, we believe that the duty to promote the interests of the company should be positioned within an overarching purpose of sustainable value creation[153] and contributing to mitigating pressures on planetary boundaries,[154] drawing up the framework within which the board shall promote the firm-specific interests of the company. Unfortunately, the Commission's proposal for the Due Diligence Directive's Article 25(2) rather goes on to say that the 'directors'

> … when fulfilling their duty to act in the best interest of the company … shall take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term.

A reference to 'take into account' is reminiscent of the 'enlightened shareholder value' approach of section 172 of the UK Companies Act and is not a good starting point.[155] While it is positive that the listing of issues is broad and inclusive, a firmer engagement with a research-based concept of sustainability would be preferable.

Even this vague 'take into account' language was too much for the Council. It stated that due to the 'strong concerns' expressed by Member States that Article 25 was an inappropriate interference with national provisions regarding 'directors' duty of care', and potentially undermining 'directors' duty to act in the best interest of the company', the Council position is to delete the provision altogether from the Directive.[156] The Parliament position, on the other hand, does not suggest to delete or revise Article 25 in the Commission proposal.

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of a company; (ii) where they are not members of the administrative, management or supervisory bodies of a company, the chief executive officer and, if such function exists in a company, the deputy chief executive officer; (iii) other persons who perform functions similar to those performed under point (i) or (ii).' Accordingly, a 'director' means not only a member of the board, but also the chief executive officer that is not a board member.

153 Which we suggest be regulated through a formulation such as: 'The board shall further ensure that the operations and activities of the business, including the full life of the products, processes and services of the business, creates sustainable value …' and specifying what this entails as guidance of the decision-makers in companies as well as for enforcement purposes: Sjåfjell et al, 'Securing the Future of European Business: SMART Reform Proposals' (n 90) s 6.2.1.

154 Recognising the difficulty of identifying what each company's contribution to mitigating pressures on planetary boundaries should be, we suggest the following formulation: 'The board shall work to ensure that the operations and activities of the business, including the full life of the products, processes and services of the business, contribute to global society mitigating pressures planetary boundaries … employing best available knowledge and technology', and then with further stipulations of what that entails, slightly paraphrased from Sjåfjell et al: ibid.

155 To the contrary, the 'enlightened shareholder value' approach has not contributed to more sustainability-oriented business, but rather continued to facilitate shareholder primacy, as is well-documented in the literature: see, eg, Charlotte Villiers, 'Sustainable Companies: Barriers and Possibilities in UK Company Law' (2015) 11(1) *International and Comparative Corporate Law Journal* 105; Johnston (n 59).

156 Council Position (n 22) [31].

The Commission's proposal is not as clear on company law board duties and sustainability as we would have liked to see. However, it is positive that Article 25(2) of the Commission's proposed Directive positions the sustainability issues into core company law through setting it out within the duties of the board, while further stating that 'Member States shall ensure that their laws, regulations and administrative provisions providing for a breach of directors' duties apply also to the provisions of this Article'. The latter provision would have the effect of broadening board liability in national company law[157] — as it is not currently harmonised in the EU law — to include breach of the duties set in the proposed Directive.[158] According to our interpretation, the Commission's proposed Article 25(2) would therefore be enforceable, for instance, under provisions in national Companies Acts that provide for holding board members and chief executive officers personally liable for damages caused by breach of the duty of care, not only to the company itself but also to parties outside the company that have been caused damage, whether they be shareholders, creditors or tort victims.

Additionally, Article 26(1) of the Commission's proposal provides that Member States shall ensure that these 'directors' are responsible for putting in place and overseeing the due diligence actions referred to in the above-mentioned Article 4 and in particular the due diligence policy referred to in Article 5. The directors shall report to the 'board of directors' in that respect, defined in Article 3(p) as

> … the administrative or supervisory body responsible for supervising the executive management of the company, or, if no such body exists, the person or persons performing equivalent functions.[159]

According to Article 26(2), Member States shall ensure that directors take steps to adapt the corporate strategy to take into account the actual and potential adverse impacts identified pursuant to Article 6 and any measures taken pursuant to Articles 7 to 9. The Council position proposes to delete Article 26 (because of its connection with Article 25), while the Parliament position rather suggests to include language on the duties of the 'directors' elsewhere in the Directive proposal.[160]

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157 With our company law focus, we do not in this article discuss the Commission proposal for Article 22 on liability for the company itself, although that may in turn lead to liability for board members, nor do we go into sanctions in Article 20.

158 As noted above, the Council Position is to delete Article 25 in the Proposal Directive, while the Parliament Position does not suggest any changes to this article.

159 A clearer introductory provision for the corporate board in the Proposed Directive would have been preferable, including some language on the senior management level to be encompassed where the company exceptionally has no board.

