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The EU's Proposed Reform of Directors' Duties and the Missing Link to Soft Law

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Abstract

In this paper, we investigate whether reform of EU company law is needed to make corporate governance more sustainable. We also consider some issues to which the EU proposals on company law and sustainability paid scant attention, such as the role of corporate governance codes and other types of soft law, mainly of international origin, in promoting sustainable governance. In addition, we underline that in recent years the EU has adopted several measures which offer better prospects for sustainable governance than the reform of directors' duties the EU is currently debating. We conclude that the failure to take corporate governance codes and the existing regulatory framework into account could seriously impair pending reforms of directors' duties and their link to sustainability.

Keywords Sustainable corporate governance · Soft law · Directors' duties · Corporate social responsibility · Stakeholder capitalism

JEL Classification G30 · G32 · G38 · K20 · K32 · L21 · M14 · P12

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1 Introduction

In this paper, we examine whether reform of EU company law is needed to make corporate governance more sustainable.[1] At the same time, we consider a few additional issues concerning the role of corporate governance codes and other types of soft law, mainly of international origin, in promoting sustainable governance. As we argue throughout our paper, most of the questions already find an answer either in corporate governance codes or in other soft law instruments of international origin. Omitting to consider the important practical role of these documents might negatively impact the legislation that the EU may adopt as a result. Moreover, we argue that the broader context of EU company law reform should be considered as well. Several measures have been adopted in recent years which were similarly motivated by the intention to curb corporate short-termism and promote sustainability in firms' management. We conclude that failure to consider soft law instruments and the broader picture of EU company law concerning managerial incentives and shareholder engagement could lead to flawed reform initiatives concerning directors' duties.

2 The Commission's Sustainable Governance Initiative

The Commission has increased its efforts to support the transition to a sustainable EU economy, in line with its commitment to achieving the objectives of the 2015 Paris Agreement[2] and the UN Sustainable Development Goals.[3] To this purpose, the EU legislator initiated a reform programme in 2018 with the formal adoption of the Action Plan 'Financing Sustainable Growth' ('Action Plan'),[4] which aims to enhance the connection between the financial industry and sustainable development. As to sustainable corporate governance, in February 2020, the Commission published the 'Study on due diligence requirements through the supply chain',[5] prepared on its behalf by the British Institute of International and Comparative Law (BIICL) in partnership with Civic Consulting and LSE Consulting. As to short-termism, in July 2020, the 'Study on directors' duties and sustainable corporate governance', prepared by EY, was published by the Commission's DG Justice and Consumers.[6] The study aimed in particular to

[1] See European Commission (2020a). See also European Commission (2020b).

[2] UN, Paris Agreement on Climate Change, UN Doc. FCCC/CP/2015/L.9/Rev.1 (12 December 2015).

[3] European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Next steps for a sustainable European future European action for sustainability, COM(2016) 739 final.

[4] European Commission, Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, Action Plan: Financing Sustainable Growth, COM(2018) 97 final (March 2018).

[5] Smit et al. (2020).

[6] EY (2020).

> assess the root causes of 'short termism' in corporate governance, discussing their relationship with current market practices and/or regulatory frameworks, and to identify possible EU-level solutions, also with a view to contributing to the attainment of the UN Sustainable Development Goals and the goals of the Paris Agreement on climate change.[7]

Distinguished scholars offered a devastating critique of the EY Report.[8] We share their criticism and highlight that the externalities at issue are particularly those that negatively affect the environment and society as a result of corporate actions. A long-term perspective in the management of a company does not guarantee that the latter's negative externalities will be reduced. The same externalities can reverberate on the company in question, which might be damaged by environmental and social failures either directly or indirectly through loss of reputation. The incentives for the company to reduce them in advance are greater here than when they mainly affect third parties. The Commission would want companies to internalise the negative externalities they produce by clarifying directors' duties. However, as we argue in this paper, such a reform is not needed as other instruments are available to reach similar or better results, including soft law, non-financial disclosure, and managerial incentives. Controlling shareholders and institutional investors can work in the same direction and should be considered in the policy discussion on sustainable governance.[9] With increasing frequency, they exert pressure on companies and their leaders, engaging them in the pursuit of sustainable growth.

Notwithstanding the criticisms, in October 2020, the Commission launched the Sustainable Corporate Governance Initiative based on the findings of the BIICL and EY studies,[10] seeking feedback from stakeholders on the need for EU intervention and on the scope and structure of any reform, in view of enabling companies to focus on long-term sustainable value creation rather than short-term benefits. Subsequently, on 11 March 2021, the European Parliament adopted, with a large majority, a legislative report by its Legal Affairs Committee on corporate due diligence and corporate accountability, providing recommendations to the Commission on the steps to take.[11] On 23 February 2022, the Commission adopted a Proposal for a Directive on Corporate Sustainability Due Diligence ('CSDD') that aims to promote sustainable and responsible business behaviour across global value chains. In this paper, we shall focus on the merits and objectives of EU legislative reform of sustainable corporate governance and on directors' duties and stakeholders.

[7] Ibid., (i).

[8] Roe et al. (2020).

[9] Pacces (2020).

[10] European Commission (2020a).

[11] See European Parliament, Resolution of 10 March 2021, with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)).

3 The Missing Link to Corporate Governance Codes

Based on the EY Report—which considers soft law approaches as only moderately effective—the Commission did not consider the role of soft law as a tool for specifying directors' duty of care. However, national codes of corporate governance and other soft law instruments that we mention below may successfully contribute to this objective. Indeed, some codes already specify the duty of care along the lines required by sustainability concerns. Therefore, the Commission could issue a recommendation to Member States inviting them to provide for such a specification of the duty of care either in the national code of corporate governance or through legislation.[12]

EU legal harmonisation does not appear to be suitable in this area. Indeed, the Commission's plan to address directors' duties has faced a resistance comparable to that objecting to the proposed Fifth Company Law Directive,[13] and the ensuing CSDD Proposal has triggered similar criticism.[14] Moreover, directors' duties are typically defined by national law provisions including broad principles such as the duty of care and the duty of loyalty. These principles are sometimes specified by rules regarding specific cases, such as, e.g., related party transactions.[15] In a similar context, the law-in-action concerning directors' duties is designed by national courts that specify the broad principles indicated above. Often, courts reach similar conclusions across countries despite differences in national laws.[16] However, any bold EU provision replacing national ones would wipe out the jurisprudential trends which have defined directors' duties over the years and possibly create legal uncertainty until when a sufficient number of new cases have been adjudicated.

