Directors' duties and sustainable corporate governance

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Reaction on the European Commission Study on
Directors' Duties and Sustainable Corporate Governance[1]

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0. Introduction – Setting the scene

Last year, the EU Commission launched an initiative on Directors' Duties and Sustainable Corporate Governance[2]. The **objective of this paper** is to **participate in the debate on** the proposal by the EU Commission for including for largest EU companies an obligation to integrate **sustainability** into their decision making and action mechanisms. This proposal is part of a wider drive on sustainability which the Commission has adopted or is proposing several specific decisions addressing issues of climate change, air pollution, sea plastic pollution, water flooding, etc. There is a wide perception in the population at large that these evils cannot continue if we want our planet to be saved, and remain healthy. Some measures call for urgent action, other call for more in depth changes on the longer term, after having studied all alternatives

GUBERNA generally supports the idea that (listed) companies should contribute to the realization of sustainability objectives, whether in their decision making or in their industrial or commercial action. GUBERNA and its members are pleased to be able to contribute to this reflection which is at the center of their preoccupations these days.

At a later stage the reflection might usefully be extended to other sources of detrimental environmental behavior, emanating from local communities, public authorities, not-for-profit organization and small companies. These entities are already quite aware of the need to contribute to a healthy environment but the implementation of proactive measures still deserves further attention.

In what follows we **elaborate on the key issues** that were raised in **the initial proposal on sustainable corporate governance** as contained in the Final Report under the title "Study on Directors Duties and Sustainable Corporate Governance" as published in July 2020. In the meantime, the discussion is on-going and even interferes with parallel EU initiatives on Corporate Due Diligence[3]. GUBERNA closely follows up on the EU developments in this matter. *We refer to the GUBERNA Reflection note[4] for a summary.*

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[1] This paper has been prepared by Prof. dr Eddy Wymeersch, University of Gent and Chairman of the Academic Council of GUBERNA, in consultation with GUBERNA

[2] EU: Study on directors' duties and sustainable corporate governance", Final Report, July 2020, ("Study") DS0320415ENN.en.pdf; Annex 1, DS0320416ENN.en.pdf

[3] https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073_EN.html

[4] GUBERNA Reflection Note : "European initiatives on Sustainable Corporate Governance and Corporate Due Diligence" April 15th 2021.

1. The Duty of directors on sustainability

The purpose of the Commission's initiative on "Directors' duties and Sustainable Corporate Governance"[5] is mainly to orient the action of large business firms -referred to as publicly listed companies- towards an overall objective of sustainability. It is part of the wider drive of the Commission's action on sustainability[6] which aims at introducing in our economic system a wider perspective for its future development and which is widely supported by the business community. **It intends to prescribe action fostering more sustainability and long-term perspectives by introducing in the companies' corporate governance or instruments, objectives of sustainability, including in the duties of directors, while in general requiring accountability for sustainable value creation**. The Belgian public opinion and the Belgian industry recognize and share the preoccupations with respect to the need to increase the efforts needed for making our world better and meeting the needs of the population, in terms of their health and well-being and ensure the long-term viability of the planet.

But differently of other EU initiatives in this field, the Study addresses the decision-making structure "corporate governance" and less the objectives to be pursued ("sustainability"), referring to "corporate governance sustainability". By so doing it incorporates the sustainability objective into corporate governance decision making, delegating to companies the responsibility for this "public interest policy" - as this is a domain in which the states themselves, and not the private initiatives, should put forward the objectives and methods. The proposal is therefore mainly focused on reforms of the corporate governance framework, within which these objectives will have to be pursued.

[5] *EU: Study on directors' duties and sustainable corporate governance", Final Report, July 2020, ("Study") DS0320415ENN.en.pdf; Annex 1, DS0320416ENN.en.pdf;*

[6] See for other Commission studies on sustainability: the European Green Deal, https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en Environment, Sustainable development, https://ec.europa.eu/environment/eussd/reports.htm; European Commission, action plan for financing sustainable growth., 7 March 2018; https://www.unpri.org/sustainable-financial-system/explaining-the-eu-action-plan-for-financing-sustainable-growth/3000.article; Overview of sustainable finance, https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/overview-sustainable-finance_en.; Action plan for Financing Sustainable growth, March 2018; the European Parliament adopted a motion : *Sustainability: businesses interests must align with society's interests, (https://www.europarl.europa.eu/news/en/press-room/20201211IPR93636/sustainability-businesses-interests-must-align-with-society-s-interests). See for an overview of Commission publications https://ec.europa.eu/info/publications/sustainable-finance-renewed-strategy_en; Sustainability is translated as follows in the EU documents: Sustainability, durabilité, duurzaamheid Nachhaltigkeit, sostenibilità, sostenibilidad.

1.1. The Scope: listed companies

The Commission's initiative addresses itself to listed companies, thereby using a criterion - listing[7]- which has no clear relationship with the objective of the initiative, but mainly refers to the size of the company and the public trading of its shares.

The **population of listed companies** presents considerable **differences** depending on the states compared: an OECD research[8] illustrates these differences both in terms of the capitalization and of number of entities :

Market	Capitalization M. $	Number of Companies
United States	30.284.174	4125
France	2.564.935	838
Germany	2.231.962	865
Switzerland	1.411.279	352
The Netherlands	884.256	103 (140)
Belgium	409.285	314

The Study adopts the position that these companies are mainly managed in a short-term perspective, which prevents them from contributing to the long-term sustainability objectives: they are the parties mainly responsible for many of the sustainability deficiencies and concerns. This falls short of reality: in the absence of shareholder pressure, many of the medium size or smaller companies raise similar concerns as to the sustainability of their action, but pay little to no attention to it. Moreover, examples of unsustainable conduct can also be pointed at in the activities of other actors, such as public administrations, the non-profit sector - public transport e.g.- or in the activities of the population in general.

The issue is therefore much wider, and it is unclear why the matter is addressed from the angle of identifying a specific category of business firms – "listed companies" – increasing the already considerable administrative burdens on these firms. **It would have been simpler to frame the scope by applying it to all EU based large firms, defined in terms of total balance sheet[9], or number of people employed.** The consolidated approach is the one followed in many other fields. It includes the subsidiaries of the parent companies.

[7] Listed company, today called "companies the shares of which are traded on public markets such as stock exchanges", see for the definition in directive 2001/34/EC of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities, coordinated version: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A02001L0034-20070120

[8] De La Cruz, A., A. Medina and Y. Tang (2019), "Owners of the World's Listed Companies", OECD Capital Market Series, Paris, https://www.oecd.org/corporate/ca/Owners-of-the-Worlds-Listed-Companies.pdf

[9] See the criteria used for defining the consolidation obligation for companies ; 20 m balance sheet and 40 m turnover, EU directive 2013/34

Also questionable is the inclusion of certain third parties which, although not related institutionally, play an essential role in the functioning of the EU companies. Here it is considered to extend the scope to the entities which belong to the "value chain" of the EU companies, the providers of goods or services, their subcontractors, or certain providers of essential services, on which the EU companies could put pressure, both in terms of human rights, or of respect for the environment.

But even then the scope would remain partial, as solving sustainability issues may not be achievable by only involving commercial companies. **It would have been more effective to define the scope of these proposals as addressing all actors whose action may raise questions in terms of sustainability, firstly belonging to the domestic scene, but in some cases also in a third country perspective.**

This might raise challenging issues for having companies in other states adhere to the same EU policies. There are some other ways for involving non-EU companies in sustainability actions developed by EU companies: standards developed by the international institutions such as the United Nations, the World Bank and the OECD[10] could be made applicable by these institutions to certain contracts with third-country companies. European companies could refuse to engage in commercial contacts with them, inflecting their business activity to maintain commercial relations.

But sustainability covers a wider range of addressees: **all** actors in society -companies, public and private bodies, investors, stakeholders, consumers- and all other participants in our world, local or not, **should be held to sustainability objectives, adapted to their specific situation.**

1.2. What is "sustainability" ?

The Study essentially deals with company law - in particular with the governance of listed companies- calling for a governance reform related to short-termism. As its general objective, the Study pleads for increasing attention to more sustainable corporate governance thereby contributing to more accountability for companies' sustainable value creation. Sustainability is seen as an ingredient of corporate governance, but the statements in the Study foremost relate to changing the governance rules.

[10] UNSDG, OECD:Environmental Standards, Standards for sustainable Bio-based products

The Study does not contain an adequate definition of sustainability, which is a complex and multidimensional objective. This lacuna is a serious difficulty in the further analysis of the proposed scheme. Also, there is no clear reference to the taxonomy regulation[11] which establishes six environmental objectives, referring to a future EU decision which will elaborate in detail on "the criteria for determining whether an economic activity qualifies as environmentally sustainable for the purposes of establishing the degree to which an investment is environmentally sustainable".

In the absence of a definition, should individuals and businesses state their own sustainability objectives: these are the subjects related to climate transition, low carbon, clean air, water management, circular economy, natural resources and rural development, as little waste as possible and no plastic abuse, clean seas,... The mentioned objectives would not be relevant for all companies: companies would have to define for themselves in which fields they could contribute to the sustainability objectives. Or should this better be defined by the public authorities? **It would be helpful if a priority list of objectives or fields was developed**, e.g. in the environmental field, defining the scope, the efforts and the type of action which companies - and their investors - are expected to support.

Companies, investors and creditors have an interest in pursuing a sustainable economy in a perspective of long-term continuity. **Some of these objectives** will be defined in the context of business associations, under the **label** of their **Corporate Social Responsibility** (CSR) which refers to responsible company conduct, awareness of the impact on society, and trying to reduce the negative consequences of the activity while improving their relations with consumers, local communities, and other companies. Companies often publicly report on their CSR activities.

But sustainability **also** covers **a humanitarian dimension**, mostly referring to the activities of companies in overseas countries in which these -often mining- companies are active. Attention to these cases has often been drawn by NGOs. The condition of the populations employed in these territories by the company, its subsidiaries but even its suppliers may be the subject of humanitarian concerns as these people are confronted with poverty, malnourishment and diseases: in these cases, sustainability refers to actions aimed at improving their living conditions, and reducing the pressure of work, especially limiting child labor. Human dignity and human rights are often the generally applicable criteria[12].

[11] Regulation 2020/852 on the establishment of a framework to facilitate sustainable investment and amending regulation 2019/2088. (taxonomy regulation) It introduces a unified classification system for sustainable activities A delegated regulation is being prepared.

[12] This was the formulation used in the Swiss referendum (Konzernverantwortungsinitiative), providing that companies located in Switzerland have to make sure in their activities that they respect human rights and environmental standards "Konzerne mit Sitz in der Schweiz sollen bei ihren Geschäften sicherstellen, dass sie die Menschenrechte respektieren und Umweltstandards einhalten" https://konzern-initiative.ch/initiative-erklaert/ applicable to 1500 groups. It allowed foreign victims to sue in Swizerland. The referendum did not obtain the double majority needed. Compare the German proposal on : "Unternehmerische Sorgfaltspflichten in Lieferketten, Referentenentwurf Min. Arbeit und Soziales, March 2021

In some European states, there have been quite a few judicial or administrative cases dealing with this kind of violations of honorable human behavior[13]. Regularly companies are heavily criticized for not abiding by standards with respect to human rights and to environmental issues. Well known cases referred to destruction of forests, employment conditions at clothing manufacturers, employment of children in mineral mines, etc. This wider geographic dimension has received quite some attention under the action of the NGOs.