160 See Parliament Position (n 24) amendments 256, 391, 405. Amendments 391 and 405 propose to delete Article 26 and amendment 256 proposes to revise Article 15(3) so that it

### D *Sustainability Due Diligence as a Key Tool for the Corporate Board*

Mandatory sustainability due diligence, encompassing open and participatory processes to include involved and affected groups and persons across global value chains, is a key tool in implementing a redefined corporate purpose of sustainable value creation that also contributes to mitigating pressures on planetary boundaries.[161] For mandatory sustainability due diligence to work as intended, it is crucial that it is firmly integrated in the company law duties of the board. We have therefore suggested that clearly defined sustainability assessment — including corporate sustainability due diligence — to identify ongoing negative sustainability impacts and principal risks of future negative sustainability impacts should be set out as an integral part of reformed board duties. This should be integrated into an obligation to ensure that the business model of the undertaking is in line with the overarching purpose, developing and publishing a strategy that integrates the purpose throughout the business, including in the internal control and risk management systems. This kind of rule would also realise the significance of rules on business model and due diligence disclosure, notably those in the EU's reporting rules mentioned above.

As we saw above in Section C, the role of the corporate board is included in a convoluted way in the Commission proposal, difficult to access and clearly reflecting the fear of going into company law proper, and now at risk of being deleted altogether. It is positive that the Commission proposal seeks to introduce a duty for companies to conduct human rights and environmental due diligence. However, it is crucial that the corporate board also has a clearly spelled out duty here to ensure the efficient follow-up of the duty imposed on the company.

As for the due diligence process, it is key, to mitigate the problems with fragmentation of corporate responsibility and accountability through the use of corporate groups, contractual value chains and various other non-equity modes of control, that it encompasses the entire business of the company, encompassing the full life of its

reads 'Member States shall ensure that directors are responsible for overseeing the obligations set out in this Article' and then goes on to speak about remuneration rather than only setting out, as the Commission proposal does, that the company should 'take into account' issues referenced in the provision in the setting of remuneration.

161 Beate Sjåfjell and Jukka Mähönen, 'Mandatory Sustainability Due Diligence is Key to a Sustainable Future', *University of Oslo: The Faculty of Law* (Web Article, 5 September 2022) <https://www.jus.uio.no/english/research/areas/sustainabilitylaw/blog/companies-markets-and-sustainability/2021/mandatory-sustainability-due-diligence--sjafjell-mahonen.html>; Sjåfjell, 'A General Corporate Law Duty to Act Sustainably' (n 96).

products and processes.[162] Although the Commission's proposal for the Directive goes some steps in that direction, it also has several weak points, including notably its scope for companies covered by the Directive, which excludes something like 99 per cent of European businesses[163] and much of the financial sector.[164] Further, for companies that are included, the proposed Directive's application is restricted to their 'established' business relationships in Article 1(a),[165] which is deemed as 'highly problematic'.[166] While the Council position generally is reticent, seeking to limit the scope of the Directive rather than expanding on the Commission proposal, the Parliament position goes some way in seeking to remedy the weaknesses of the Commission proposal. However, as reflected in the call for improvement of the Directive in the crucial phase of the trilogue negotiations, the Parliament positions also fall short.[167]

We have suggested that the due diligence process should be set out to encompass consultative processes for engagement with local communities, including Indigenous Peoples and other groups and persons affected by the operations and activities of the business, encompassing as relevant in the specific case, workers, subcontractors, and local or national interest groups and community representatives. Follow-up of the due diligence process should also be stipulated, where identified lack of legal compliance should be rectified immediately. For other identified sustainability impacts and risks, an ambitious continuous improvement process should be drawn up under

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[162] Sjåfjell et al, 'Securing the Future of European Business: SMART Reform Proposals' (n 90) s 6.2.1.

[163] Proposed Directive (n 21) art 2.

[164] See, eg, United Nations Working Group on Business and Human Rights, 'Mandate of the Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises' (Statement, 12 July 2023) <https://www.ohchr.org/sites/default/files/documents/issues/business/workinggroupbusiness/Statement-Financial-Sector-WG-business-12July2023.pdf>: The statement criticises all drafts of the Proposed Directive for the way the financial sector is not properly included, highlighting that 'creating carveouts or presumptions for the financial sector in the draft Corporate Sustainability Due Diligence Directive would be *inconsistent* with international standards on business and human rights' (emphasis in original).

[165] With 'established business relationships' defined in Article 3(f) as 'a business relationship, whether direct or indirect, which is, or which is expected to be lasting, in view of its intensity or duration and which does not represent a negligible or merely ancillary part of the value chain', which may constrain the practical use of the relatively speaking broader definition of value chains in Article 3(g).

[166] 'It arbitrarily narrows a company's due diligence focus to its longer-term and more frequent business relationships, even if those are not the relationships most subject to risk. This would result in significant oversight of business relationships and actual risks, undermining the purpose of the law': Ingrams, Wilde-Ramsing and Vanpeperstraete (n 137).