Nor would a directive providing an optional regime completely avoid these concerns. To deliver effective harmonisation, such a directive should define the options amongst which Member States could select their preferred regime. Each item of the menu would, however, be either prone to the problems just mentioned—if the options envisaged were not sufficiently aligned with the national approaches—or trivial if they were too close to them. If EU legislation were nonetheless adopted to clarify the directors' duties as to sustainability, corporate governance codes could work as a complement to legislation and further specify the standards established

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[12] See, for instance, European Commission, Internal Market and Services (2011); European Commission (2011a, b); Commission Recommendation 2005/162/EC of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board; Commission Recommendation 2004/913/EC of 14 December 2004 on fostering an appropriate regime for the remuneration of directors of listed companies.

[13] Proposal for a Fifth Directive on the coordination of safeguards which for the protection of the interests of members and outsiders, are required by Member States of companies within the meaning of Article 59, second paragraph, with respect to company structure and to the power and responsibilities of company boards (COM(72) 887 final, 27 September 1972, Bulletin of the European Communities, Supplement 10/72).

[14] Krüger Andersen et al. (2022).

[15] See Gerner-Beuerle and Schuster (2014).

[16] Ibid., p 231.

at EU level (for instance, in relation to directors' skills and competencies as to sustainability).

To analyse the potential contribution of corporate governance codes to sustainability, we briefly examine the state of the art in this area. While several studies have investigated the effectiveness of corporate governance codes in the EU,[17] only a few have considered the role of the codes in promoting environmental and social responsibility.[18] Two of us recently investigated the level of integration of sustainability in corporate governance codes across the EU Member States.[19] Our study evaluated, in particular, the topic of sustainability integration according to the following indicators: (a) reference to sustainable development/CSR/environmental and social responsibility in the definition of corporate governance (when provided); (b) inclusion of sustainability concerns in the description of the function and purpose of the code; (c) specific provisions/recommendations addressing CSR/sustainability concerns; (d) definitions of stakeholders and their rights; (e) provisions concerning employees' rights and engagement; (f) gender diversity criteria for board composition; (g) recommended attribution of CSR functions to a pre-existing board committee or to an ad hoc social responsibility committee; (h) reference to non-financial criteria or to sustainable value creation in the design of compensation policy; and (i) reference to non-financial reporting requirements.

We found that most European codes presently include sustainability considerations in their principles and recommendations.[20] In fact, 15 out of 27 corporate governance codes[21] either address CSR and sustainable value creation or devote an entire chapter/principle of the code to the duties of the company towards its stakeholders. For instance, the Italian and Spanish codes—following the model of the recently revised UK Code—recommend that the board of directors should lead the company towards 'sustainable success', which is defined by the Italian code as

> the objective that guides the actions of the board of directors and that consists of creating long-term value for the benefit of the shareholders, taking into account the interests of other stakeholders relevant to the company.[22]

Similar criteria should also guide the definition of the compensation policy[23] and the activities performed within the internal control system.[24] Similarly, the codes of Austria, Belgium, the Czech Republic, France, Germany, the Netherlands and Sweden recommend that companies should be directed to ensure sustainable development/value creation/sustainable long-term value, to be understood as the

[17] See, for example, Wymeersch (2013); Böckli et al. (2014); Ferrero-Ferrero and Ackrill (2016); Stiglbauer and Velte (2014); Bianchi et al. (2011); and RiskMetrics Group et al. (2009).

[18] See Siri and Zhu (2021); Sjåfjell (2016); Szabó and Sørensen (2013); and Tsagas (2020).

[19] See Siri and Zhu (2021).

[20] See also Sjåfjell (2016); and Szabó and Sørensen (2013).

[21] Codes of Austria, Belgium, Bulgaria, the Czech Republic, Croatia, Germany, Italy, Lithuania, Luxembourg, Malta, the Netherlands, Slovakia, Slovenia, Spain and Sweden.

[22] Italian Corporate Governance Code (2020), Principle I.

[23] Ibid., Principle XV.

[24] Ibid., Principle XIII.

maximisation of shareholders' wealth with the permanent consideration of stakeholders' interests.[25] Other codes (of Bulgaria, Denmark, Luxembourg, Malta, Slovenia and Spain) include recommendations related to the adoption of CSR initiatives. According to our study, amongst the codes analysed, the most 'sustainability inclusive' is the Luxembourgish code, which refers to a long-term and sustainable approach to value creation as one of the main drivers for the latest revision of the code. The Dutch and the Spanish codes are also good models in this respect.

Nonetheless, the numerous weaknesses and inconsistencies of existing codes suggest that further efforts are needed for the full integration of environmental and social issues in similar documents. A first shortcoming endangering the effectiveness of the codes regards their implementation,[26] which also depends on the enforcement of rules concerning the disclosure of compliance with the codes and the supervision by securities markets authorities.[27] Indeed, the lack of homogeneity amongst national codes, their custodians' different nature, and the monitoring of their implementation determine major differences in corporate governance practices. As argued by Wymeersch, all corporate governance codes issued in the EU follow a comply-or-explain approach, but the application of this principle in practice is quite diverse in the various jurisdictions.[28] Where a code has been adopted on a voluntary basis, corporate failure to comply with it generally carries reputational consequences but no legal sanctions. The situation changes in jurisdictions where the corporate governance code is integrated into company law, and enforcement mechanisms are found in legal instruments. Nonetheless, given the diversity of the legal frameworks in which

[25] Austrian Code of Corporate Governance (2020), Preamble; 2020 Belgian Code on Corporate Governance, §§ 2.1, 2.2; German Corporate Governance Code (2020), p 2; Dutch Corporate Governance Code (2016), § 1.1.1; Swedish Corporate Governance Code (2020), Principle 3.

[26] The implementation and enforcement of corporate governance codes in the EU has been widely analysed in the literature. See, for example, Berglöf and Claessens (2004); and Wymeersch (2013); RiskMetrics Group et al. (2009).