Defining "sustainability" objectives for an individual company will very much depend on the specific circumstances with which this company is confronted: as a consequence, and as far as remedial action is concerned, only that company will be able to describe what action has to be undertaken, and how it will best deal with the matter. **A regulation could only define the general objectives. To recognize a high degree of subsidiarity will be a guarantee for effectiveness.**

According to the Study, **the "sustainability" objective** is a factor which should inspire not only the policies of large companies – which it certainly does these days - but should generally be **included in their individual company purpose**, ensuring that their decisions sufficiently reflect awareness of the sustainability aspects and consequences[14].

Among the initiatives aimed at achieving a higher degree of sustainability one can e.g. mention different issues relating to the climate and environmental concerns, reducing the pollution levels e.g. by reducing the use of cars in cities, avoiding mixing clean water, etc. Most of the achievements in these fields have been brought about not by requiring explicit sustainability measures but by other measures such as adapting taxation e.g. on the users of polluting cars, by introducing more efficient oil combustion engines, or by offering financial benefits for more selective waste collection. In these matters, many companies – but also many individuals - have acted according to "social responsibility". Sustainability refers more clearly to the challenges confronting earth, and its inhabitants exposed to the hard effects of climate change, e.g. in its large desert-like areas.

[13] United Nations Human rights standards and principles; See for the French cases, under the "vigilance" regime: L. 225-102-4 and 5, of 27 March 2017: A.Pietrancosta, Intérêt social et raison d'être Considérations sur deux dispositions clés de la loi PACTE amendant le droit commun des sociétés, Realites industrielles Novembre 2020; A. PIetrancosta, nt.8 ;

[14] See the list of other changes in company law in the Annex.

The Study however does **not contain a clear concept of "sustainability", as different from CSR**[15]. There is some confusion between these two concepts: sustainability would rather refer to the long-term effects of company decisions on the environment, CSR relates to the company's business and the socially affected population [16]. Without sufficient clarification, implementing these ideas would be confusing. Due to the very wide geographical ambit of the principle, domestic as well as non-domestic events would be included, making preventative action much more difficult to develop, often unpredictable. Risks at the company itself, but also at its subsidiaries or activities by clients or providers may have to be included. Also, the related risks would be unfathomable, both for the companies but also for their directors, the latter however being exposed to liability[17].

The absence of an explicit requirement to strive for "sustainability" has not prevented businesses to be aware of their responsibilities and of the challenges to which today's world is confronted: Projects which were implemented years ago would today qualify as inspired by sustainability, the notion being unknown at that time. It is striking that managers confronted with concrete situations, often know what is sustainable and what not. **In the future, a clear definition of "sustainability in action", identifying the parties responsible for it, and indicating the remedies for correction will therefore be helpful or in some cases necessary.**

1.3. How to introduce a "sustainability" action

There are several methods to introduce sustainability in the action of the large companies. The Study **mainly refers to company law mechanisms**, such as the adaptation in company law and regulation, formulating the corporate *purpose* as referring to sustainability matters, but also requiring presence in the boards of directors of members with proven awareness of sustainability issues. The presence of stakeholders in the boards would also increase awareness. The remuneration of directors and managers should include an ESG component. And shareholders should adhere to the same approach. Green policies should be developed and clearly put forward in external communications.

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[15] Whether CSR and sustainability are different concepts has been discussed: R.J. Baumgartner, Managing Corporate Sustainability and CSR: A Conceptual Framework Combining Values, Strategies and Instruments Contributing to Sustainable Development, 2013, Corp. Soc. Responsib. Environ. Mgmt. 21, 258–271 (2014). http://www.pmir.it/fileCaricati/1/Baumgartner%20(2014).pdf

[16] See; Commission, Corporate social responsibility & Responsible business conduct, https://ec.europa.eu/growth/industry/sustainability/corporate-social-responsibility_en; Definitions differ: compare: **Sustainability and CSR, https://www.csr-in-deutschland.de/EN/What-is-CSR/Background/Sustainability-and-CSR/sustainability-and-csr.html; S. Bahu,** Corporate Sustainability vs. CSR: What's the Difference?, 22 June 2020

[17] See Deepwater Horizon – BP Gulf of Mexico Oil Spill. BP was primarily responsible for the oil spill because of its gross negligence and reckless conduct https://www.epa.gov/enforcement/deepwater-horizon-bp-gulf-mexico-oil-spill

The Study proposes to introduce "sustainable corporate governance", an innovation in the corporate governance world. The Study **urges the business firms, through their corporate governance framework**, **to develop the core**, if not the sole instrument for **dealing with "sustainability issues"**, it is adapting their governance to this broader perspective. Sustainability would permeate the entire functioning of companies and - by extension - the world of the larger businesses[18].

It is far from clear that introducing adaptations to company law decision making or corporate governance, is the most effective way for achieving this higher standard of sustainability. It would have been a more direct and probably more effective way for reaching the same outcome to directly formulate in the regulation its objectives and require companies and other larger entities to adhere to the said objectives, and develop concrete sustainability projects. The present approach is therefore to be qualified as more inspirational than an actual company law standard.

Several other instruments known to be quite effective have not even been mentioned, such as taxation policies[19], building policies and related permits, advanced disclosure policies, but also plain regulatory measures, or finance-based public policies steering companies towards more environmentally friendly approaches (by subsidies, licenses, etc.).
These alternative instruments should be usefully investigated, assessing their degree of effectiveness.

The present analysis only concerns the methods by which the Study has approached the subject of sustainability: it fully underwrites its usefulness as an objective for our societies - including its businesses - to pay more attention to the negative developments which they are confronted with, and the widespread awareness that remedial action should be undertaken to alleviate the downside.

This awareness is not new, but should in the future be formulated as an ingredient of social governance, being an explicit objective for socially acceptable corporate action, a clear definition of "sustainability in action", identifying the parties responsible and even being introduced as a condition for operating businesses and other firms. An open discussion should be held with respect to the effectiveness of these different approaches, and the contributions each could make to the overarching objective.

[18] The appointment of directors, the board decision making but also the functioning of the AGM would be impregnated by the sustainability concern, see the list in the Annex, below.
[19] See J. Coffee,nt,33 proposing to use taxation against excessive buybacks, or against short periods of shareholding, https://ecgi.global/news/european-commission-considers-"short-termism"-and-"what-do-you-mean-"

2. Companies' actions for more sustainability.

The initiative starts from the assertion that company law does not make sufficient efforts to "foster sustainable corporate governance and contribute to companies' sustainable value creation". These two concepts are presented as closely related and the Study contains proposals for each of them. This assertion is not supported by factual elements**. Sustainable actions are the product of company decisions, not of company law. Moreover, business leaders repeatedly declare that they pay great attention to issues of sustainability**, especially to matters of climate or environmental risk. In many instances, these initiatives underlie the business activity of these firms, avoiding harm due to their activity, but also contributing to their public standing and reputation as "good corporate citizens". They are the result of a deliberate policy of their boards of directors which approve their initiatives after due deliberation on all aspects, including the effect on the environment, announce them publicly to support their position, and mention them in their annual reports, prospectuses and similar statements referring to their public financing of projects beneficial to the environment. **Much of this is not very new:** in the last years of the 19th century, there was a long-standing tradition for companies to look after the welfare of their employees, mainly by taking care of their housing[20]. In some of these cities, today's housing is still a testimony of that approach, which was not reported under the heading of "sustainability". They were considered part of the moral obligations of the boss – "le patron" – towards his "personnel." In today's terminology, it would be referred to as "Corporate Social Responsibility", defined by the Commission as " the responsibility of enterprises for their impact on society " [21]

European companies have been very active in sustainability actions, as part of their general business activity, **especially in the fields of climate change and carbon constraints**, supporting the emerging climate economy. A list of the 100 most "sustainable companies of 2020" worldwide indicates that 24 out of the hundred most sustainable companies are European companies or groups, followed by North American companies (22/100).[22]

[20] The industry in Wallonia and North of France, places where the industrial revolution started in the second half of the 19th century.

[21] See EU Commission, Corporate social responsibility & Responsible business conduct, adding "it should be company led". A company can become socially responsible by 1. " integrating social, environmental, ethical, consumer, and human rights concerns into their business strategy and operations; 2.following the law"; https://ec.europa.eu/growth/industry/sustainability/corporate-social-responsibility_en; also: Communication from the Commission : A renewed EU Strategy 2011-14 for corporate social responsibility/*Com/2011/0681 final */

[22]Danica Lo, The world's 20 most sustainable companies in the world, https://hk.asiatatler.com/life/most-sustainable-companies, 25 January 2021, Samantha Todd, Who are the 100 most sustainable companies of 2020, https://www.forbes.com/sites/samanthatodd/2020/01/21/who-are-the-100-most-sustainable-companies-of-2020/#4fe0641914a4, This ranking was probably based on the outlays companies reported under the heading of sustainability.
More details and ranking is to be found in Corporate Knights, The voice for clean capitalism, https://www.corporateknights.com/reports/2020-global-100/2020-global-100-ranking-15795648/

A field in which **sustainability** has received **much attention**, both in theory and in practice is that of **financial services**. Under different denominations, sustainability has become a major driver in the framing of financial products and the related saving instruments, mainly those addressing long-term savings. Sustainable lending[23] , Green bonds[24], Green energy stocks, Green exchange traded funds (ETFs) have massively attracted funds from financial institutions, financed by dedicated savings from individuals, or from long term institutional investors [25], standing globally for $ 17,5 Tn [26], while in the field of investment funds, funds investing in ESG – Environmental, Social and Governance projects – have collected 1 Tr in 2020[27], much of which originating from individual, environmental conscious investors. The investee companies in which pension funds, low risk diversified funds, but also rich sovereign wealth funds are making long term investments, have adopted strict sustainability objectives in their investment plans. And EU regulation mostly governs disclosures in this field[28]. A major investment information service publishes for all of its thousands analyzed investment products a separate "sustainability rating" applicable to all the listed investment products[29]. Banks offering investment products to the wider public increasingly refer to sustainability characteristics of their products, obviously with a view of raising the interest of the investors.

All this indicates that the Study's assertion that companies do not make sufficient efforts to "foster sustainable corporate governance and contribute to companies' sustainable value creation" does not correspond to today's reality.

[23] "Sustainable Lending is one of the good governance disciplines that are, since the late 1990's, managed by the Members of the OECD Working Party on Export Credits and Credit Guarantees (ECG)." http://www.oecd.org/trade/topics/export-credits/sustainable-lending/

[24] Naumann, B, Analysts expect as much as $500 bn of green bonds in bumper 2021, FT 4 January 2021. Among the previous developments Green building; A.R. Pearce, The State of Sustainability Best Practices in Construction: A Benchmark Study, Journal of Green Building, Aug 2010, 116-130

[25] ETFs accounted for $ 8 Tn end of 2020 ,FT 13 January 2021. EU Commission, Screening of websites for "greenwashing" half of green claims lack evidence, 28 January 2021 https://ec.europa.eu/commission/presscorner/detail/en/ip_21_269

[26] OECD, ESG INVESTING: Practices , Progress and Challenges, https://www.oecd.org/finance/ESG-Investing-Practices-Progress-Challenges.pdf ; Referring to Global sustainable Investment Alliance

[27] ESG fund assets recover strongly, hitting USD 1 trillion mark in Q 2 -2020, , 82% having been contributed by Europe. OECD, ESG INVESTING, nt. 22 Practices, Progress and Challenges, nt. 22

[28] REGULATION (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial services sector (SFDR) . Requiring i.a. transparency on the integration of sustainability risks. The sectorally competent authorities (the securities supervisors) will monitor the compliance of financial market participants and financial advisers with the requirements of this Regulation (Article 14) . See: ESMA, Report on Regulatory Technical Standards, 2 February 2021, JC 2021, 03 with the draft delegated regulation.