[167] Ingrams, Wilde-Ramsing and Vanpeperstraete (n 137); International Federation for Human Rights, *Europe Can Do Better: How EU Policy Makers Can Strengthen the Corporate Sustainability Due Diligence Directive* (June 2022).

the leadership of the board.[168] The ambitious continuous improvement plan should include qualitative and quantitative key performance indicators (KPIs) where appropriate. The process should be verified by external experts and through that give a basis for relevant and reliable reporting.[169]

In the Directive proposal, this is not set out clearly enough, with a repeated reference to 'stakeholders' and stakeholder involvement rather than clearly setting out what the board is responsible to ensure is done and how it is to be followed up. This lack of specificity may dilute the effect of these proposed rules, create some of the problems connected with stakeholder references outlined above and invoke the dichotomy we have warned against.[170] That the Parliament in its position seeks to 'mainstream' stakeholder engagement throughout the due diligence process[171] may therefore be a double-edged sword.

According to the Commission proposal, Article 7(1),

> Member States shall ensure that companies take appropriate measures to prevent, or where prevention is not possible or not immediately possible, adequately mitigate potential adverse human rights impacts and adverse environmental impacts that have been, or should have been, identified pursuant to [other Articles of the Directive].

To avoid box-ticking, it is fundamental that the responsibility cannot be delegated from a lead European company down through its contractual value chain. However, that is what the proposed Directive risks doing, in the way it establishes a system of 'contractual assurance' in the Commission proposal[172] and supported by the Council position. The Parliament position, on the other hand, seeks to clarify and strengthen the due diligence duties.

### E *Assurance, Reporting, Auditing and Enforcement*

To finally start taking people and the environment as seriously as financial issues have been taken for decades, a legislative reform should include external verification and auditing — as well as public and private enforcement. The Commission's proposal for the Due Diligence Directive goes some way in encompassing such issues, by setting up rules on the civil liability of the company itself (Article

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[168] Sjåfjell, 'Reforming EU Company Law to Secure the Future of European Business' (n 4) 215–6.
[169] See below Subsection E.
[170] See above Section III.
[171] Ingrams, Wilde-Ramsing and Vanpeperstraete (n 137).
[172] See Proposed Directive (n 21) arts 7(2)(b), (4), 8(3)(c), 8(5). This is also reflected in the reactions from civil society: see, eg, 'New EU Corporate Accountability Law "Riddled with Loopholes"', *Trócaire* (Web Page, 23 Feb 2022) <https://www.trocaire.org/news/new-eu-corporate-accountability-law-riddled-with-loopholes/>.

25(1)) and a system for EU-wide supervision (Articles 17, 18 and 21).[173] However, there are weaknesses in the proposal that need to be rectified in the further work.[174]

According to our proposal, EU law should provide for external verification that the due diligence process is undertaken in accordance with the rules, and annual reporting on this should be audited. Together, this would provide a good basis for legal certainty for the board that it is following this up as it should and a level playing field in the sense that it would know that other undertakings would be subject to the same rules.

The Corporate Sustainability *Reporting* Directive includes provisions on audit and verification of the sustainability information in management reports, finally establishing for the first time mandatory assurance of sustainability reporting in EU law.[175] According to Article 34 of that Directive, the statutory auditor of the undertaking must perform a 'limited assurance engagement' on a company's sustainability reporting with the sustainability reporting standards issued by the Commission, a check of the process carried out by companies to identify the information reported pursuant to the standards, a check of the mark-up for sustainability reporting and a check of the indicators reported pursuant to Article 8 of the Taxonomy Regulation. However, the Directive permits Member States to allow any accredited independent assurance services provider accredited in accordance with *Regulation (EC) No 765/2008 of the European Parliament and of the Council*[176] to provide an opinion on sustainability reporting on the basis of a limited assurance engagement. It also requires Member States to ensure that consistent requirements are set out for all persons and firms, including statutory auditors and audit firms who are allowed to provide an opinion on the assurance of sustainability reporting. According to Article 26a of the Audit

[173] As mentioned above, Article 25 is proposed to be deleted in the Council Position. Articles 17, 18 and 21, on the other hand, are left untouched by the Council, and proposed to be strengthened in the Parliament Position.

[174] See, eg, International Federation of Human Rights, 'Corporate Accountability: EU Must Not Squander Historic Opportunity to Tackle Environmental Crisis, Human Rights Abuses' (Press Release, 23 Feb 2022) <https://www.fidh.org/en/issues/globalisation-human-rights/business-and-human-rights/corporate-accountability-eu-must-not-squander-historic-opportunity-to>; Finance Watch, 'Commission Bends to Lobby Pressure on Sustainable Corporate Governance' (Press Release, 23 Feb 2022) <https://www.finance-watch.org/press-release/eu-commission-bends-to-lobby-pressure-watering-down-proposals-on-directors-duties-and-remuneration-mandatory-corporate-sustainability-due-diligence-is-welcome-but-too-limited-in-scope/>.