[27] The codes' effectiveness is addressed by the laws implementing Directive 2006/46/EC amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings, which requires listed companies to include a corporate governance statement in their annual reports, together with a reference to the corporate governance code applied and the reasons for not applying individual provisions of it. The initial inadequacy of corporate governance reporting in relation to the comply-or-explain provision was remedied to some extent by the Commission, as announced in its 2012 Corporate Governance Action Plan, with the Recommendation on the quality of corporate governance reporting issued in 2014. However, an explicit link between corporate governance and sustainable development had been missing until 2018 when the Commission Action Plan on financing sustainable growth was adopted. See Böckli et al. (2014), Wymeersch (2013). See also Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan: European company law and corporate governance—a modern legal framework for more engaged shareholders and sustainable companies, COM(2012) 740 final.

[28] Some codes have a mere self-regulatory nature, having been developed as recommendations by professional associations or academics acting as private custodians (e.g., Austria, France, Sweden and Portugal), while others have been issued in strict connection with stock exchanges, are referred to in the listing rules or in separate recommendations, and are subject to the surveillance of stock exchanges (e.g., Luxembourg, Lithuania and Poland). Other codes are based on the law and are subject to public/mixed surveillance (e.g., the Netherlands and Germany). See OECD (2019), pp 41–47; and Wymeersch (2005).

the individual codes have been developed, the enforcement instruments also vary.[29] Other weaknesses concern the monitoring of implementation practices, which in some countries are subject to yearly reports,[30] but not in others (namely the Czech Republic, Greece and Poland).[31] Moreover, it is difficult for both national 'reporters' and scholars to assess the level of integration of sustainability concerns in corporate governance, given that provisions addressing them have only recently been adopted. As a result, only a few reports already consider the progress made by listed companies in performing sustainable governance practices.[32]

From a broader perspective, our findings[33] suggest that even influential documents such as the OECD Principles (whether in their current or proposed new version)[34] and the UK Code[35] are not significantly advanced and inclusive as to sustainability, despite recent attempts to improve them in this respect. For instance, neither the UK Code nor the OECD Principles suggest establishing a sustainability committee. Moreover, the UK Code fails to provide a definition of stakeholders and does not recommend the adoption of a code of ethics, while the OECD Principles do not recommend that compensation should be linked to sustainability criteria. However, the OECD Principles make a clear reference to other, more detailed soft law tools that provide guidelines as to business conduct, such as the OECD Guidelines for Multinational Enterprises, the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, the UN Guiding Principles on Business and Human Rights, and the ILO Declaration on Fundamental Principles and Rights at Work.[36] A similar approach was followed by the drafters of the Slovak code, that considers

[29] Wymeersch (2005), p 4; Gargantini and Siri (2023), pp 94–5, 107–9.

[30] These are generally issued by national securities regulators (e.g., the Comisión Nacional del Mercado de Valores in Spain) in conjunction with or, alternatively, to stock exchanges (e.g., the Bourse de Luxembourg), private institutions (e.g., the Berlin Center of Corporate Governance in Germany) or mixed private-public institutions (e.g., the Monitoring Committee in the Netherlands).

[31] See OECD (2019), pp 47,49.

[32] This is the case for Italy and Luxembourg. In Italy, Consob, Assonime and the Corporate Governance Committee already started monitoring sustainability integration into corporate governance practices in their last reports. A specific focus has been placed on the link between variable compensation and ESG objectives, an approach followed by about 33% of listed companies in 2020 (against 12% in 2019). The establishment of a sustainability committee was subject to analysis by Consob, which found that, in 2018, a percentage of about 23% of listed companies established such committees, as suggested by the code. See Consob (2019); Assonime (2021); Corporate Governance Committee (2020). In Luxembourg, the 2018 report issued by the Bourse de Luxembourg found that, among the 13 companies listed on the national exchange, 85% published a sustainability report, but only 38% mentioned the adoption of a CSR strategy, and 62% established a sustainability committee. The reception of sustainability recommendations therefore seems positive, though a more robust and widespread evaluation of practices is still needed. See Bourse de Luxembourg (2019).

[33] See Siri and Zhu (2021).

[34] G20/OECD Code of Corporate Governance (2015).

[35] UK Corporate Governance Code (2018).

[36] G20/OECD (2015), p 10.

as good practice for a company to commit itself to additional international principles, such as the UN Guiding Principles on Business and Human Rights or the OECD Guidelines for Multinational Enterprises.[37]

4 The Role of International Company Law

The growing importance and diffusion of the principles and guidelines issued by international organisations and standard setters (including the IMF, OECD, World Bank and United Nations) have led some authors to identify a new field of the law which Pargendler significantly dubbed as 'international corporate law' (ICL).[38] According to her, the emergence of ICL has partially responded to the 'interjurisdictional externalities and nationalist bias of domestic regimes' and, with specific reference to corporate responsibility towards the environment and society, it has the potential to fill the gaps in national legislations by establishing new standards for corporate behaviour that take into account the negative effects of company activities on third parties. A significant role in this regard has been played by the UN and the OECD with the issuance of many guidelines and principles in the last decade.

As to the former, the two main sets of guidelines addressing corporate responsibility are the UN Guiding Principles on Business and Human Rights (UN Guiding Principles) and the UN Global Compact Principles. The UN Guiding Principles provide standards for both states and business enterprises to prevent, address and remedy human rights abuses committed in business operations. On the corporate side, the guidance includes 14 principles specifically addressing the responsibilities of business enterprises in relation to the respect of human rights. It also provides a set of operational recommendations ranging from the issuance of a specific policy on human rights to the performance of human rights due diligence and the provision of remedies to the adverse impacts the company has caused or contributed to generating. The Human Rights Council formally endorsed the Guiding Principles on Business and Human Rights in 2011, which were later adopted by many large companies through a formal statement in compliance with Principle 16.[39] Unlike the UN Guiding Principles, the UN Global Compact is an initiative that global corporations can commit to by respecting 10 key principles of business behaviour regarding human rights, labour, the environment and corruption.[40] Currently, the UN Global Compact counts more than 12000 signatories in over 160 countries, covering all business sectors.[41]

The OECD Guidelines for Multinational Enterprises, first adopted in 1976, are also important. They consist of a set of voluntary standards and principles for responsible business conduct addressed to multinational enterprises operating in or

[37] Corporate Governance Code for Slovakia (2016), p 17.

[38] Pargendler (2021).

[39] See https://www.ohchr.org/en/publications/reference-publications/guiding-principles-business-and-human-rights (accessed 7 May 2023).

[40] See https://www.unglobalcompact.org/what-is-gc/mission/principles (accessed 7 May 2023).