[29] See Morningstar, ESG Commitment Level, Methodology, described as : A qualitative, analyst-driven evaluation of investment strategies and asset managers from an Environmental, Social and Governance (ESG) perspective. https://www.morningstar.com/research/signature?utm_source=morningstar.nl&utm_medium=referral&utm_content=research/signature

3. Demystifying the myth of short-termism

One of the fundamental reasonings on which the Study is based, attributes the lower degree of sustainability in European company action to the short-term view which directs EU companies' policies, management and action. This opinion is actively debated in the US, where it extends to the management of most listed companies[30]. Notwithstanding the companies' efforts for engaging in sustainability projects, **the Study purports "that EU companies focus on short-term benefits of shareholders rather than the long-term interest of the company**". This short termism is described as rooted in the regulatory framework and in market practices." As a consequence, companies purportedly do not pay sufficient attention to sustainability matters, nor do they invest in related projects. The Study calls for changes in many fields, starting with declaring companies and boards responsible for the adoption of sustainable or responsible decisions.

More in detail the Study lists **7 key problem drivers**, which allegedly are all related to the short-term nature of governance, and resulting in insufficient involvement of companies in sustainability objectives:

1. Short term maximization of shareholder value is the companies' main objective
2. Financial results are short term under investor pressure
3. No strategic sustainability perspective – risks and impacts are not identified
4. Board remuneration is strictly focused on the short term
5. Board composition does not fully support sustainability objective
6. No voice for long-term stakeholders
7. Enforcement for the long-term is limited

In summary, the Study denounces "shareholder primacy and short-term pressure from the financial markets influencing corporate decision-making[31] "; "the consequences of unsustainability are very serious and have EU-wide - and global - implications". It calls for changes in many fields, starting with a call for companies and boards to be responsible for the consequences of their short-term views.

[30] See for a discussion of the arguments against short-termism from the angle of the listed companies: R.L. Martin, Yes, Short-Termism really is a Problem, Harvard Business Review, October 15, 2015, https://hbr.org/2015/10/yes-short-termism-really-is-a-problem. The data on reinvestments of distributed profits are not discussed. Comp:, John Coffee, The European Commission Considers "Short-Termism" (And "What Do You Mean By That?")HTTPS://ECGI.GLOBAL/NEWS/EUROPEAN-COMMISSION-CONSIDERS-"SHORT-TERMISM"-AND-"WHAT-DO-YOU-MEAN-" November 12 2020

[31] Commission requested advice from ESMA, EBA and EIOPA on undue short-term pressure from the financial sector on corporations., 1 February 2019; EBA Report on Undue Short-term pressure from the financial sector, 18 December 2019, https://eba.europa.eu/sites/default/documents/files/document_-library/Final%20EBA%20report%20on%20undue%20short-term%20pressures%20from%20the%20financial%20sector%20v2_0.pdf

In Annex 1 to the Study[32], the Commission makes an "Analysis of the Possible Effects of Corporate Short-termism on the attainment of SDGs"[33] which seems to attribute all possible evils in the world to corporate short-termism. In the absence of a strict definition, this annex also gives a view on the obligations which could be imposed in case the proposed regime is implemented in a directive with legally binding implementation. This list has not been reproduced in the Study[34].

The argument that European companies do not pay sufficient attention to sustainability matters is further discussed in the Study from different angles, pointing to **the four main causes** of this "weakness":

(a) Ownership: is it stable and concentrated?
(b) Profit distribution to shareholders and directors.
(c) Higher remuneration to directors and executives
(d) Limited contacts with different groups of stakeholders.

(a) Ownership structure

Differently from their US or UK counterparts, **European companies** – even listed ones - are generally based on **concentrated ownership**, **less diversified than their US counterparts**. Most companies have a stable, often institutional shareholdership, very often based on family relations[35] . The boards are appointed with the agreement of these shareholders, and manage the company in a long term, stable perspective, thereby serving the interests of these shareholders[36].

[32] See: EU, Study on directors' duties and sustainable corporate governance, July 2020 https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en DS0320416ENN.en

[33] SDGs are the 17 standards formulated by the United Nations, Sustainable Development, and SDG related goals, https://sdgs.un.org;. Several of these standards would not fit the business context. also: SDG good practices

[34] The same reasoning underlies the opposition to quarterly reporting and earnings guidance, and restrictions to sell shares received as payment, other points which the Study considers contrary to the long term interest of the company .

[35] See for an overview for2002, indicating that business firms in Europe are predominantly family businesses (https://www.campdenfb.com/article/family-performance-indices-0, Febr 2002) . In most jurisdictions they represented between 55 % and 90 % of the total of companies (http://www.europeanfamilybusinesses.eu/family-businesses/facts-figures (2009) and stand for 40% to 50% of employment (European Family Business – Families in business for the long term, http://www.europeanfamilybusinesses.eu/family-businesses/facts-figures. It is mentioned that these businesses reinvest profits responsibly preferring equity to debt financing . They strive at the transmission of family values with a high sense of social responsibility). The top 100 family business stood for combined revenues of 1,1 trillion euros in 2009, equivalent to Spain's GDP. The family ownership varies between 100 and 27%, There are relatively few UK companies in the list, mostly of a smaller dimension. See: http://www.europeanfamilybusinesses.eu/family-businesses/facts-figures (2009). Nine out of 10 private companies in Germany were family businesses in 2017. See also: J.Franks, C. Mayer, St. Rossi, Ownership, Evolution and regulation, ECGI, 990/2003.

[36] Dual class shares – now usual in the US – are exceptional in Europe: K. Papadopoulos , Dual-Class Shares: Governance Risks and Company Performance, K. Papadopoulos, June 28, 2019, Harvard Law School Dual-Class shares: The Good, the Bad and the Ugly, CFA Institute 2018

The percentage of shares owned by public investors is low, about 32%, but even then, relatively stable[37]. Long term investment vehicles, non-profit organizations but especially pension funds and sovereign wealth funds[38] often hold relatively important percentages, although their views would not imply management to be directly influenced. Based on a 2010 survey, the European Union has adopted a directive to activate the contacts of the company leadership with long-term shareholders leading to more mutual engagement[39]. Shareholders have a right to vote ("say-on-pay") on the remuneration policy on the basis of the information made available to them: the remuneration policy shall contribute "to the company's business strategy and long-term interests and sustainability" [40] . These directive provisions have now become part of company law in most EU states.

As a consequence of concentrated share ownership, **control is most of the time in the hands of a limited group of persons or entities**, who through their ownership of shares or through other mechanisms, agree on the essential policies for the company, for its subsidiaries and further down, for the whole group of dependent subsidiary companies. These shareholders are often family descendants from the original founders, or shareholders acting jointly. They invest for the long term, following a long-standing business policy and with a view of transmitting the business to the next generation. Therefore, **they reinvest most of their revenues from the companies in the group itself, and develop a business policy which reflects this continuity perspective**[41]. In some company's laws this long-term perspective has been expressly formulated: in the Dutch company law, the continuity of the enterprise is an important legal objective[42].

[37] For details see; De La Cruz, A Medina and Y Tang, Owners of the world's listed companies, OECD, owners of the world's listed companies,. OECD Capital market Series (2019) https://www.oecd.org/corporate/Owners-of-the-Worlds-Listed-Companies.pdf,2 019, mentioning i.a. that institutional investors hold 41% of global market capitalisation. As to the regional distribution, 32% of the shares of European listed companies are classified as free-float, 38% as owned by institutional investors (Table 3) .

[38] For Sovereign Wealth Funds holdings and ranking see swfInstitue.org, https://www.swfinstitute.org/profile/598cdaa60124e9fd2d05b9af ; also the largest Fund Rankings by Total Assets, in which the central bank hold a very prominent place.

[39] DIRECTIVE (EU) 2017/828 of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement. Institutional investors and asset managers will develop an engagement policy.

[40] Article 9 a (6) Directive 2017/828. According to the directive, sustainability only comes into play for remuneration issues. Rules on corporate governance and remuneration in non-systemic investment firms can be found in the Investment Firms Directive (Directive 2019/2034) and the Investment Firms Regulation (Regulation 2019/2033).

[41] Horobet, A. Belascu a.o. , Ownership Concentration and Performance Recovery Patterns in the European Union stating, " there is a positive link between ownership concentration and corporate performance in the case of Western companies, but not for Eastern-based companies", February 2019 https://www.researchgate.net/publication/331090956_-Ownership_Concentration_and_Performance_Recovery_Patterns_in_the_European_Union

[42] Hoge Raad, Inversiones/ Cancun Holding, HR 4 April 2014; also: HR 7 July 1982, ***NJ*** 1983, 35 m.nt. Maeijer (Enka);Hof Amsterdam (OK) 16 November 2012, ***ARO*** 2012, 162; Hof Amsterdam (OK) 18 Januari 2013, ***ARO*** 2013, 27; HR 7 juli 1982, ***NJ*** 1983, 35 m.nt. Maeijer (Enka). "In the performance of their duties, the directors must act in the interests of the company and its related enterprise" (comp art. 2:239 lid 5 NBW).

In line with this shareholder structure, boards of continental EU companies generally reflect the shareholder population: **boards are mainly composed of representatives of shareholders, of non-executive directors and of independent directors** [43]. The majority of directors is appointed on the basis of their business expertise, their specific knowledge of the company affairs, or in other technical fields such as IT. Independent directors are often recruited on the basis of their expertise and their interest in matters pertaining to all shareholders. In Italy, representatives of minority shareholders are elected on a slate[44]. In some countries, especially in the Nordic countries, the company structure is largely based on ownership by non-profit organizations, foundations, SWFs etc. as shareholders controlling the majority of the votes[45]. **Remuneration reflects this structure**: management is remunerated at competitive rates, usually hired on the recommendation of specialized search firms. The average level of directors' remuneration in the EU continental businesses is lower than in the US or UK whereby the German and French managing directors are best remunerated among their European equivalents[46].

The importance of the ownership structure is an important factor in the short-termism debate in the US or in the UK, due to the presence of activist investors, such as hedge funds, asset managers or other short-term investors. The large diversified institutional investors serve there as the stable shareholders.[47] **The US or UK analysis should not be exported to the EU without the necessary reservations**.

On the basis of the data published by the FSMA, the regulator of the Belgian financial markets, there were 125 companies listed on the Brussels Stock Exchange[48]. Of these more than half were owned by controlling shareholders at the + 50%, and several at more than 75% level. Especially the large family-owned companies still present a concentrated ownership pattern.

The European ownership concentration figures[49] points into the direction of stable ownership of European companies : concentration in France is higher (about 60%) than in Germany (about 55%) or in the Netherlands (30%).

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[43] On the composition of boards and their different components, see: IFC, A Guide to Corporate Governance Practices in the European Union , 2015, https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/resources/guidelines_reviews+and+case+studies/a+guide+to+corporate+governance+practices+in+the+european+union; See: The European Model of Share Ownership , p. 27, IFC/ ECODA

[44] In Italy 'slate voting' is used, thereby reserving some seats to representatives of minority shareholders. For instance, *see* M. Belcredi,, S. Bozzi, .and C. Di Noia, 'Board Elections and Shareholder Activism: the Italian Experiment' in: M. Belcredi and F. Ferrarini (eds.), Boards and Shareholders in European Listed Companies(Cambridge, United Kingdom: Cambridge University Press, 2013).