[175] *Accounting Directive* (n 121) as amended by *Corporate Sustainability Reporting Directive* (n 112) art 34.

[176] *Regulation (EC) No 765/2008 of the European Parliament and of the Council of 9 July 2008 Setting out the Requirements for Accreditation and Market Surveillance Relating to the Marketing of Products and Repealing Regulation (EEC) No 339/93* [2008] OJ L 218/30.

Directive, Member States will require auditors to carry out assurance engagements for sustainability reporting in accordance with assurance standards adopted by the Commission.[177]

These are steps forward although we proposed a mandatory full audit of sustainability reports in all circumstances.[178] First, the Corporate Sustainability Reporting Directive introduces, for the first time, a standardised 'nearly full audit' for reports other than financial statements. Second, the scope of undertakings preparing and finally being subject to auditing is much broader than for existing 'non-financial' reports. Third, auditing of sustainability reports is to be standardised. Fourth, fear of a concentration of audit service providers and decreased competition will, at least partly, be eliminated by creating the possibility for non-audit assurance provider markets. Finally, auditing of sustainability reports will require advanced professionalism on the part of auditors, assured by regulated training and certification.[179] However, the provisions still constitute a modest advance in expansion of auditors' assurance duties to approximately 49,000 undertakings in the EU. Yet, it is a good start, compared to 11,000 undertakings without any kind of auditor assurance under the previous Non-Financial Reporting Directive regime.[180]

The provisions in Article 11(1) of the Corporate Sustainability Due Diligence Directive proposal are much weaker, with a convoluted and rather cryptic connection to the EU reporting regime.[181] There are, however, no provisions on verification of this information and no proposal for verification standards, as mandated in the Corporate Sustainability Reporting Directive. It can be read out of the preamble of the proposed Corporate Sustainability Due Diligence Directive that the Corporate Sustainability Reporting Directive is meant to apply to the reporting based on the Due Diligence Directive,[182] but this could have been more clearly expressed in the proposed Due Diligence Directive itself. It also leaves the question open about how the website reporting from companies not encompassed by the current accounting rules will be followed up on.[183]

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177 Mähönen, 'Auditors' Role in Corporate Governance' (n 116) 393.

178 Sjåfjell et al, 'Securing the Future of European Business: SMART Reform Proposals' (n 90) s 6.2.4.2.

179 Mähönen, 'Auditors' Role in Corporate Governance' (n 116) 394.

180 Ibid.

181 The Parliament amendments include some minor improvements on that point with more detailed regulation on reporting by companies not falling under the *Corporate Sustainability Reporting Directive* (n 112). The Council proposed no amendments.

182 CSDDD Proposal (n 21) Preamble para 44. In the Parliament position, a clarification is included with direct references to the *Corporate Sustainability Reporting Directive* (n 112), as a new Preamble para 44a. The Council proposed no amendments.

183 According to the amendments adopted by the European Parliament, for companies that do not have a website, Member States shall dedicate a website to the publication of the annual

### F *Towards a Level Playing Field and Legal Certainty?*

The emerging recognition that mandatory, well-founded and enforced rules may mitigate the risks of unsustainability, including the extreme legal uncertainty concerning potential lawsuits for harms across the global value chains, gives some hope that coherent and forceful legislation will eventually be adopted. The response from business, inter alia reported on in the study on due diligence undertaken for the European Commission, shows support for legislative reforms that can give business a level playing field in the transition to sustainability.[184] The question is whether business and all those impacted by business are now getting what they require and need with this proposed Corporate Sustainability Due Diligence Directive.

Well-founded EU due diligence rules would provide legal certainty for the undertaking as concerns its sustainability impacts, effectively mitigating risks of unsustainability. As Lise Smit and Claire Bright point out,[185] it is important that due diligence does not act as a safe harbour — ie, that affected parties cannot maintain a lawsuit against the undertaking or its board because the undertaking has conducted due diligence— nor must it devolve into a box-ticking exercise. Compliance with a thoughtfully formulated mandatory sustainability due diligence regime as we have suggested would serve as a defence for the undertaking and its board. This would increase the legal certainty for European business, while providing better access to justice for affected workers and communities. The proposed Corporate Sustainability Due Diligence Directive makes a start on the path towards achieving these objectives, but there is much more work to be done in the further rounds with the proposal before it can be fully said that a level playing field and legal certainty are provided in a way that ensures the contribution of European business to sustainability.