[41] See https://www.unglobalcompact.org/what-is-gc/participants (accessed 7 May 2023).

from the adhering countries. Specifically, the latest version of the OECD Guidelines was adopted in 2011 by the 42 OECD and non-OECD governments adhering to the OECD Declaration on International Investment and Multinational Enterprises. Currently, 49 governments have established a National Contact Point with the duty of ensuring the effectiveness of the OECD Guidelines by undertaking promotional activities, handling enquiries, and providing a grievance mechanism to resolve cases with regard to the non-observance of the recommendations. The OECD Guidelines cover a diverse range of topics related to business behaviour, from company disclosure and reporting on financial, social and environmental material information, to the respect of employees, human rights, the environment, consumers' interest and the fight against bribery and other illicit conducts, as well as the promotion of science and technology development, fair competition and tax compliance. To complement the standards of behaviour established by the OECD Guidelines, in 2018, the OECD Due Diligence Guidance for Responsible Business Conduct was adopted,[42] with the aim of providing practical support to business enterprises on the implementation of the OECD Guidelines. Moreover, the OECD has developed sector-specific due diligence guidance and good practice documents for the minerals,[43] agriculture[44] and garment and footwear supply chains,[45] as well as for the extractive sector.[46]

Notwithstanding the non-binding nature of such recommendations and their limited enforcement,[47] companies' policies and practices increasingly comply with these principles and standards and respond to investors' growing attention to the ESG performance of investee companies, including the formal adoption of due diligence, environmental and human rights policies in line with international standards. In the sustainable investment strategies usually followed by institutional investors, the 'norm-based screening'—which screens issuers against minimum standards of business practice based on international frameworks, such as the UN treaties, the UN Global Compact, the OECD Guidelines for Multinational Enterprises and the International Labour Organization standards—is one of the most commonly used for portfolio selection.[48] Moreover, common voluntary standards have been developed targeting investor stewardship obligations (such as the ICGN Global Stewardship

[42] OECD (2018).

[43] OECD (2016).

[44] OECD, Recommendation of the Council on the OECD-FAO Guidance for Responsible Agricultural Supply Chains, OECD/LEGAL/0428.

[45] OECD (2017).

[46] OECD, Recommendation of the Council on the due diligence guidance for meaningful stakeholder engagement in the extractive sector, 2016.

[47] See Pargendler (2021).

[48] See PRI, Introduction to responsible investment: screening, https://www.unpri.org/an-introduction-to-responsible-investment/an-introduction-to-responsible-investment-screening/5834.article. See also Eurosif (2018) for an overview of trends related to SRI strategies in Europe. See also ISS ESG (2020) for an overview of the methodological process adopted by ISS ESG to evaluate corporate compliance/failure to comply with international principles (in particular, the Principles of the UN Global Compact and the OECD Guidelines for Multinational Enterprises).

Principles and the EFAMA Stewardship Code)[49] or sustainable investment (such as the Principles for Responsible Investment)[50] which put further pressure on investors with regard to the sustainability-related initiatives and policies of investee companies.

5 Should EU Company Law Cover Directors' Duties?

At the core of the European debate, the legal treatment of directors' duties of care might soon encounter some changes. As a matter of fact, the European Union is exploring the possibility of clarifying and expanding directors' duties of care.[51] The short-terminist focus of EU companies[52] would require some changes directed to lengthen the time horizon of corporate decision-making and to promote sustainable corporate governance. In the Commission's view, companies' social performance should be enhanced through better specification of directors' duties and, possibly, through modifications to the legal regime applicable to them under EU company law.[53] A remarkable step in this direction can be found in the CSDD Proposal, which sets forth a directors' duty to include considerations on sustainability matters in the pursuit of the company's best interest (Article 25 of the Proposal).

These changes would meet with shareholders' approval as there is a growing demand from investors to take into consideration the impact of their business operations on ESG issues, such as the environment, society and human rights violations.[54] In the preparatory works that led to the adoption of the most recent proposals, the Commission asked in this regard whether companies and their directors 'should take account of these interests in corporate decisions alongside financial interests of shareholders, beyond what is currently required by EU law'. One could easily agree on the premise (companies should take account of the interests of stakeholders), but not on the conclusion (EU company law should be changed to include a mandatory provision to this effect).[55]

The premise clearly reflects the 'enlightened shareholder value' (ESV) approach to the direction and management of companies firstly suggested by Michael Jensen and subsequently followed by the UK legislator.[56] Under this approach, corporations should take care of the interests of stakeholders in view of long-term shareholder value maximisation. The implication that the Commission drew (imposing ESV through a mandatory provision) is, however, ambiguous. Firstly, there is no specific

[49] Alvaro et al. (2019), p 19.

[50] Kim and Yoon (2023).

[51] European Commission (2021).

[52] European Commission, Directorate-General for Justice and Consumers (2020).

[53] See, for further insights, the European Commission (2020a) on sustainable corporate governance. Indeed, some of the core questions asked by the European Commission in its consultation concern the legal treatment of directors' duties.

[54] Ringe (2021).

[55] European Company Law Experts Group (ECLE) (2020).

[56] Ferrarini (2020).

requirement of EU law concerning the purpose of companies that a new directive, such as the CSDD Directive, should clarify. Secondly, it is uncertain whether adding a similar requirement through a directive would make corporate behaviour more sustainable. No doubt, ESV is widely followed by responsible companies in practice, both for reputational reasons and because satisfying core stakeholders' interests generally maximises long-term shareholder wealth. Some empirical papers on CSR already prove that being socially responsible leads companies to better financial performance or at least does not negatively affect their performance.[57] Therefore, we believe that mandating ESV would not substantially change the present situation, also considering the enforcement problems discussed below (Sect. 10). Thirdly, it is unclear why legislation should be adopted at EU level, rather than by Member States under the subsidiarity principle.

There are two possible reasons for legislation on directors' duties and sustainability. One is to protect directors from liability towards the company and its shareholders when motivating corporate decisions by reference to the interests of stakeholders. In this regard, changing directors' duties would make them *less* exposed to liability in case they pursue ESG-based policies, even when these do not maximise shareholder welfare—assuming the scant enforcement directors' duties receive in the European Union requires this measure, as we shall see. The other reason for legislating on directors' duties is that company law performs an education function with respect to corporate directors and managers, leading them to take a wider account of sustainability issues.[58] Moreover, EU provisions could only be motivated by the need for a level playing field for companies in the internal market and by the willingness to control externalities across borders. Individual Member States, however, already provide rules on either corporate purpose or the company's interest in terms that are sufficiently flexible and therefore compatible with sustainability goals.[59] Some jurisdictions (like Germany) follow multiple approaches to corporate purpose, which refer to both shareholders' and stakeholders' interests in defining corporate goals. Even jurisdictions that follow a shareholder primacy approach generally allow or require companies to consider stakeholders' interests in view of maximising long-term profits.[60] Therefore, in accordance with the subsidiarity principle, the resulting conclusion should be that there is no need for EU company law to define corporate purpose and directors' duties as they already seem clear at Member States' level. The need for a level playing field in the EU seems to be unjustified, given that companies tend to follow uniform practices in this area across borders.[61] Moreover, as we explain below, it is doubtful whether the specification of directors' duties can effectively control externalities.