[45] See: The Nordic corporate governance model, Per Lekvall (ed) https://corporategovernance.dk/sites/default/files/150209-the-nordic-cg-model.pdf, 2014. This percentage is considerable higher than for the UK companies, which were often included among the European companies.

[46] G. Ferrrarini and N Moloney, Executive remuneration in the EU: the context for reform, ECGI April 1, 2005

[47] See: J.Coffee, nt 33.

[48] https://www.fsma.be/en/shareholding-structure

[49] Different criteria may lead to different results: Comp J. Franks, Institutional Ownership and Governance, ECGI,656, January 2020.

The distribution of the respective types of shareholders point to significant differences between the US and the EU companies: institutional investors represent 72% in the US, v. 23% in the EU; Strategic individuals 4% v. 8 %; private investors 2% v. 17%. The free float is 19% for US companies, 30% for European ones and 40% for French and German companies where about 60% of the shares are in the hands of the 3 main shareholders.

German listed companies, as compared with US companies, show that with a market capitalization of 1/3rd of their US counterparts, their shares are owned by pension funds at a much lower degree than in US companies: in Germany 13,3 % of their shares are in the hands of pension funds while in the US 69,2 % [50].

The markets with the lowest ownership concentration, measured as the combined holdings of the 3 largest shareholders, are the United States, the United Kingdom, Canada and Japan, where the 3 largest shareholders on average still hold a significant combined share, ranging between 25% and 30% of the company's capital. In a large number of jurisdictions, the 20 largest shareholders hold between 50 and 60%. The report concludes that "no jurisdictions systematically features the kind of atomistic dispersed ownership structure that still influences much of the corporate governance debate". In most markets, the single largest owner is typically a private corporation or a strategic individual. [51]

(b) Distribution of profits: short-termism

The Study assumes that the distribution of profits is one of the underlying drivers of a large part of company conduct, especially **referring to the excessive distributions of dividends, of directors' or executive remunerations**[52], **bonuses, buy backs, etc**. These distributions lead to a weakening of the company's financial position and its inability to honor its long-term obligations among which the development of a meaningful sustainability policy. This reasoning is frequently defended in the US, especially in the political and more popular press, but is very controversial as it is based on several analytically flawed data, as has been exposed by leading academics[53].

[50] Figures for 2010/2011; previous figures for 2003 were respectively 9,2 v. 70,3 ; see also https://www.familienunternehmen.de/de/daten-fakten-zahlen; 90 % of business firms belong to families; 40% of listed companies also are family owned and grow double as fast as the firms owned by dispersed shareholders; there are 865 listed German companies.

[51] OECD, Owners of the world's listed companies, p. 17., 17 October 2019.

[52] See Roe, Spamann, Fried, Wang, Discussion and Analysis of EY Report's Major Flaws.pdf.Law and Business Professors' Submission to the EU on EY's "Study on directors' duties and sustainable corporate governance , Oct 8, 2020
Alex Edmans, Xavier Gabaix, Dirk Jenter, EXECUTIVE COMPENSATION: A SURVEY OF THEORY AND EVIDENCE NBER, Working Paper 23596, giving i.a. an overview of the different types of remuneration
https://www.nber.org/system/files/working https://www.nber.org/system/files/working_papers/w23596/w23596.pdf. This paper contains data about remuneration in European companies, p.144

[53] See M. Roe Stock Market Short-termism Impact, 2018, 115, ECGI, 426/2018, August 2020, ; M. Roe Short termism 17 November 2018, Univ Pen Law review

From a macro point of view, distributions to shareholders e.g. do not weaken the overall availability of funding in the corporate sector, but lead to additional (re-) investments in the same company or in the economy at large. According to these studies, overall figures for R&D have increased significantly, not necessarily in the same company, but in other entities or sectors as well. These evolutions have therefore to be analyzed on a macro basis, not only on company by company basis.

In a recent paper J. Fried and Ch. Wang[54] stated that in the EU context: "the conclusion drawn by EY about short-termism with respect to the excessive distribution to shareholders and executives is based on a narrow view on the financial flows". In their paper, Fried and Wang analyze the financial flows as follows: net distributions have to be analyzed as part of the entire financing structure of listed firms. Large amounts of capital are moving from investors to the same or to other EU firms, especially the smaller ones. The data indicate that while pay-outs to investors were relatively moderate, investment intensity has been rising, as evidenced by increased cash balances and R&D investments. Also, net income should be calculated after expenses and adjusted after deduction of R&D including the cost of future oriented activities or investments which are expensed.

Based upon a detailed analysis, M. Roe concludes that "all told, the stock-market driven short-termism story is very weak", an opinion which is shared by several other leading US academics[55].The link with the alleged low level of sustainability should therefore be regarded with skepticism.[56]

(c) Levels of remuneration of directors and executives

A recent study by Fried and Wang[57] contains comparative data on remunerations for US/UK companies but also for companies of several EU states. They concluded on the basis of actual data that "these provide little basis for the view that short-termism in the EU warrants corporate governance reforms". A somewhat older study by Edmans, Gabaix and Jenter, based on comparative data from US and EU companies, documents in great detail the different types of compensation paid by US companies and for some data also by companies of several EU states. It indicates that remuneration in the EU states generally consisted more of wages, fewer stock options, bonuses or the like. The latter were predominant in the US, the UK and Switzerland, smaller in Norway and Sweden, but substantially lower in Belgium and France, all much lower than in the US.[58]

[54] J. M. FRIED AND C.. WANG, SHORT-TERMISM, SHAREHOLDER PAYOUTS, AND INVESTMENT IN THE EU, ECGI, *544/2020*
[55] Roe,nt. 4**8,** Coffee, nt.25.
[56] Roe, nt 48
[57] Short-Termism, Shareholder Payouts, and Investment in the EU, ECGI, 544, 20
[58] See Fried and Wang, nt. 42, table 5, p. 16

The overall levels of compensation presented a similar profile: US and UK are the highest, followed by Switzerland, Germany, Italy and France with Belgium, Sweden and Norway at the lower end. The remuneration of CEOs of medium size companies showed a net decrease of median pay for European CEOs (2014-2018)[59].

None of these findings point to the conclusion that European CEO are considerably overpaid to the point that investment in sustainability projects would be jeopardized.

(d) Voice to Long-term Stakeholders

The Study rightly points to the importance of giving voice to the long-term stakeholders, being the employees, the clients, creditors, the neighborhood, and other parties exposed to the company's action, success or failure. **In several European legislations, including company law, representation of certain groups of stakeholders in the decision-making bodies has been provided for several decennia:** a 2002 directive [60] requires the management to consult with employees "with a view to reaching an agreement on decisions within the scope of the employer's powers".

The **input of stakeholders** in company decision making may take **many forms**. Apart from the Nordic countries[61], the German, Dutch, French, Luxemburg, Hungarian, Polish, Slovenian company laws provide for board representation of employees, employee co-decision – or co-determination – which have profoundly modelled the business climate in these jurisdictions[62].

[59] Compensation for CEOs of median size companies, see: CEO Pay Trends around the Globe, 2019 Harvard Law School Forum on Corporate governance, pointing to a net decrease of median pay for European CEOs (2014-2018); *For an evolutionary view: D. Lerner, Board of directors , compensation past present and future Board of Directors Compensation, Harvard Law School Forum on Corporate Governance, February 2021*

[60] Directive 2002/14 11 March 2002 establishing a general framework for informing and consulting employees in the European Community; see also Directive 2009/38/EC establishing European Works Councils. In some company law directives, co-determination rights have been provided: this is the case for the European Company statute (SE) 2001/86, for the European Cooperative society (2003/72) and for the directive 2019/2121 on cross-border merger, conversions and divisions.

[61] See: Per Lekval (ed) THE NORDIC CORPORATE GOVERNANCE MODEL. https://corporategovernance.dk/sites/default; SNS FÖRLAG

[62] See on the effect of co-determination: Labour in the boardroom: The effects of codetermination on firm performance and wages , Jörg Heining, Simon Jäger, Benjamin Schoefer , 8 April 2020, concluding *that shared governance can lead to an increase in capital formation, based on an empirical investigation: https://voxeu.org/article/codetermination-firm-performance-and-;* N. V.. Munkholm Board level employee representation in Europe: an overview, 2018, https://eu.eventscloud.com/file_uploads/e0bd9a01e363e66c18f92cf50aa88485_Munkholm_Final_EN.pdf

In most EU states, **employees** are represented in public i.e. state-owned companies but also in 13 out of 18 private company types[63]. In some EU states, and depending on its conditions, co-determination allows labor representatives to exercise significant influence on all company decisions and is an important element in the relations between companies and unions. In other states, co-determination has been controversial for many years, even to the point of not being favored by the national labor representatives. In addition, employee representation is made mandatory in the Work's council of private companies not only for remuneration matters, but other employment related topics, eventually also when redundancies are discussed[64]. Detailed company information is made available to the council members.

The input from **other stakeholders** - customers or users - takes different forms: some companies have introduced a users' committee[65], but the influence of customers is more readily expressed in their preference for the company's products. Therefore, written consultations on clients' preferences are frequently launched, especially for assessing their services or products in the distribution sector. Users' associations also intervene in the information flow between these companies and the users of their products. For specific aspects, e.g., air pollution, neighborhood committees dialogue with management about solving conflicts.[66] Other categories of stakeholders – creditors, providers, subcontractors - are consulted on a topical basis, depending on the issues calling for their special attention. The recent trends to more democratic or egalitarian input in a wide range of societal issues - such as women's rights -also influence company decision making.

This overview illustrates that in practice, the position of the stakeholders is widely considered albeit through other channels than institutional representation.

[63] OECD Board-level employee representation, https://www.oecd.org/employment/emp/Board-level%20employee%20representation.pdf on the basis of a survey which covers 13 out of 14 EU states. See: European Trade Union Confederation position paper - Orientation for a new EU framework on information, consultation and board-level representation rights. This is a recurring demand of the trade union movement as part of its campaign for 'more democracy at work'. https://www.etuc.org/en/document/etuc-position-paper-orientation-new-eu-framework-information-consultation-and-board-level .

[64] DIRECTIVE 2009/38/EC of 6 May 2009 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees.

[65] See the user committees in the two main European CSDs: Euroclear, User Committee, described as a "vital and highly valued advisory body" https://www.euroclear.com/about/en/ourgovernancestructure/Usercommittees.html ; also: Clearstream https://www.luxcsd.com/clearstream-en/about-clearstream/company-governance/group-committees/cbl-committees/user-committee-cbl. See also: https://www.id2s.eu/PDF/ORGR0008_User_Committee_Charter_v6.0.pdf. User committees have been organized in information systems. In some other companies, they have been introduced on the initiative of the board.

[66] Resolving neighborhood disputes, the right way to deal with conflicts, Htpps://www.credit Suisse.com/CH/en/Articles/Private banking/nachbarschaftsstreit-Bewaeltigen des richtige vorgehen-im- konfliktfall—202007.html

4. The Reform Proposals

4.1. Three Alternatives for adapting company and governance rules

The Study is based on the presumption that sustainability can best be dealt with by declaring the companies legally in charge and responsible by including "sustainability" among the objectives of company, putting the board responsible for its realization[67]. According to the Study, a certain number of company issues are directly related to sustainability objectives and accordingly, remedial legal mechanisms are proposed.