Currently, sustainability-oriented businesses have to compete with businesses that do not take the various requirements seriously, creating a highly uneven playing field. A level playing field for sustainability-oriented businesses would give them the competitive advantage and promote the development of sustainable business models with all its positive impacts for European society and economy, with knock-on effects for countries outside of the EU. Mandatory sustainability due diligence for small and medium-sized enterprises (SMEs) would

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statement of the companies concerned (Article 11(2)(3)). The Council proposed no amendments to Article 11.

184 Lise Smit et al, *Study on Due Diligence Requirements through the Supply Chain: Final Report* (European Commission, 2020).

185 Lise Smit and Claire Bright, 'The Concept of a "Safe Harbour" and Mandatory Human Rights Due Diligence', (Working Paper No 1, Research Centre on Law and Society, NOVA School of Law, December 2020).

provide this legal certainty also for them. Conversely, excluding undertakings under a certain threshold (as proposed in the Corporate Sustainability Due Diligence Directive) would mean taking opportunities away from SMEs, which constitute a significant part of the European economy.

Today business is met with a plethora of various requirements through a fragmented picture of some sector-based EU requirements, some requirements (usually thematic) in national legislation in the various countries in which they operate or are registered, and through influential international guidance such as the UNGPs and the OECD Guidelines for Multinational Enterprises. This leaves business with a difficult task in figuring out the various requirements and expectations. Harmonisation on an EU level would bring legal certainty and the benefits of simplification and clarity.

## VII The Counterproductive Resistance to Change

Moving beyond the shareholder v stakeholder dichotomy is necessary to mitigate the risks of continued unsustainability. It is time to reject this dichotomy and identify how we can secure the contribution of business to a sustainable future.

When the Commission launched its Sustainable Corporate Governance initiative in 2020, aiming to facilitate the contribution of business to sustainability, there was an immediate pushback from some business organisations and individual academics, focusing very strongly on one report amongst the body of background research and studies on which the Commission is basing its work.[186]

Some of these reactions, which may be perceived as employing a 'straw man' argumentation, seem to either be based on actual misunderstandings of what is intended to be achieved with sustainable corporate governance, or a lacking recognition of the chaos and legal uncertainty cross-border business faces today both within the European Economic Area and in the world beyond.

The biggest mistake the European Commission has made in its Sustainable Corporate Governance initiative was to speak the stakeholder language.[187] Opponents of change were thereby given the

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[186] See, eg, Jan-Olof Jacke et al, Chief Executives, Nordic Confederations of Industries of Sweden, Denmark, Finland, Norway, Estonia and Iceland, 'Letter: Brussels' Sustainable Corporate Governance Plan is Flawed', *Financial Times* (online, 23 April 2021) <www.ft.com/content/a2ab26b3-c9fc-4f33-a4bf-96a6e136f890>. See also Sarah Anne Aarup and Barbara Moens, 'EU's Business Ethics Rules Risk Falling Apart', *Politico* (online, 9 December 2021) <www.politico.eu/article/eus-new-business-ethics-rules-face-battle-for-survival/>.

[187] See 'Sustainable Corporate Governance' (n 14): 'This initiative aims to improve the EU regulatory framework on company law and corporate governance. It would enable companies to focus on long-term sustainable value creation rather than short-term benefits.

ammunition of being able to postulate that the proposal would mean incorporating some kind of stakeholder primacy into the boardrooms. Shareholder primacy proponents could then use this to argue that their way of seeing the boards as 'agents' of shareholders is the only way to ensure that companies are run efficiently and well — through the faulty logic of the legal-economic thinking underpinning the still prevailing paradigm.

This includes very much the so-called group of Nordic company law scholars, who have chosen to present themselves in a way that has been understood — falsely — as being a statement on behalf of Nordic company law scholars generally,[188] and even further — as representative of Nordic countries.[189] Following up these grandiose statements with claims that the Commission at one point had 'abandoned its proposal' and that the reawakened 'zombie proposal' was motivated by a desire to harmonise — out of all context — corporate governance in the EU[190] only further underlines the ideologically charged opposition to change. Claiming that we are on the right track to resolving sustainability issues because not all environmental news is negative is as poorly founded as straw man claims of extremists declaring the 'capitalist system' to be doomed are irrelevant.[191]

This resistance is in clear contrast to the business responses presented in the report for the Commission by Lise Smit and others, which strongly underlined the need for mandatory due diligence requirements and showed that over 70 per cent of surveyed businesses support mandatory legislation in this area.[192] The Commission also carried out a public consultation under its Sustainable Corporate Governance initiative, which shows a much more positive response

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It aims to better align the interests of companies, their shareholders, managers, stakeholders and society'. They asked in their public consultation, amongst other things: '... if corporate directors [sic!] should be required by law to identify stakeholders' interests, to manage the risks for the company in relation to stakeholder interests, and to identify the opportunities': Directorate-General Justice and Consumers, European Commission, *Summary Report: Public Consultation* (2021) <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/public-consultation_en>.