[57] See, for instance, Dyck et al. (2019); Friede et al. (2015).

[58] See Bebchuk and Tallarita (2020).

[59] Ferrarini (2020).

[60] Ibid.

[61] Ibid.

6 Should EU Company Law Cover Due Diligence Requirements?

The Commission has underlined the necessity of setting up an efficient system dealing with the identification, prevention and mitigation of risks and adverse impacts on human rights, health and safety, and the environment in companies' operations and through their value chain.[62] These regulatory objectives are now included in the Commission's Proposal on CSDD. The fundamental idea is to anticipate the operation of due diligence requirements for companies in order to prevent and account for the negative effects of their activities on human rights, health and the environment (especially climate change) along the supply chains. This process could force directors to take a wider group of stakeholders' interests into consideration and even consider them prevalent in case of conflicts with a company's commercial interests.[63]

It is controversial, however, to what extent an EU legal framework for supply chain due diligence should be adopted to address adverse impacts on human rights and environmental issues and whether investors' interests should succumb entirely to stakeholders' interests. These questions relate to the more general topic of due diligence that we do not specifically consider in the present paper, which focuses on directors' duties rather than on duties of the corporation. Nevertheless, we believe that an EU legal framework for supply chain due diligence should carry positive effects on human rights and the environment, also considering that international standards in this area –such as the OECD Due Diligence Guidance for Responsible Business Conduct—have obtained wide approval and are already followed by many corporations in practice. In this regard, the CSDD Proposal aims to cover the six steps of the OECD Due Diligence Guidance, and could therefore enhance the implementation of those standards by a greater number of firms and improve their engagement in sustainability matters (Recital 16 of the proposal). If a public enforcement regime were adopted, deterrence would improve compliance with the relevant standards and rules, while a level playing field would be created amongst corporations at EU level.

Moreover, the enforcement of due diligence obligations could be more effective than that of directors' duties in fostering long-termism while reducing the negative spill-overs of corporate activity. Any of the traditional approaches to tackling (negative) externalities, such as command-and-control prohibitions and Pigouvian taxation, could be followed.[64] Cap-and-trade tools may also be suitable to some types of externalities, such as air pollution.[65] Private enforcement through civil liability could also play a role and be facilitated by detailed rules of conduct.

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[62] See the second preliminary question posed by the Commission in Section I of the European Commission Consultation on sustainable corporate governance (European Commission (2020a), on whether an EU legal framework for supply chain due diligence should be developed to address adverse impacts on human rights and environmental issues. This question relates to the wider ones included in Section III of the Consultation, concerning due diligence in general.

[63] See Och (2022).

[64] Lambert (2017), p 22.

[65] Ibid., p 57.

At the same time, the OECD guidance would complement public regulation by specifying the standards established therein. In the CSDD Proposal, responsibility for putting in place due diligence actions is upon directors (Recital 64 and Article 25 of the CSDD Proposal). In our view, imposing due diligence duties on corporations rather than on directors would be preferable for two reasons. Firstly, compliance with similar duties requires an organisational effort that firms should undertake at managerial level under the monitoring of the board. Secondly, corporations should face liability for breaches of those duties, while directors will be liable for breaches of their monitoring duties. Therefore, we support, in principle, the policy of the European Parliament to recommend the adoption of a directive on corporate due diligence and corporate accountability and to establish responsibility for such policies upon firms.[66]

7 Should EU Company Law Specify the Duty of Care?

The company laws of all Member States require directors to act with care and diligence in the interest of the company (duty of care). However, in most Member States, the law does not clearly define what this means. According to the Commission, the lack of clarity contributes to short-termism and to a narrow interpretation of the duty of care focusing predominantly on shareholders' financial interests. It may also lead to disregard of stakeholders' interests, notwithstanding that stakeholders may also contribute to the long-term success, resilience and viability of the company.[67]

In our view, it is questionable that the duty of care is not clearly defined at Member States' level. Being a general standard, its definition cannot be very specific, with the courts asking to specify it in individual cases.[68] Directors are required to decide on asset allocation in a context of incomplete contracts.[69] The very reason why their duties are defined through general standards lies with the need to ensure flexibility in unforeseen circumstances. Specifying directors' duties is a tricky task because duties that are too detailed would run against the very reason why directors exist in the first place. Indeed, it is crucial that directors retain broad discretion and do not undergo scrutiny that is too detailed, as the need for a business judgement rule in its various forms demonstrates.

Neither can it be said that the lack of a clear definition contributes to short-termism and to a narrow interpretation of the duty of care as requiring a predominant focus on shareholders' financial interests. In most Member States, the duty of care either requires or at least allows directors to take stakeholders' interests into account

[66] European Parliament, *supra* n. 11.

[67] Some criticisms have been expressed on the formulation of the directors' duty of care, which is considered too vague and unable to clarify what the interest of the company is. See European Company Law Experts Group (ECLE) (2022), Agostini and Corgatelli (2022), Ruggie (2021).

[68] On the choice between rules and standards in company law, see Kraakman et al. (2017), p 32.

[69] On incomplete contracts and the allocation of the residual right of control in corporations, see Hart (1988); Bolton (2014).

to pursue the firm's long-term profits.[70] The sole pursuit of short-term shareholders' interests would not necessarily comply with the duty of care of directors, especially if stakeholders' interests are ignored.[71] Furthermore, the Commission Proposal[72] ignores that several corporate governance codes in the EU not only recommend boards to maximise shareholder value in the long term, taking into account stakeholders' interests, but also encourage them to adopt CSR policies, linking the variable component of executive remuneration to CSR criteria and assigning CSR functions to a pre-existing board committee or to an ad hoc committee.[73]

Indeed, one should not forget that context matters. Setting directors duties in law is not just like setting them in a corporate governance code. Overall, corporate governance codes seem to be better placed than hard law to deal with directors' duties with a higher level of precision. It is hard to devise sufficiently detailed rules that suit all listed companies, while the 'comply or explain' standard allows corporate governance codes to accommodate for some variance.