Three main approaches – being three levels of regulatory approach[68] - are identified: apart from the "no action" case, sustainability inspired measures could be the subject of **(A) corporate governance practices** or **(B)** be laid out in **recommendations based on national regulations** and thirdly **(C)** reforms to be included in **EU legislative interventions**, especially in **a directive** providing for minimum common rules to be implemented in the national company laws of the EU Member States[69]. Each of these options are subject to a detailed comparative assessment per individual proposal; the final outcome results **in a preference for a directive**, pursuant to which company law would include "more sustainable corporate governance and contribute to more accountability for companies' sustainable value creation"[70]. This choice has considerable consequences for company's decision making and action. The relationship with the other objectives of companies, such as their production, continuity, growth, funding or financial stability are not systematically discussed in the Study. The implications of these options on company law, on the position of directors, their liabilities, on shareholders rights and the position of third parties should be analyzed in more detail.

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[67] See above for the list of "sustainability issues"`. This thesis has been criticised by several US academics: J.C. Coffee, The European Commission Considers "Short-Termism" (And "What Do You Mean By That?"), ECGI, November 12 2020; M.Roe, Short termism by Mark Roe 17 November 2018, Univ Pen Law review – Stock Market Short-Termism's Impact , ECGI, 426/2018, August 2020; A. Edmans Response to the EU Commission Study on sustainable corporate governance, *www.alexedmans.com;* J.Fried and Ch.Wang, Short-Termism, Shareholder Payouts, and Investment in the EU , nt 42, SSRN, 3706499, Oct 2020

[68] Three levels of intervention are mentioned: the Options A, B and C

- A *(non-legislative/soft*) sustainable corporate governance practices through awareness raising activities, communications and green papers.
- B (*non-legislative/soft*) Foster national regulatory initiatives aimed at orienting corporate governance approaches towards sustainability through recommendations
- **C** (*legislative/hard*) – Set minimum common rules to enhance the creation of long-term value while ensuring a level playing field through EU legislative interventions

[69] These are the options A, B and C, in the Study. p VII. A feasibility assessment is made for the each of issues according to the options A, B and c.

[70] The overall objective is formulated as follows: general objective of fostering more sustainable corporate governance and contributing to more accountability for companies' sustainable value creation . The main specific objectives of the reform would be : Strengthening the role of directors in pursuing their company's long-term interests ; Improving directors' accountability towards integrating sustainability into corporate decision-making ; Promoting corporate governance practices that contribute to company sustainability e.g. in the area of corporate reporting, board remuneration, board composition, stakeholder involvement . Several of these points are related to the short-termist analysis

4.2. Amending company law towards sustainability

The Study mainly identifies conceptual objectives or "sustainability issues" which each would be submitted to an assessment under the mentioned three forms of regulation. These are summarized here in shorthand:

- Integrate sustainability aspects in the business strategy, aligned with overarching goals as SDG[71] and the Paris Climate Accord;
- Directors should balance the different interests of the stakeholders of the company , including employees, customers, environments and society at large;
- The duty of care of directors includes the identification and mitigation of sustainability risks;
- Foster long term shareholder engagement and longer shareholding periods;
- A new directive defining directors' duties and the company interest and the balancing of these;
- Identify and mitigate sustainability risks and impacts;
- Prohibit quarterly reporting and earnings guidance;
- Boards should integrate sustainability aspects into their business strategy, aligned with goals as SDGs and Paris Climate change agreement;
- Board remuneration to be linked to sustainability targets through a change of the Shareholder Rights directive II;
- Restrict executives' ability to sell shares received as pay;
- Sustainability expertise and relating criteria in board nomination process to be considered;
- Creation of a new board role, the Chief Value Officer;
- Involvement of internal and external stakeholders.

Most of these topics are in line with the general drive for a more active sustainability approach. But **putting these topics in mandatory legal provisions** - becoming directly applicable rules - would have **a significant impact on company's business and management**. Some implicit proposals would require a substantial revision of several company law provisions, and would fundamentally change today's company law. Moreover, it is not clear whether these proposals would effectively deal with the sustainability issues, as these are identified these days, e.g. issues of human rights. Altogether, one could have the impression that sustainability is the main, or even the sole- objective of companies and their regulation, without regard to the direct impact on companies' business activity and management .

[71] SDG or the United Nations sustainable development goals: https://sdgs.un.org/goals. The list of these goals are not directly within the field of action of companies, such as No poverty, Zero hunger, etc.

As mentioned above, companies are already making important, mostly voluntary efforts in dealing with several of the sustainability related issues which are within the boundaries of their field of action. These are the result of initiatives at several levels of the company structure. Some of these issues relate to the internal functioning of the company's business itself, others relate to the position of the company in the different jurisdictions or fields in which it is operating. Sustainability actions addressing *local* challenges deal with relations with employees, clients, the supply chain, the political world, focusing on the local environment in terms e.g. of pollution, or climate change matters, of building plans, production processes, and other potential sustainability issues. Sustainability in the *wider world*, in other, often remote jurisdictions, deals with a quite different and often more complex set of issues, as these may raise concerns of human dignity, human rights, fairness for which corrective measures are needed but which are often difficult to pursue, economically and politically as well[72]. In both cases, it is up to the company to decide whether and which measures have to be adopted.

Implementing the above-mentioned list of changes to company law would introduce a far going reform of the structure and the functioning of the listed companies, their boards and their group decision making structures. Introducing this complex series of mandatory obligations and prohibitions would also substantially change the position of the directors, including their liability, affecting the cost of managing these groups. Whether this is justified for dealing with a not clearly defined concept as "sustainability" can be doubted. Other solutions should therefore be considered.

4.3. Defining sustainability action of the company

Legally, **companies will be limited to initiatives that fit into the company's field of action, as defined in its statutory objective, part of the company's charter**. Otherwise, stepping outside this agreed field of action, might trigger negative consequences, expose directors to considerable liabilities, and even undermine the validity of the decisions adopted. In addition, where these – domestic - objectives imply action in other countries, this may raise considerable political hurdles, impacting the position of these companies in these countries.

[72] See the actions undertaken in France on the basis of the Loi Pacte, articles L.225-102-4 and 225-102-5 (loi du 22 mai 2019 relative à la croissance et la transformation des entreprises,), Stephane Brabant and Elsa Savourey, France's Law on the Corporate Duty of Vigilance: A Practical and Multidimensional Analysis in English, https://www.business-humanrights.org/en/latest-news/frances-law-on-the-corporate-duty-of-vigilance-a-practical-and-multidimensional-analysis-in-english/; Elsa Savourey and Herbert Smith Freehills, France's Law on the Corporate Duty of Vigilance: Process, Pedagogy and Pragmatism as the wayforward.https://media.business-humanrights.org/media/documents/files/ /FINAL_ENG_Vigilance_Law_-3_recommendations -_2310188_EA2.pdf

Under the traditional reading of the company's objective, companies principally exist to serve their shareholders i.e. to pursue the creation of added value in financial terms[73]. This reading is widely considered too narrow these days, as it becomes increasingly apparent that especially larger companies are a nexus of interests, being decision-making centers, where the needs of and commitments to *all* stakeholders—including customers, employees, suppliers, and local communities—will converge, and not just the expectations of its shareholders. Taking into account the interest of these stakeholders, e.g. the employees or the long-term creditors, will be a component of serving the long-term interests of the company and its shareholders.

The Study is based on the assumption that companies will only contribute to the objectives it states, if the law expressly requires that companies will deal with those in sustainability terms, but without defining in a precise manner the fields in which actions have to be adopted or the concrete objectives to be achieved. The very broad definition of the company's objective, read against the background of the sustainability criterion, would make it technically very difficult to precisely redefine, in legal terms, the company's purpose, but allows companies confronted with the concrete challenges to identify themselves the issues which they consider most relevant at that moment and for which they can effectively develop appropriate remedial action. To be effective, sustainability actions have to be specific, directly responding to the needs of the time and subject matter. Said actions will often imply cooperation with other companies, but also with other administrative or political decision makers.

4.3.1 Adapting the company's proper "corporate purpose"

Rather than requiring that the legislator determines in specific terms which sustainability objectives have to be pursued and how this has to be done, the Study **includes the individual sustainability objectives in the companies' "purpose and corporate governance", outlining a procedure which can be applied to the concrete needs, with flexibility but also effectiveness.** The perimeter and content of the resulting action should then be determined by the company itself, appealing to its sense of social responsibility. This approach would be preferable to a regulatory approach, outlining what is the sustainability objective in the concrete case. In this way, the Study deals with the internal organization of the companies' leadership, as this is exercised by the board under the ultimate control of the general meeting and of its members, the shareholders, and this in accordance with its articles of association.

[73] This refers to the Milton Friedman line of thinking: "There is one and only one social responsibility of business–to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."

By incorporating sustainability as a separate objective as part of the corporate purpose as well as including it the relating governance mechanisms, the Study modifies the company's "raison d'être", as the latter should be geared towards pursuing its economic objectives as laid down in its company charter. Only in a *subordinate* way, and to better serve its own purposes can companies, as separate legal entities, contribute to sustainability actions and this within their field of action. In these cases, sustainability actions will become part of the overall corporate objectives, which may translate in its business terms, in social aims, or in reputational or environmental results. The company's corporate purpose will reflect this reasoning[74]. One can presume that beyond the direct company related environment, sustainability objectives in wider fields will be part of the mission of other entities, such as the not-for-profit sector, or public institutions: where applicable they could draw these companies' attention to the questions which are left unanswered.

4.3.2 Sustainability action within the company's sphere of action

Even within the limits of the company's direct sphere of action, **the company's specific individual position will mark the nature and the boundaries of its sustainability initiatives**[75]. This means that the relevant sustainability challenges will be limited and will differ depending on core company related factors, such as: the company's field of activity, its individual geographical location, its physical and social environment, its business sector, its range of products, its production methods, its expertise, and so on. Companies cannot be expected to engage in sustainability actions which are unrelated to its statutorily defined field of activity.

It is up to the company to determine whether a certain action is relevant to its own range of activity, and adopt the right answers to the changing environment in which it operates. This will be the task of company management – under the control of the board and the general meeting - to regularly undertake a systematic analysis of its position in terms of its business development, including sustainability: this exercise should be part of the more general analysis of risks, challenges and threats which regularly take place in all larger companies, distinguishing the direct v. the indirect risks, and short-term v. the longer term[76]. Depending on the intensity of the threat, and its ability to remedy, the company may consider reacting, immediately or preventatively, searching answers over the longer term. Active risk management, also relating to long-term sustainability issues should help prevent the most threatening cases.

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[74] G. Ferrarini, Corporate Purpose and Sustainability, ECGI,559/2020, with an analysis of the different concepts in litterature.H. Fleischer, Corporate purpose, a management comcept and its implications for company law, 8 February 2021, ECGI, *561/2021*

[75] The study does not identify in which fields sustainability concerns are likely to develop: in the financial sector, the "framework to facilitate sustainable investment" could be used as a reference: see: 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 , where environmentally sustainable activities are defined with respect to activities by financial market participants and issuers of bonds or financial products.

[76] Some proposed to involve the stakeholders, but without voting rights

4.3.3 Measuring sustainability action and reporting

The measures adopted pursuant to these sustainability initiatives will have to be defined within the company's area of activity and remain within the agreed budgetary limits. Focused reviews are required in order to regularly monitor the effectiveness of these initiatives and ensuing interventions. Therefore, **well-defined Key Performance Indicators (KPI)[77] should be developed, adapted to the specific initiative,** and delivering a mostly quantitative measure as to what has been achieved, or what still remains to be realized. As KPIs are analyzed and approved by the board, they allow the company to set its targets in a time perspective. Using comparable KPIs from other firms would allow to differentiate the achievements in the different areas where sustainability measures have been adopted. The achievements and the progress attained or still to be covered should be regularly discussed in the different appropriate company bodies**. Disclosure is essential for justifying the actions undertaken and illustrate the achievements for the different periods considered.** Annual reports would contain more detailed substantive explanations in that respect, The KPIs of different companies should be comparable and used for assessment by i.a. rating agencies[78]. Their substance and contribution to the sustainability objectives should be explained to the public in clear terms and avoid box-ticking.