188 Paul Krüger Andersen et al, 'Response to the Study on Directors' Duties and Sustainable Corporate Governance by Nordic Company Law Scholars' (Research Paper No 2020-100, University of Copenhagen, October 7, 2020) <https://ssrn.com/abstract=3709762>.

189 Jesper Lau Hansen, 'EC Corporate Governance Initiative Series: Sustainable Corporate Governance? — A Response from the Nordic Countries', *University of Oxford: Faculty of Law Blogs* (Blog Post, 2 November 2020) <https://www.law.ox.ac.uk/business-law-blog/blog/2020/11/ec-corporate-governance-initiative-series-sustainable-corporate>.

190 Jesper Lau Hansen, 'Zombies v Subsidiarity: Opening on 8 December 2021', *University of Oxford: Faculty of Law Blogs* (Blog Post, 28 October 2021) <https://www.law.ox.ac.uk/business-law-blog/blog/2021/10/zombies-v-subsidiarity-opening-8-december-2021>.

191 Ibid.

192 Smit et al (n 184).

than did the first consultation on the Inception Assessment and strong support for change.[193]

More nuanced commentators have argued that softer approaches such as reporting measures and voluntary due diligence should be tried first.[194] Although the more stringent rules on verified disclosure of due diligence in the Corporate Sustainability Reporting Directive are positive, there is a danger that reporting measures will remain ineffective, remembering that we have behind us decades of such attempts without success, unless the reporting and assurance standards are stringent. In this respect, the ESRSs adopted by the Commission are detailed and show a genuine will to change the quality of reporting.[195] Concerning verification, neither standards nor proposals for standards have been published yet.

The same danger lies in voluntary initiatives, including voluntary due diligence, and while we welcome the reforms of corporate governance codes emphasising sustainable value creation, these are quite tentative attempts at internalising sustainability into often still shareholder primacy informed norm sets and are insufficient to fundamentally change the way business operates.[196] It is clear that shareholder primacy, still the social norm behind corporate governance self-regulation, continues to sharply constrain 'our collective sense of the possible'.[197]

The corporate and financial risks of unsustainability bring home the significance of integrating sustainability throughout the business of any undertaking. If this is not done, the risks will increasingly materialise, as the international trend of lawsuits against European businesses is already showing. Ultimately, the risk of continuing with 'business as usual' is existential.[198] The global catastrophic risks of continued environmental degradation cannot be ignored, nor can the risks of continuing with exploitation of human beings and increasing inequality between and across jurisdictions. There are several scenarios that can lead to societal collapse, and in none of these are steady returns for investors or profitable business likely.[199]

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[193] See, eg, Kasia Klaczynska Lewis, 'Conclusions from Public Consultations on the EU Sustainable Corporate Governance Initiative', *EY* (Web Article, 27 May 2021) <www.ey.com/en_pl/law/insights-from-public-consultations-on-the-eu-sustainable-corporate-governance-initiative>.

[194] See Möslein and Engsig Sørensen (n 4).

[195] See *Regulation Regarding Sustainability Reporting Standards* (n 125) annex I, ESRS 1, s 3.7, paras 58–61, ESRS 2, Objective, Disclosure Requirement GOV-4 – Statement on Due Diligence, paras 30–3, Appendix A, Disclosure Requirement GOV-4 – Statement on Due Diligence, paras AR 8–AR 10. Paras AR 8–AR 10 reference due diligence in other ESRSs.

[196] Sjåfjell and Tsagas (n 94).

[197] Bruner and Sjåfjell (n 49) 716.

[198] Patrick W Keys et al, 'Anthropocene Risk' (2019) 2(8) *Nature Sustainability* 667.

[199] Sjåfjell, 'Taking Finance Seriously: Understanding the Financial Risks of Unsustainability' (n 118).

One key factor amongst the risks of unsustainability already being realised is the liability risk. The international trend of lawsuits against companies and states for environmental and human rights harms indicates the growing lack of acceptance of the status quo.[200] Amongst many examples, we can mention two cases from 2021: the famous and much discussed Dutch Shell climate case[201] and the less well-known Norwegian Supreme Court *Fosen* case against wind energy producers in Norway — one of them being a Norwegian state-controlled enterprise.[202] The lawsuits are brought by states, individuals, non-governmental organisations and other businesses against corporations, including parent corporations, for environmental or social harm allegedly caused by their subsidiaries, and against lead corporations for negative environmental or social impacts in their global value chains.[203] While many cases are rejected for procedural reasons, often based on underdeveloped international private law rules, and many lost, some are won. The sheer multitude of cases makes them a risk to be reckoned with.[204]

Court activism is a good thing for driving the development, but it may also cause problems for companies that seriously work towards more sustainable business. It causes an unlevel playing field for companies from different jurisdictions and legal uncertainty for boards and senior managements about the content of duties. Accordingly, there is a strong basis for harmonisation on an EU level.[205] Mitigating the risks of unsustainability, including the extreme legal uncertainty about potential lawsuits for harms across the global value chains,

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[200] Mark B Taylor, 'Litigating Sustainability: Towards a Taxonomy of Counter Corporate Litigation' (Research Paper No 2020-08, Faculty of Law, University of Oslo, 8 July 2020).