Concerns surrounding the non-binding nature of corporate governance codes are better addressed with external constraints. For instance, the legal requirement on corporate due diligence that the CSDD Proposal sets forth can strengthen a practice already widespread in the market.[74] Due diligence requirements are beyond the present paper's scope, but their introduction in EU legislation would be in line with Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation).[75] Article 3 of this Regulation requires business activities to comply with the minimum safeguards set out in Article 18 in order to be considered as 'environmentally sustainable', i.e., establishing procedures

> to ensure the alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights.

[70] Kraakman et al., (2017), p 23, noting that 'the corporation—and, in particular, its shareholders, as the firm's residual claimants and risk-bearers—have a direct pecuniary interest in making sure that corporate transactions are beneficial, not just to the shareholders, but to all parties who deal with the firm'.

[71] See Davies (2020), p 179, with specific reference to the enlightened shareholder value approach followed by section 172 of the UK Companies Act 2006.

[72] See, for example, Roe et al. (2020).

[73] The variable remuneration is one of the oldest tools used to align management and shareholder interests. However, it is a risky technique because shareholders are given the right to hire, fire and set the compensation of top-level managers, while all the liability stays with the directors. See Jensen and Ruback (1983).

[74] A minimum process and definition approach would provide a harmonised definition relying on existing EU and international conventions.

[75] 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.

All this means that companies should adopt a specific human rights policy, establish human rights due diligence processes, and provide a system of remedies for adverse impacts.

At the same time, corporate governance codes seem more suitable than hard law to address directors' duties and incentives on sustainability matters. For instance, director remuneration is a powerful tool in driving directors' incentives. Adopting recommendations that leverage on remuneration as a means to pursue ESG-related targets seems therefore a wise choice for corporate governance codes.[76] These provisions can also rely on the procedural and transparency duties that are now set forth in the Shareholder Rights Directive II (SRD II). Here, the CSDD Proposal may go too far in mandating that the fulfilment of sustainability targets shall be part of the variable remuneration that is linked to the company's business strategy and long-term interests and sustainability (Article 15(3) of the Proposal).[77]

The Luxembourgish code, for instance, recommends the board 'to serve all the shareholders by ensuring the long-term success of the company' while considering corporate social responsibility and taking the interests of all stakeholders into account in their deliberations.[78] Similarly, the Spanish code recommends that the board, 'in pursuing the corporate interest', should

> strive to reconcile its own interests with the legitimate interests of its employees, suppliers, clients and other stakeholders, as well as with the impact of its activities on the broader community and the natural environment.[79]

More specifically, it recommends the adoption of a CSR policy[80] and provides for a detailed description of the minimum content of such a policy,[81] in addition to requiring to report on corporate social responsibility developments in the directors' report or in a separate document, using an internationally accepted methodology. Like the Luxembourgish code, the Spanish code encourages companies to identify

76 See Fenwick et al. (2022).

77 Krüger Andersen et al. (2022).

78 The X Principles of Corporate Governance of the Luxembourg Stock Exchange (2017), Principle 2. In particular, Recommendation 2.3. states that 'in defining the values of the company, the board shall take into consideration all CSR aspects of the business', while Recommendation 9.3 specifies that the board shall 'regularly consider the company's non-financial risks, including in particular the social and environmental risks'. In addition, the board shall 'define, precisely and explicitly, the quantitative and qualitative criteria linked to the CSR aspects when determining the variable part of the remuneration of members of the Executive Management' (Recommendation 9.3, Guideline 1) and shall 'set up a specialised committee to deal with CSR aspects ...' (Guideline 2).

79 (Spanish) Good Governance Code of Listed Companies (2020), Recommendation 12.

80 Ibid., Principle 24.

81 Ibid., Recommendation 54: '[...] (a) the goals of its corporate social responsibility policy and the support instruments to be deployed; ((b) the corporate strategy with regard to sustainability, the environment and social issues; c) concrete practices in matters relative to: shareholders, employees, clients, suppliers, social welfare issues, the environment, diversity, fiscal responsibility, respect for human rights and the prevention of illegal conducts; (d) the methods or systems for monitoring the results of the practices referred to above, and identifying and managing related risks; (e) the mechanisms for supervising non-financial risk, ethics and business conduct; (f) channels for stakeholder communication, participation and dialogue; (g) responsible communication practices that prevent the manipulation of information and protect the company's honour and integrity.'

and assign specific CSR functions to a pre-existing committee (such as the audit committee or the nomination committee) or to an ad hoc corporate governance and social responsibility committee.[82] The same recommendation is also made by the Danish code,[83] i.e., that the board of directors adopt policies on corporate social responsibility.[84] The correlation between executive remuneration and ESG criteria is even more explicit in the German code,[85] which recommends that 'the remuneration structure of listed companies is to be oriented towards the company's sustainable and long-term development'. As stressed by some authors,[86] this principle is a powerful example of the incorporation of sustainability standards and long-termism into the internal organisation of corporate governance.

8 To What Extent Should Directors Consider Stakeholders' Interests?

A crucial and long-debated question concerning directors' duty of care is whether it should include a consideration of stakeholders' interests and to what extent company law should be modified to reflect it. Even assuming that stakeholders' interests should be integrated in the directors' duty of care, as the CSDD Proposal suggests, the debate is far from over. Defining what interests are geared towards the long-term development and sustainable success of the company is a complex issue. It is questionable, moreover, whether corporate directors should be required by law to identify the company's stakeholders, manage the risks for the company in relation to them, and identify the opportunities arising from promoting stakeholders' interests.

A positive answer would reflect the recent academic research which highlights that the pursuit of profit maximisation (especially in the short run) should not be the only corporate purpose.[87] A new approach to corporate purpose is gaining momentum also in the policy debate, on the backdrop of multi-faceted theoretical analyses. There are indeed various theories that stress the importance of including social values amongst the aims that directors (and managers) should consider when making corporate decisions.[88] The ESV approach can be considered a moderate type of stakeholderism, as it reconciles the pursuit of stakeholders' interests with that of long-term shareholder interests. Other theories suggest that shareholder welfare maximisation should also include non-financial interests, which leads to including ethical considerations amongst the guiding criteria directors should follow.[89] Stakeholders' interests play a more pervasive role in the line of thought that focuses on the nature of corporations as organisations meant to pursue a purpose—not to be confused with mere profit, which is only a part of it. Companies' ability to coordinate

82 Ibid., Principle 23 and Recommendation 53.

83 (Danish) Recommendations on Corporate Governance (2019), Recommendation 3.4.