The data on which these KPIs and related disclosures will be based will be **generated internally and monitored by expert staff.** The data should be overseen externally in order to maintain confidence. As these data are part of the company's overall functioning, they will be integrated in the other information streams, from which they will be extracted by specific auditing and reporting tools. The outcomes will be linked to the taxonomy classification system, allowing wider sectoral and intersectoral analysis. Under the label of non-financial reporting, (see the NFR Directive[79]) companies report on the different aspects of their activity in one single set of statements, reporting in a transparent way on issues which are not identified in common financial reporting, allowing to establish the relationship between social, economic and economic matters. Integrated reporting will throw another light on some of these issues, integrating the impact of the different segments of activity and their respective interdependence in terms of risks and value creation[80].

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[77] Ivo Hristov, A. Chirico, The Role of Sustainability Key Performance Indicators (KPIs) in: Implementing Sustainable Strategies, 17 Oct 2019 , https://www.researchgate.net/publication/336619063_The_Role_of_Sustainability_Key_Performance_Indicators_KPIs_in_Implementing_Sustainable_Strategies ; also in MDPI.

[78] For distinguishing solvency and sustainability ratings, see: ESMA Technical Advice to the European Commission on Sustainability Considerations in the credit rating market , 18 July 2019; Also: D Guzman, Growth in sustainability-linked loans boosts ESG Ratings, Reuters, 21 Oct 2019

[79] See: Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, but not specifically focuses on sustainability.The directive invited the Commission to develop non-binding guidelines and methodology for reporting non-financial information, including non-financial KPIs. This information should fed into the integrated reporting statements, as adopting a wider view.

[80] The relationship between integrated and sustainability reporting has been analysed in the literature: J C Jensen and N Berg, Determinants of Traditional Sustainability Reporting Versus Integrated Reporting. An Institutionalist Approach

Integrated reporting is a subject which is familiar to many audit firms for at least 20 years. With respect to sustainability reporting, the auditing profession, especially the so-called Big Four, have marked their interest for this subject, which will in any case be closely linked to their auditing activity[81]. In this case, one will have to provide the necessary safeguards in terms of auditor independence and conflicting duties, a subject matter which would fall under the general regime applicable to the professional auditors as contained in the applicable ethical standards[82].

5. Voluntary company action or public regulation

Are sustainability rules to be mandated by regulation or by public order or will they be the result of voluntary company initiatives? This question pervades a large part of the practical sustainability discussion. The answer is not black or white: it depends on the formulation of the requirements, whether the requirements are laid down in formal law, or in a more flexible general instrument. In many instances, regulations already mandate companies to adopt strict risk limitation decisions, which otherwise would have belonged to the category of 'sustainability", as belonging to the company's wider responsibility. Often these are monitored by public authorities.

Cooperation between the two levels – regulation or voluntary action - will often yield the better answer: take e.g. the case of repair works to a bridge[83], which would otherwise create a risk for people living in the neighborhood, for those repairing the bridge, or walking under it. If the risk is manifest, it would be the initiative of the owner – i.e., the public authority - of the bridge to make urgent repairs or bring it down. If not, an engineer might have inspected the bridge and report the deficiency to the local authority who will command it to be repaired or give a warning to the owner of the dangerous bridge. Private initiatives may contribute to call attention to the dangerous situation and call for remedial action, in some cases even for intervention of the public authorities.

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http://www.latec.uff.br/mestrado/sites/default/files/documentos-de-apoio/determinants_of_traditional_sustainability_reporting.pdf (2012)
See also the standards of the sustainability accounting standards board, SASB, on the basis of which businesses and investors will be informed about the impact of sustainability; See also: Sustainability reporting and integrated Reporting, https://www.iasplus.com/en-gb/resources/sustainability-en-gb/sustainability; Elbano de Nuccio , **From Non-Financial Disclosure to Integrated Reporting,** February 18, 2020, IFAC, https://www.ifac.org/knowledge-gateway/preparing-future-ready-professionals/discussion/non-financial-disclosure-integrated-reporting; H. Hoogervorst, The IASB and Integrated Reporting, IASB Speech, 26 April 2017 ,https://cdn.ifrs.org/-/media/feature/news/speeches/2017/hans-hoogervorst-integrated-reporting-april-2017.pdf?la=en

[81] G. Tett, Big Four join forces to unveil ESG reporting framework , FT 23 September 2020, Auditors target common standards; issues range from emissions to pay. See: IFRS Foundation, Consultation Paper on Sustainability Reporting , Sept 2020; also: https://cdn.ifrs.org/-/media/feature/news/speeches/2017/hans-hoogervorst-integrated-reporting-april-2017.pdf?la=en

[82] According to the ethical standard for auditors; see: International Code of Ethics, for Professional accountants, https://www.iasplus.com/en-gb/resources/sustainability-en-gb/sustainability.

[83] See the case of the imploded Morandi bridge in Genua; G. Mattioli, What caused the Genoa Bridge to collapse and the end of an Italian national myth? The Guardian, 26 February 2019, referring to neglect in maintenance by its owners.

Public-private joint action will occur in many cases, the private company having to adopt the concrete measures, while other entities, such as the public sector, undertaking accompanying action, e.g. safety certification. The duty of care and the avoidance of future liability will be the legal basis for both parties.

5.1. Identifying sustainability needs and remedies

For sustainability issues which are occurring outside the direct view of the company - such as labor related human rights issues or in the value chain, here or in other parts of the world - **the company's sustainability alertness will be the *trigger* for actions**, deciding whether, when and how much actions have to be developed. For some types of infringement, e.g. on human rights, the effect on the company's reputation, the gravity of the damage e.g. on health or on natural habitat, the influence of action groups at local and international level active before the courts, are determinant factors for companies to undertake remedial action. Incidents reported in the press indicate that in the absence of voluntary action, remedial action is often quite limited[84] . But the analysis has to be refined: in the field of air pollution, efforts are made to reduce the exhaust by ships or by cars, or to produce less polluting planes, leading to mandated action increasingly supported by the developed world. Not only companies but local authorities and the population at large is willing to contribute. **Awareness of the sustainability case, in all its aspects, is therefore an important driver for change.**

This consideration also applies to company action: awareness, close follow up, systematic or programmed action are to be preferred to public regulation and commands. Large companies will be more sensitive to the need to undertake voluntary action, while for the small ones, public measures may continue to be needed. This is part of the company's risk management, which deserves to generally become more aware of its wider social responsibilities.

In public-private mixed initiatives, the question will be raised to what extent private companies can contribute to initiatives which are beyond their limited statutory field of action and are undertaken on a not-for-profit basis. As stated above, non-profit actions, i.e. not directly related to the profit-making activity of the company, are justified to the extent that they are part of a wider context of the company's purpose, e.g. opening the way to further developments which may reduce risks for further sustainability concerns.

[84] See on the duty of vigilance in French law, Vigilance sociétale, Centre de resources http://www.vigilance-societale.com/documentation. Most cases were terminated on a finding of a violation of the "devoir de vigilance", but obviously no further sanctions were imposed.

Public regulation constitutes an important framework within which sustainability actions are undertaken, but it is not the most efficient driver: private actors' sense of the common good, their awareness of the public interest, but also the views from the public markets, including the financial markets, and even from the credit rating agencies[85], will along with the public opinion steer company's action towards more effective sustainability initiatives. A reform initiative should try to bundle these forces.

5.2. Sustainability vigilance and role of the risk committee

Even limiting the sustainability analysis to the company's direct sphere of action, the internal organization of the company should be structured so as to allow effective identification of the relevant sustainability issues, followed by an expert analysis of possible alternatives. This process consists of several stages: at the board level, there will often be general awareness of sustainability issues. **A risk framework would be an indispensable tool** to systematically scan the risk environment of the company, to be regularly updated. But this analysis is the task of the executives and their assistants: they should screen the activities of the company, follow-up deficiencies over time, and evaluate the possible consequences for its future. This is **the duty of vigilance**. Once specific risks have been identified, even outside the direct view of the company, these will be submitted to an internal consultation. This approach is very similar to the one followed for business risks, where the risk assessment is undertaken at company level, analyzed within a specialized committee, where agreement is reached on the action to be followed. The board's general "**duty of care**" will identify the need to develop actions for preventing damage to be inflicted and therefore destroy economic value for the company or for third parties.

In the banking field, this is the role of the mandatory "**risk committee**", in charge of "taking up, managing, monitoring and mitigating the risks the institution is or might be exposed to" [86]. The mandatory procedures developed in banking law could be a useful inspiration source of procedural information for dealing with sustainability risks, which should also be first identified as potential dangers and if needed prevented or mitigated, even for risks that might only occur in the longer term or need preventative monitoring[87].

[85] See ESMA,.Technical advice to the European Commission on sustainability considerations in the credit rating market, 18 July 2019, Esma 33-9-231

[86] See CRD IV, article 76(4) . Whether the committee should be composed of company insides or also representatives of stakeholders may have to be considered.

[87] Reference can here be made to the duty of vigilance, introduced by the French law of 21 February 2017. Systematic analysis of potential risks would be necessary, involving some stakeholder advisory groups. Harassment on the labor floor ("me too"type) should be part of the vigilance.

The "Chief Value Officer" would be the equivalent to the Chief Risk Officer in banking. In the non-financial sector, a risk/sustainability committee composed of directors and executives would have to be put in charge of this due diligence exercise, analyzing challenges, even on the longer term, formulating solutions or remedies, which are to be submitted to the board, including their budgetary implications.[88]

6. Directive or other instruments

The Study pays considerable attention to the different legal techniques for introducing a scheme pursuant to which companies will consider sustainability issues within their organization and their field of action. **The Study results in a clear preference for the last option – a directive - as the legal basis for defining the companies' obligations, resulting in laying down the core of "sustainability corporate governance processes" in a series of mandatory legal provisions.**

The mandatory proposals require changes in company law, especially in governance rules, to be transposed into national law (see also the Annex), but would further trigger changes in company management, structure and related responsibilities

As stated above, the Study does not contain substantive proposals as to the sustainability obligations. It mainly contains a series of proposals for changes of company law and corporate governance, on the basis of which companies should elaborate their sustainability plans. This is the list supra in section 4.2. As a consequence, it would therefore mainly remain an issue of national company law, as an implementation of Directive, to have the large companies develop sustainability plans and related actions and this only with respect to the fields in which *companies* consider that sustainability actions have to be adopted. It will depend on national law to what extent these plans will include a detailed sustainability plan, or be limited to the overall principles in the matter of sustainability. However, the Commission may later evaluate whether the Directive has been adequately implemented by the listed companies and launch additional regulatory initiatives on this basis. In this case it seems likely that this oversight will be delegated to the national markets' supervisors, coordinated by an European Supervisory Authority, in this case ESMA. **The study makes no reference to this supervisory aspect**.