[201] See, eg, Joseph Wilde-Ramsing, David Ollivier de Leth and Manon Wolfkamp, 'The Shell Climate Verdict: A Major Win for Mandatory Due Diligence and Corporate Accountability', *Business & Human Rights Resource Centre* (Web Article, 1 June 2021) <https://www.business-humanrights.org/en/blog/the-shell-climate-verdict-a-major-win-for-mandatory-due-diligence-and-corporate-accountability/>.

[202] *Statnett SF v Sør-Fosen sijte* [2021] HR S 1975. For further examples, see, eg, European Coalition for Corporate Justice, 'Suing Goliath: An Analysis of Civil Proceedings Brought against EU Companies for Human Rights and Environmental Harm in Their Global Operations and Value Chains, and Key Recommendations to Improve Access to Judicial Remedy' (2021).

[203] Jukka Mähönen, 'Doing by Suing: What Is the Role of the States?', *University of Oslo: The Faculty of* Law, (Web Article, 9 October 2020) <https://www.jus.uio.no/english/research/areas/sustainabilitylaw/blog/companies-markets-and-sustainability/doing-by-suing-mahonen.html>.

[204] Taylor, 'Litigating Sustainability' (n 200); Carol Liao, 'Regulation by Litigation on the Path to Sustainable Corporations' in Beate Sjåfjell, Carol Liao and Argyrou Argyrou (eds), *Innovating Business for Sustainability: Regulatory Approaches in the Anthropocene* (Edward Elgar Publishing, 2022) 230.

[205] Which according to the EU Treaties must only take place in fields of shared competence, relevant here, when the objectives cannot be sufficiently achieved by the Member States: *Treaty on European Union*, opened for signature 7 February 1992, [2009] OJ C 115/13 (entered into force 1 November 1993) art 5(3); *CSDDD Proposal* (n 21) 1–3.

would be a crucial benefit of harmonised European mandatory requirements. This puts the resistance touched upon above in perspective. This also strengthens the case for company law taking back the power of defining corporate purpose and setting out thoughtful corporate board duties.

A reform along the lines of what we have proposed resonates with what the European Commission has signalled through its European Green Deal: an unprecedented broad and ambitious approach towards transitioning to a sustainable future. Mandatory sustainability due diligence as a duty for corporate boards is key to achieving the relevance and reliability of information from businesses. Relevant and reliable information is currently the missing link[206] in the EU's Sustainable Finance Initiative[207] (in spite of the positive elements of the new European corporate sustainability reporting regime). Providing such reliable and verified information will give sustainability-oriented investors and investees the level playing field that they are asking for. Integrating sustainability into corporate governance in this way also provides a better basis for sustainable public procurement[208] and would resonate with and strengthen the EU's Circular Economy initiative.[209] The proposed Corporate Sustainability Due Diligence Directive is very reticent in its inclusion of company law board duties into this picture and the proposed rules should be made clearer to more fully realise their potential as an integrated part of an EU regulatory framework.

## VIII Concluding Reflections

Corporate purpose is the core overarching issue of company law. Positioning and constraining corporate purpose within the shareholder v stakeholder dichotomy undermines the revitalisation of this important company law discussion. What we have sought to show in this article is how corporate purpose and the duties of the board are key company law issues and not something that should be framed

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[206] David Monciardini, Jukka Tapio Mähönen and Georgina Tsagas, 'Rethinking Non-Financial Reporting: A Blueprint for Structural Regulatory Changes' (2020) 10(2) *Accounting, Economics, and Law: A Convivium* 20200092:1–43.

[207] 'Sustainable Finance' (n 18).

[208] 'Green Public Procurement', *European Commission* (Web Page) <https://ec.europa.eu/environment/gpp/versus_en.htm>.

[209] *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A New Circular Economy Action Plan for a Cleaner and More Competitive Europe* [2020] COM 98; 'Circular Economy Action Plan', European Commission (Web Page) <https://ec.europa.eu/environment/strategy/circular-economy-action-plan_en>. The Action Plan is referred to in Preamble Recital 11 of the Proposed Directive (n 21). The *Corporate Sustainability Reporting Directive* (n 112) does not engage properly with circular economy: see Monciardini, Mähönen and Tsagas (n 207).

within path-dependent Anglo-American inspired law-and-economics-based postulates about why we have companies and what the duties of the core decision-makers are. Rather, we need to take seriously the company law and its historical and current basis for the discussion of corporate purpose and the operationalisation of this on the level of the corporate board.