84 Ibid., Recommendation 2.2.

85 (German) Corporate Governance Code (2020), Principle 23.

86 Ringe (2021).

87 See Licht and Adams (2021).

88 See Ferrarini (2021), p 85.

89 Hart and Zingales (2017).

different members of the production team (shareholders, employees, creditors, customers and other stakeholders) is reflected, according to this view, in the need to accomplish the corporate purpose and to deliver long-term prosperity for all parties involved.[90] In this context, the board of directors is required to mediate among different constituencies, none of which should be represented on an exclusive basis.

Whatever the preferred conceptualisation of directors' duty and corporate purpose(s), we believe that already today directors of well-run companies should identify the company's stakeholders and manage risks with respect to them. This is generally suggested by management theory, best practices and corporate reputation, as in the case of the materiality assessment required for sustainability reporting.[91] Moreover, directors of 'good' companies already consider the business opportunities which arise from promoting stakeholders' interests, often under a 'shared value' approach.[92] In fact, the pursuit of stakeholders' interests can be combined with long-term value maximisation in ways that increase the pie's total size (which is made up of corporate profit and the social value created by the firm). However, this should not be strictly mandated by the law, for the simple reason that similar outcomes can be reached by the managers through the exercise of their business judgement, with the flexibility allowed by the application of a legal standard like the duty of care. Mandating the pursuit of 'shared value' in precise terms would bureaucratise managerial conduct, which would, in most cases, escape enforcement of the relevant provisions given the general applicability of the business judgement rule.

Some codes of corporate governance already include provisions on the treatment of stakeholders' interests. Our previous study found that 20 out of 27 corporate governance codes mention stakeholders, with 12 of them also including a detailed definition of them.[93] Most of the definitions provided (for example, by the Luxembourgish and Greek codes) refer to the OECD Principles' notion of stakeholders and specify the interest groups that fall under it (employees, clients, investors, suppliers, local community, and regulators). Other codes (such as the Bulgarian and Dutch ones) mention the concept of reciprocal, direct and indirect 'influence' between the company and such groups. In addition, the codes of Bulgaria, Croatia, Lithuania, Slovakia and Slovenia include an entire chapter describing the duties of the company towards its stakeholders. More specifically, in different combinations, all the codes just cited recommend the board to: (1) identify the stakeholders who are in the position to influence and impact the company's sustainable development;[94] (2)

[90] Mayer (2018).

[91] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, Article 2(16). In this regard, we are considering, among others, the materiality assessment that companies should perform when adopting the GRI reporting standards—which are the most frequently adopted standards for sustainability reporting—for their non-financial disclosure activities.

[92] See Porter and Kramer (2011). See also Henderson (2020), focusing on the importance of organisations and of their ability to create motivation towards the pursuit of shared value.

[93] Siri and Zhu (2021).

[94] (Bulgarian) National Corporate Governance Code (2016), § 38.

comply with existing laws protecting stakeholders' rights;[95] (3) ensure transparency and access to information through constant dialogue and non-financial disclosure;[96] (4) ensure that stakeholders can freely communicate their concerns about illegal or unethical practices to the board;[97] (5) promote stakeholder participation in corporate decisions (such as employee participation in certain key decisions and/or in the company's share capital; creditor involvement in governance in the context of the company's insolvency, etc.);[98] and (6) report on the board's relationships with stakeholders.[99]

On the whole, corporate governance codes that already follow an ESV approach encourage corporate boards to take stakeholders' interests into account. However, only a minority of the codes further specify to what extent such interests should be served by offering a detailed description of the duties of the board towards company stakeholders.

In the discussion on the directors' duty of care, another important issue arises from the necessity of introducing mandatory requirements for company directors to identify, prevent and mitigate the potential risks for stakeholders' interests, i.e., human rights, social, health and environmental impacts. The European Commission has, indeed, included such requirements in its Proposal for the CSDD Directive (Article 25). The Proposal expands the list of directors' duties by making corporate directors legally accountable for the promotion of ESG goals. Under this approach, corporate directors would be required to introduce adequate procedures (Article 26). Where relevant, this could require directors to rely on measurable (science-based) targets in order to prevent and mitigate adverse impacts on ESG factors.

Large corporations are already moving in this direction and include stakeholders in their risk management systems. This is done to reduce both stakeholders' risks to the company, including reputational risks, and the company's negative impacts on the environment and society, as widely recommended by the international documents cited above. The provision suggested by the Commission as a possible addition to EU company law is consistent with the guidance offered by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and the World Business Council for Sustainable Development (WOBCSD) in a document[100]

[95] Ibid., § 39; (Lithuanian) Corporate Governance Code for the Companies Listed on NASDAQ OMX Vilnius (2010), Principe 9.1; (Croatian) Corporate Governance Code (2019), p 23; Corporate Governance Code for Slovakia (2016), p 17.

[96] (Bulgarian) National Corporate Governance Code (2016), §§ 42-43; (Czech) Corporate Governance Code Based on the OECD Principles (2004), p 18; (Lithuanian) Corporate Governance Code for the Companies Listed on NASDAQ OMX Vilnius (2010), Principle 9.3; Slovenian Corporate Governance Code for Listed Companies (2016), p 8; (Maltese) Code of Principles of Good Corporate Governance, Principle 4.

[97] Corporate Governance Code for Slovakia (2016), p 18; (Czech) Corporate Governance Code Based on the OECD Principles (2004), p 18.

[98] (Lithuanian) Corporate Governance Code for the Companies Listed on NASDAQ OMX Vilnius (2010), Principle 9.2; Corporate Governance Code for Slovakia (2016), p 17; Slovenian Corporate Governance Code for Listed Companies (2016), p 8.

[99] Slovenian Corporate Governance Code for Listed Companies (2016), p 8.