[88] See for the comparison, Wymeersch, Systemic Risk in non-financial companies, FS K.J. Hopt, De Gruyter (2020) . Some stakeholders could be involved in advising the company on possible risk related needs. Some have warned for conflicting interests. Ultimately, it is to the board to decide about their role

6.1. Individualization of sustainability policy and relationship with other involved parties

The **formulation of a sustainability policy will be a difficult task** for each company concerned: the policy will have to conform to the specifications of the company concerned, avoid developments unrelated to its statutory objective[89], be limited to its field of activity and purpose, its location, identify its own risks and formulate in advance the remedies which will be applied. **Depending on the location of the company and its industrial infrastructure, this will require close coordination with local authorities and support services**.

Some companies have accumulated great experience in preventing or dealing with major risks which may disrupt their continuity and affect their sustainability: this would be the case e.g. for airports, for maritime installations, for certain industrial plants, petroleum refineries, but also for certain public service firms. In other cases, expert assistance will be needed, in coordination with different service providers and experts, and coordinated by the company.

As long as the geographical impact is limited or can be kept under control, this task remains feasible and would come close to the risk policy laid down in detailed legal provisions (e.g. for banking) and is already quite developed in sectors with a high exposure to considerable collective risks[90]. Due to the large variety of incidents possibly having a massive sustainability impact, models and common procedures could be developed, detailing the procedure for each of the participants. Moreover, in case of need, specialized outside assistance will have to be called on, including from the public authorities[91]. With respect to its part of the sustainability project, these measures will be prepared and coordinated by the company itself, planned by its board within its specific additional sustainability perspective, the company having the best view on the direct but also on the indirect risk incidence[92].

At the national level, sustainability **risks are generally better known** and **more easily individualized**, so that effective policies can be put in place to allow maximum damage limitation or optimal redress according to the views or the needs of the local population[93]. But the task becomes considerably **more difficult** if the obligation includes comparable sustainability **risks at subsidiaries, or even at local providers**, where the consequences may be much more dramatic, both in environmental and social terms.

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[89] Otherwise risks of ultra vires nullity and liability of directors might ensue depending on national company law.

[90] See above e.g. the mentioned cases of harbors or airports, but also nuclear plants or chemical plants, etc. where considerable long term damage would be inflicted to the wider population: see e.g. R. Harding, Fukushima nuclear disaster haunts Japan's climate change debate, FT 11 March 2021

[91] See e.g. a fire brigade, or ambulance services.

[92] The relation between risk policy and sustainability has been discussed in: Swiss Re, Sustainability Risk framework, "Sustainability Risk Framework which is designed to identify and mitigate such risks through embedding the principles of respect for human rights, environmental protection and due diligence into everything we do". It is: an essential risk management tool fully embedded in our standard operating procedures." https://www.swissre.com/dam/jcr:f402aa58-4108-473c-b5a7 36fb50f05e88/Sustainability_Risk_Framework_Brochure_en.pdf

[93] The needs of the local population would be translated in the consultative groups

Also some cases may involve multiple parties, possibly in different parts of the country[94,95]. It will be quite difficult for the company headquarters to know which sustainability risks exist at a remote subsidiary or at the level of a local provider, and whether these are common to several entities. In addition, action by the parent company may in some cases not be enforceable, or be contrary to the view of the local authorities, while deficiencies may be attributed to the local management. This would create an additional risk in case the parent company would be responsible for all these events and their further implications[96]. In many cases, the responsibility will be split over several actors, including some public authorities, while in some no one will be really responsible, or willing to act accordingly. Could this not best be dealt with as part of the parent's sustainability policy, covered by its insurance policies and described in subsequent disclosure reports?

The Study concludes however that these risks should be dealt within a formal EU regulation[97], rendering the company legally responsible in general terms. It would often be difficult to identify the appropriate measures: ultimately, the definition of the specific measures to be applied and the format of the action, would remain a company decision, not a regulatory one, if applicable under the oversight of the public authorities. The application of a regulation in which general sustainability objectives are formulated will in practice often be quite unclear, attributing liabilities to parties who although aware, did not have the capacity to develop adequate remedies. This might be the case where the liability first and foremost belonged to the – especially foreign – state, unwilling or unable to recognize the problem, or to deal with it[98].

In addition, as these regulations would be EU measures, they would be **legally binding**, and could be **formulated, monitored and enforced by the existing legal means**, by the competent authorities, or by judicial decisions. Also, private interest groups, such as activist investors, or NGOs might have an interest in the legal enforcement of these public measures.

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[94] Examples abound in the environmental field, for developments contributing to climate change, to devastating flooding, or massive air pollution, floods due to dam breaches, exploding oil rigs, excessive logging, widespread flooding, massive explosions; See Beirut harbor explosion: tracing the timeline of the disaster, 20 October 2020, https://www.ship-technology.com/features/beirut-explosion-timeline/ For destructions of historical mines, see: Mining giant Rio Tinto decided to destroy two 46,000-year-old Aboriginal rock shelters in order to access $135 million worth of iron ore that would not have been available under alternative mining plans avoiding the culturally significant site;7 Aug. 2020. https://www.smh.com.au/business/companies/rio-tinto-blasted-ancient-aboriginal-caves-for-135m-of-iron-ore-20200807-p55jia.

[95] Mining giant Rio Tinto decided to destroy two 46,000-year-old Aboriginal rock shelters in order to access $135 million worth of iron ore that would not have been available under alternative mining plans avoiding the culturally significant site;7 Aug. 2020. https://www.smh.com.au/business/companies/rio-tinto-blasted-ancient-aboriginal-caves-for-135m-of-iron-ore-20200807-p55jia.

[96] A good example is the use of palm oil, the planting of palm trees in some parts of the world being the cause of massive deforestation: without palm oil, many of the daily product in western food could not be produced.

[97] State regulation, or European directive implementation through EU regulations, applied at national level.

[98] See the cases of excessive logging in several parts of the world. See Total, Systematically taking the environment into account,presenting a time line for the integration of environmental protection in its oil exploration projects, https://www.total.com/group/commitment/environmental-issues-challenges/environment-protection/environmental-engineering

6.2. Effectiveness through adhesion to voluntary standards

The wide scope of application -including in foreign jurisdictions with very different social and legal traditions- may make the regulation-based application unpredictable, and policies and relating plans ineffective, as local authorities or instances may forbid it, or may not want to intervene, nor have the same view as the multinational company. In many cases it will seem unrealistic to involve the EU based supervisory authorities in this unchartered field in charge of monitoring based on the company disclosures. The directors and executives of the company have a primary interest in identifying and mitigating these risks, their business position being directly involved, and their reputation at stake.

Rather than the external, rule-based implementation which is likely to be limited to formal conformity with the administrative requirements, **internalization in the procedures of the company would allow to go more in-depth and therefore be more effective**. These subjects could then be dealt with as a *business risk*, for which large companies have adequate procedures in place for identifying internal potential risks and assessing the urgency of interventions. In addition, business firms **could voluntarily adopt internal policies or standard procedures** which largely reflect the overall sustainability concerns, e.g. by voluntary adhesion, by copying their colleagues in the same activity, or making agreements with third parties. Voluntary or concerted adhesion to best practices occurs frequently, under the pressure of the shareholders, on the advice of an internal consultative panel, or of the public opinion.

In some EU member states, the law - including the case law - has already recognized that **persons** directly or indirectly employed for the production of modestly priced items should be **entitled to a treatment respecting their human dignity**[99] : abusive exploitation of the local labor force, violations of human rights or even extreme poverty due to too low wages, should not be allowed for products distributed by Europe-based companies. Being employed by these companies, by their subsidiaries or even indirectly by their providers, these persons might benefit from actions of European companies aimed at improving their condition, as is already the case in many instances. Companies should be attentive that developments degrading the dignity of the people directly or indirectly employed should not continue.

[99] https://www.ohchr.org/en/issues/SDGS/pages/the2030agenda.aspx

The French law Pacte [100] has followed this reasoning, by introducing the notion of a "devoir de vigilance" according to which the largest French companies (+5000 employees at group level[101]) will have to draw up a "vigilance plan" in which these risks will be identified and analysed, with special attention to the serious violations of human rights and of fundamental freedoms, in human labor conditions, but also to the damages to the environment.[102] Several court cases have been rendered and made findings of violations of these principles[103]. No further measures or sanctions have yet been imposed, but the pressure on management and reputation damage may be considerable[104].

6.3. Mandatory or voluntary implementation

The Study occasionally points to the many business firms which adopted voluntary procedures and standards which reflects the specific management concerns, e.g. as an individual development, or by allying with other firms in the same branch of activity[105]. In the past, this is the way **business firms** adopted similar policies for dealing with their governance issues, resulting in systems covering their relations with shareholders and stakeholders, ultimately resulting in **a common philosophy** known under the name of "**corporate governance codes**"[106]. Companies could develop a voluntary sustainability governance guide into a voluntary public statement, containing the principles for the management of company boards to which the company has committed itself, as would have been officially recognized in company law.

[100] La loi n°2017-399 relative au devoir de vigilance des sociétés mères et entreprises donneuses d'ordre, aussi dite loi sur le devoir de vigilance ; \Wikipedia.org, https://fr.wikipedia.org/wiki/Loi_relative_au_devoir_de_vigilance_des_sociétés_mères_et_entreprises_donneuses_d%27ordre, mentioning several cases of application of the law, i.a. the cases involving Total. See A. Pietrancosta, Intérêt social" and "raison d'être": Thoughts about two core provisions of the Business Growth and Transformation Action Plan (PACTE) Act that amend corporate law, Research , 23 September 2020

[101] Including providers and sub-contactors.

[102] "Le plan comporte les mesures de vigilance raisonnable propres à identifier les risques et à prévenir les atteintes graves envers les droits humains et les libertés fondamentales, la santé et la sécurité des personnes ainsi que l'environnement »

[103] See A, Pietrancosta, nt 107

[104] See the cases referred to in nt. 67. In some cases, this has regularly led to the resignation of the CEO, of the chairman of the board, or other leading managers.

[105] In most large companies, depending on the business activity, fire brigades are available on a continuous basis. E.g. in the chemical or the petroleum industry.

[106] For the list of corporate governance and stewardship codes from many countries in the world, see ECGI, Governance Codes, https://ecgi.global/content/codes-0 x

Beyond these, **the Commission further plans to introduce binding rules in a host of other governance matters, which are related to sustainability, and to incorporate these into the details of company law and management**[107]. These numerous, often substantive legal changes would considerably modify existing company law, by changing the composition of the corporate bodies, the conditions for election to the board and the relations between the different participants in the company, redefining some of the decision making functions, but also changing their remuneration rules or career perspectives, - all in a negative direction- and being dominated by sustainability considerations. This would certainly lead to strong opposition of the business world. The requirements would demotivate foreign companies to start up an activity in the EU, making EU establishment less attractive than that in other jurisdictions. Foreign company directors or ambitious entrepreneurs would shy away from the EU. Including these items in their policies would considerably increase the burden for the companies, and reduce flexibility in their management. The mandatory character of this regime would increase the resistance to the introduction of the main sustainability reform.