We continue to strongly suggest that EU company law become a part of the regulatory framework for sustainability by taking back the power to redefine corporate purpose and the duties of the corporate board with efficient enforcement mechanisms. This can and should be done in a way that gives room for the variety of different national approaches and business forms, and the innovative and creative governance of businesses in Europe, while giving a clear regulatory infrastructure for sustainable value creation that also contributes to mitigating pressures on planetary boundaries. Sustainability due diligence is a key tool for the board to carry out its duties, but relying on due diligence rules that are not firmly connected to duties of the board may lead to the same failures as with sustainability reporting regimes. Although the proposed Corporate Sustainability Due Diligence Directive has company law elements, they are not taking pride of place but rather — it seems — sought snuck in through the back door to avoid provoking shareholder primacy proponents.

Corporate purpose is an essential part of company law. As legal persons, companies have an identity of their own that is formulated through the purpose for the corporate activities. For over a century, the corporate purpose was seen as a legal concept, and then it was in practice replaced as a social norm by an economic concept. The historically different approaches in the EU to core company law issues[210] have entrenched perceptions of core company law being something that the EU must not touch. Together, this has led to a situation where company law has been a missing piece in sustainability law discussions. In a similar way accounting law, the counterpart of company law, has for far too long been based on a societal understanding of a company as an accounting entity and accounting to monetarise the relationships between the company and its interest parties.

As with accounting law, company law was historically based on precaution, taking into consideration the interests of the society and those whom the corporate actions influence. Both in accounting and in

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[210] See, eg, Erik Werlauff, *EU Company Law: Common Business Law of 28 States* (DJØF Publishing, 2nd ed, 2003) 85–7. See also Möslein and Engsig Sørensen, 'Sustainable Corporate Governance: A Way Forward' (n 4) citing Stefan Grundmann, *European Company Law: Organization, Finance and Capital Markets* (Intersentia, 2nd ed, 2012) 12, 14, 247–76, 318–52.

company law and corporate governance, precaution has been replaced by shareholder primacy and specific ideas of agency, at least on the social norm level. As we have seen with financial accounting where sustainability issues have until very recently been categorised as 'non-financial', we can expect the Directive proposal to be very strongly labelled as 'non-company law' as an attempt to protect the assumed hard core of company law. As we see it, both propositions are outdated: Both financial accounting and company law should reflect a modern approach with sustainable value creation that also contributes to mitigating pressures on planetary boundaries at the core of business.

The current regulatory framework to encourage sustainable business in EU law consists of partial solutions, notably the previous 'non-financial reporting' regime and the new and somewhat improved corporate sustainability reporting, as well as the 'sustainable finance' regime. These are in many ways attempts to 'green' European business and finance.[211] However, this is insufficient to change the fundamentals in financial accounting and company law — and it is a siloed approach based on the emergent understanding of the risks of climate change and a lack of understanding of the broader sustainability picture and the importance of including business and finance fully in it.

In spite of all the positive aspects of the EU's unprecedented engagement towards sustainability, we see that the policy-making is constrained through path-dependent ideas underpinning the regulation of business, and the public debate is fraught with a lack of coherent and knowledge-based discussions, giving a chaotic political picture. All the issues we have discussed here concerning company law, accounting and reporting and finance still reflect compartmentalisation, silo-thinking and incoherence in EU laws and policies. If we are to achieve overarching societal sustainability goals, policy coherence for sustainability must be the guideline for further EU intervention.[212] Freeing itself from path-dependent and obsolete ideas of what corporate purpose is and taking company law seriously is one key element.

The development of the Commission's Sustainable Corporate Governance initiative has turned out to be a missed opportunity for sustainable corporate governance. We hope that future policy work

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[211] Hanna Ahlström and David Monciardini, 'The Regulatory Dynamics of Sustainable Finance: Paradoxical Success and Limitations of EU Reforms' (2022) 177(1) *Journal of Business Ethics* 193; Jay Cullen, Jukka Mähönen and Heidi Rapp Nilsen, 'Financing Sustainable Value Creation' in Beate Sjåfjell, Georgina Tsagas and Charlotte Villiers (eds), *Sustainable Value Creation in the European Union: Towards Pathways to a Sustainable Future through Crises* (Cambridge University Press, 2023) 185.

[212] Hanna Ahlström and Beate Sjåfjell, 'Why Policy Coherence in the European Union Matters for Global Sustainability' (2022) 33(3) *Environmental Policy and Governance* 272.

will properly engage with a research-based concept of sustainability and take company law and corporate governance seriously, rather than allowing the misleading shareholder v stakeholder dichotomy to set the parameters for continued siloing of core company law as the regulatory infrastructure for corporate decision-making.