It is likely that in in case the third option would be followed– implementation by directive - binding common rules would be further developed by generally applicable EU legislative and regulatory interventions which would be introduced in addition to the provisions on sustainability. As in other fields, an avalanche of detailed level 2 or level 3 rules can be expected. **How these rules will be enforced is not specified**: as company law rules, applicable to listed companies, they would be formally enforced by the national supervisory authorities and by the judiciary, inter alia by adding to directors' liability. Whether these authorities or the courts would intervene in sustainability matters, which are very much subjective and open to interpretation, is unclear: the business judgment rule would be an important yardstick. In cases involving foreign jurisdictions, political motives may come into play, preventing any action. **There is no mention whether public enforcement would include the creation of an authority involved in the formulation, analysis or enforcement of the required measures while defining an overall policy guaranteeing the level playing field**. If that would be the case, a voluminous body of administrative regulations is likely to be developed. As these measures are EU measures, they would be monitored and implemented by the existing legal instruments, most likely by the existing financial supervisory authorities as part of their oversight of company disclosures. Some states may prefer to designate a local body, or an authority in charge of issuing locally inspired specific sustainability recommendations, guidelines, statements, or other non-binding instruments: the regulatory burden would be equally heavy and come on top of the existing disclosure and oversight provisions. The mandatory implementation would result in a considerable additional burden to the listed groups.

[107] These are the changes as proposed in the Annex 1.

6.4. Preference for a voluntary instrument

The study analyses in great detail the alternative options on the basis of theoretical classifications (the above-mentioned Options A, B and C). It however **bypasses the possibility that business firms voluntarily adopt policies** which largely reflect the specific sustainability concerns, e.g. by voluntary adhesion, or by copying their colleagues in the same activity, and which are widely supported. In the past, this is the way business firms adopted policies dealing with their governance systems. This approach was the one followed by the **Corporate Governance Codes**, which have now been introduced in all EU jurisdictions, and are widely considered as the yardstick for corporate action, protecting both directors, shareholders, and in some cases even stakeholders. **These codes were initially purely voluntary, but adopted by companies according to the "comply and explain" rule**. The latter is not a devise for non-application of the code, but has become a tool for better adapting the requirement to the intentions of the code. The fact that some company legislations expressly refer to the code[108] should not been seen as an upgrade of the code to that of a legal instrument: it remains a voluntary device, inviting companies to excel beyond the conditions formulated in the code. **Flexibility, adaptability, voluntary adherence are key** to the effective implementation of the code[109]. References in the directive[110] and in national legislation have anchored the code, however without having the content determined by the legislature. Also, the codes are regularly adapted to the changing needs and views of the practitioners, of management and of legal analysis.

An alternative approach whereby the largest companies adopt **a number of *voluntary* guidelines** - in this case dealing with their position on sustainability issues - could constitute a valid basis for opening this new line of action. It would allow the sustainability action to be adapted to the needs of the individual issue, while conforming to the applicable legal requirements. **Extending the reach of the corporate governance code by including a reference to sustainability would be a simple and effective approach, which might be rooted in law as is the case for the code itself.** This would be in line with the successful experiment with the Cadbury code which was launched almost 30 years ago and has been one of the most widely followed drivers in the corporate governance debate in most European states. Many of the delicate issues relating to the position of directors, their professional duties and their relations to shareholders, would not have found acceptable solutions if the corporate governance codes, based on extensive experience, had not contained the appropriate guidance for the action of board, directors and shareholders, without putting the matter in hard law.

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[108] See the Belgian Company law 2019 article 3.6 § 2, ; compare the Dutch Art. 2:391 lid 5 Civil Code, Bk 2 (mandatory, see: www.mccg.nl and the French code . L225-37 du Code de Commerce (facultative)

[109] Pietrancosta, A, Enforcement of corporate governance codes: A legal perspective, RTDF, May 2014.; Wymeersch, Enforcement of Corporate Governance Codes, SSRN 759364

[110] Directive (2006/46/EC) of June 14,2006, amending, article 46 of directive 78/660, according to which apart from the comply or explain principle, information on several aspects of company life had to be made public.

Some code provisions have even been recognized as expressing a general principle of law, offering a basis for legal action[111]. **By including the sustainability action in the internal functioning of the companies rather than in a formal legal requirement, the action will remain within the limits of the company's statutory purpose, adapted to the specific situation of the company and avoid any ultra vires arguments to be raised.**

The responsibilities – and risks - of the directors **will be different** in case a voluntary approach is followed: in case the duties are laid down in company law, the company and all directors would be responsible and liable, in case there would be a violation of company law. If the sustainability duty is laid down outside the legal framework, e.g. in the governance code, the sanctions for the directors would mainly be reputational, while the directors directly in charge of sustainability matters may be held liable before the board. This was also an argument for developing corporate governance codes as internal instruments, not as legal requirements: responsibility rather than liability. Liability for sustainability plans might then only result from gross disregard of environmental or sustainability risks[112].

Objections may be formulated with respect to the non-binding nature of the provisions on corporate governance. **An alternative** may be found by including the sustainability **requirement in the listing conditions of these companies**: these conditions will be formulated pursuant to a European directive, [113] but it would be up to the company to determine in which fields sustainability action will be undertaken. Reporting to the market would be applicable as for other listing conditions[114]. The national listing authorities will make sure that the companies comply with the principles laid down in the directive.

Market led enforcement should not be underestimated: the disclosures of listed companies are analyzed by a host of financial specialists, while the rating agencies, based on the opinions of the auditors and accountants, will express their opinion on the quality of this part of the management's report. Shareholders have become increasingly active in raising sustainability questions in general meetings[115].

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[111] References to Dutch Supreme court case, HR 14 September 2007, ECLI:NL:HR:2007:BA4888 (Versatel), ann S. Bartman in JOR 2007/239; comp HR 21 Februari 2003, ECLI:NL:PHR:2003:AF1486 (HBG) on the basis of a general duty of care; R.T.L. Vaessen, Bestuurdersaansprakelijkheid en corporate governance, http://www.openaccessadvocate.nl/tijdschrift/maandbladvermogensrecht/2017/12/

[112] Therefore applying the general "duty of care" addressing the interests of all stakeholders; but ultimately it is up to the board to decide and assume responsibility for its decision.

[113] Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities, consolidated version.

[114] See for the different disclosures by listed companies: Directive 2001/34.

[115] For a detailed overview on the Dutch situation, see A. Lafarre and C. Van der Elst,, Shareholder Sustainability Activism in the Netherlands, ECGI, 396/2018, giving a detailed overview of the shareholders' uses of their question time in the general meeting, but also pointing to an increase of shareholder questions related to sustainability issues. (5.2% in 2004 to 12.0% in 2017)

The public will assess the company's ESG rating, resulting in stock market pricing reflecting this rating. Activist investors, dissatisfied by the company's sustainability action, may also become active and request different types of measures, even suing the directors in liability[116] or requesting the company to be reorganized or even split. Shareholders may short the shares and investment funds will have to disinvest due to tensions with the ESG standards. All this will lead to changes in the markets. Market led enforcement has therefore become an important voluntary driver for ESG even without any regulatory basis, and would be extended to sustainability in general. The legal status would be comparable to the existing governance standards. External enforcement of the requirements would be **based on auditor-approved** information on the actions undertaken by the company, while disclosure would ensure that other parties, that shareholders and stakeholders in general would adequately be informed and could engage with the board, under the same terms as used in the field of corporate governance.

[116] See Deepwater Horizon – BP Gulf of Mexico Oil Spill https://www.epa.gov/enforcement/deepwater-horizon-bp-gulf-mexico-oil-spill

Conclusion

The Study on "Directors' duties and sustainable corporate governance", as prepared by EY, aims at introducing "sustainability" as one of the core objectives of listed companies' action. This objective is part of a vast program of the EU Commission with a view of including sustainability elements in a wide range of domains, including company's actions and related reporting. The concept of sustainability has not been defined, leaving questions unanswered as to the legal consequences of this fundamental change. On the basis of an enquiry, the Study concludes that only a formal legal instrument, in casu a *directiv*e is likely to yield a satisfactory answer, thereby possibly triggering considerable legal consequences for companies and directors on terms of management duties, risks and liabilities.

While GUBERNA subscribes to the overall objectives of including elements of sustainability in the company's purpose, it expresses its preference for a more flexible approach.

In this respect, GUBERNA proposes to focus on the enlargement of the company "purpose" – now part of Belgian company law-, in the sense that companies, while striving for value creation for their owners and investors, *will have a responsibility for the wider environment in which they operate, while deciding for themselves how they contribute to these objectives, their priorities in and the financial means affected to them.*

Legally, the further interpretation/implementation of the company purpose takes the form of a reference in the corporate governance codes, as a part of the board's duty to pursue sustainable value creation, and follow a similar comply or explain path. Disclosure on the project and on the efforts made should be made public in the annual reports- as "integrated reporting", already practiced, measured in terms of KPIs, and financially assessed by the statutory auditors.

The enforcement of this regime would largely be put in the hand of the investors and other stakeholders, which today already assess the governance mechanisms.
As far as the shareholders are concerned, this could moreover be shaped as a "say on purpose" mechanism comparable to the "say on pay" vote.

Post scriptum

The debate about the duties of large companies is developing rapidly in the EU. A first attempt was published in a Study by the Commission with the assistance of EY, aimed at dealing with the duties of directors and sustainable corporate governance. The purpose of companies would be changed by introducing an element of "sustainability" in their corporate organization and decision making, this concept not being defined This would have led to wide consequences for company management and the companies' activity. The project as submitted by the Commission has been submitted to a public consultation, the outcome of which is still unknown. The present Paper on Directors' Duties and Sustainable Corporate Governance was drafted at the beginning of this year, in the context of a widely supported response to this project.

Simultaneously, a group of members of the Parliament tabled an alternative plan for a directive on "Corporate Due diligence and Corporate Accountability." 117 Aimed at ensuring that large undertakings would fulfil their duty to respect human rights, the environment and good governance, the larger companies would be responsible to include these three objectives into their action. The definition of "human right, environment and good governance "would be established by reference to a multitude of international standards. This duty would not only affect the companies and their group, but also their value chain, defined as all those with whom it has a business relationship, whether as supplier of products of services of as client for the same, whether inside or outside Europe. Companies would firstly undertake a due diligence exercise to verify whether and to what extent they achieve the said three objectives. This action would be externally supervised but it is unclear who this supervisor will be. Oversight of the responses of management would be by public authorities, by stakeholder groups and by the courts. Liability could result.

Attention points can also be raised regarding the implications of this proposal which are equally disturbing and unlikely to be serving the proposed objectives. The attention of the members of the European Parliament and the members of the European Council should be further drawn to the negative impact of this proposed legislation.

28 May 2021

[117] https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073_EN.html

Annex

Changes to Company law derived for the proposed mandatory sustainability objective

The EU/EY Study contains a number of proposals dealing with company law issues, and which would be linked to the sustainability objective. These proposals would have to be introduced in the planned directive and would considerably modify the present company law legal regime. The following list is a first inventory, there may be more items in the Study.

1. *Board functioning in a sustainability mode*

Sustainability criteria for board nominations
Boards involving internal and external stakeholders
Chief value officer in the board
Strengthen enforcement rules to ensure that directors act in the interest of the company
Higher level of corporate responsibility

- Spread sustainable corporate governance practices through awareness raising activities, communications and green papers;
- Foster national regulatory initiatives aimed at orienting corporate governance approaches towards sustainability through recommendations;

2. *Remuneration*

ESG Metrics for executive pay
Bonus share remuneration to be blocked over longer period
No earning guidance

3. *Shareholders*

Longer shareholding periods - long term shareholder engagement
Preference for shareholders with long term engagement which benefits the company interest
No earning guidance
No quarterly reporting

4. *Short termism*

Long term sustainable value creation – preference for investments with sustainability added value – Reduced focus on short term financial returns -
Reduce short term pressures of the financial markets and on decision making
To be pursued in corporate governance framework

Set minimum common rules to enhance the creation of long-term value while ensuring a

5. *Level playing field*

Pursuing level playing field through EU legislative interventions.