[100] COSO and WOBCSD (2018).

designed to apply to COSO's enterprise risk management (ERM) framework[101] and addressing the need for companies to integrate environmental, social and governance-related risks (ESG) into their ERM processes. The guidance notes that over the last 10 years the prevalence of ESG-related risks has accelerated rapidly:

> In addition to a clear rise in the number of environmental and social issues that entities now need to consider, the internal oversight, governance and culture for managing these risks also require greater focus.[102]

The World Economic Forum reported that in 2018 four of the top five risks were environmental or societal, including extreme weather events, water crises, natural disasters, and failure of climate change mitigation and adaptation.[103] In 2020, all five top risks were environmental, including extreme weather, climate action failure, natural disasters, biodiversity loss and human-made environmental disasters.[104]

Given that best practice is already oriented towards including ESG-related risks in the ERM process and that detailed guidance is provided in this regard, which naturally fits with the duty of care of directors, we doubt that the provision suggested above would add much value to what is already the law in practice. We also doubt that an EU provision is needed, given that the Member States are in a better position to choose whether to clarify directors' duties through either company law or a corporate governance code. They can also choose to what extent the relevant provisions or recommendations should refer to the international documents and guidance considered above.

In the complex system of balancing stakeholders' and shareholders' interests, a misunderstanding often occurs. The long-term stakeholders' perspectives are contrasted with the short-term financial results pursued by investors. In the discussion on directors' mandatory requirements, the question arises whether balancing all stakeholders' interests, rather than pure financial results, should be clarified in legislation as part of directors' duty of care, as the Commission proposes in its draft CSDD Directive (Article 25).[105]

Nevertheless, the ultimatum between the interests of all stakeholders and the focus on short-term financial interests of shareholders is highly misleading. A balance of the gamut of stakeholders' interests should be reached that is subsequently balanced with those of shareholders, which are not necessarily short-term oriented. The corporation should pursue a profit goal and satisfy the interests of stakeholders to the extent necessary to reach this goal. It is therefore crucial that a provision such as the one suggested by the Commission in the CSDD Proposal, if it enters into force, is not interpreted in the sense that the interests of stakeholders always prevail over the short-term interests of shareholders. Indeed, short-term shareholder interests should not always be set aside, for there are cases in which they also deserve protection. For example, temporarily blocking salary increases could help achieve

[101] COSO (2017).

[102] Ibid., p 2.

[103] World Economic Forum (2018), Fig. 1.

[104] Ibid.

[105] See European Commission (2020a), Questions 8 and 9.

short-term financial targets to enable employees and shareholders to subsequently divide a larger pie amongst themselves. In general, directors should identify and reconcile the range of stakeholders' interests and balance these with those of shareholders to pursue long-term financial gains.

Accordingly, a strategic orientation on sustainability risks, impacts and opportunities should be integrated into the company's strategy decisions and oversight within the company. We believe that sustainability issues, including non-financial reporting, should be integrated into the firm's direction and management. Therefore, the firm's strategies and its risk management systems should take sustainability issues into account. Also, decisions made by the board of directors should take into account stakeholders' interests.

We see no objection to company law recognising explicitly the need to integrate sustainability considerations in the firm's direction and leadership, except that this could also be provided, to some extent, by corporate governance codes rather than by legislation. The Swedish code, for instance, already includes amongst the main duties of directors the task of 'identifying how sustainability issues impact risks to and business opportunities for the company'.[106]

9 Enforcement of Directors' Duties

The discussion on the enforcement of directors' duty of care requires a thorough analysis of the internal limits of the system. Enforcement of such duty is, in fact, largely limited to the possible intervention by the board of directors, the supervisory board (where such a separate board exists) and the general meeting of shareholders. According to the vision of the European Commission, this has arguably contributed to a narrow understanding of the duty of care according to which directors are required to act predominantly in the short-term financial interests of shareholders. In addition, currently, actions to enforce directors' duties are rare in all Member States. Reference is implicitly made to the liability actions against directors and managers promoted by either the board of directors, the supervisory board or the shareholders' meeting.[107] Derivative suits should also be considered, which can be brought by the shareholders on behalf of the company in some national systems, including the Italian one.[108] The Commission assumes that the limits within which liability suits can be brought in the national systems have contributed to the narrow interpretation of the duty of care under which directors supposedly perform their duty by acting in the company's short-term interests. To our knowledge, a similar thesis has never been advanced by scholars, who argue instead that liability suits for breaches of the duty of care are rare in the Member States as a consequence of the business judgement rule[109] and other hurdles created by the law of civil procedure, particularly in

[106] Swedish Corporate Governance Code (2020), Principle 3.2.

[107] Gelter (2018).

[108] See Giudici (2009).

[109] See Spamann (2016).

the area of discovery, in addition to high costs of litigation and lack of incentives.[110] Derivative suits could no doubt ease the enforcement of the duty of care provided that the hurdles deriving from civil procedure rules are overcome.[111] In light of the above, the narrow interpretation of the duty of care lamented by the Commission has little to do with the low rate of liability litigation brought by shareholders in Europe. Moreover, the business judgement rule rightly protects directors to the extent that it is difficult to ground civil liability claims, as this would deter efficient risk-taking[112] and courts generally do not possess adequate expertise to make a proper evaluation of business decision-making.[113]

It is controversial, however, whether stakeholders and third parties should be given enforcement rights, specifically referring to stakeholders such as employees, the environment or people affected by the operations of the company as represented by civil society organisations. In our view, only shareholders should be entitled to bring a derivative suit for breaches of the duty of care for the simple reason that directors act on their behalf and in the interest of the company. Stakeholders are nonetheless entitled to bring an action against the company for breaches of the rules protecting them, for instance, in the area of environmental protection. There are no reasons for allowing stakeholders to bring either a direct action or a derivative suit against directors for breaches of the duty of care which directors owe directly to the company. However, external measures such as due diligence requirements lend themselves very well to ex-post enforcement. Similar requirements have a specific target and do not involve the weighting of different purposes. Any scrutiny of corporate behaviour in this regard can rely on clear guidance. On the other hand, director discretion is subject to general duties and inevitably involves gauging different potential outcomes of an action against the interests directors are bound to pursue.[114] Whether one believes that these interests are those belonging to one single class or should include the interests of other stakeholders, this kind of assessment entails more discretion and is not perfectly amenable to second-guessing.

10 Final Remarks

Even assuming widespread short-termism in managerial actions, reforming directors' duties does not seem to be the most effective way to control it. Other reforms may be more effective, such as those concerning the incentives of corporate executives as to the environmental and social performance of their companies. EU

[110] See Gelter (2012); Giudici (2009), p 93; Siems (2012); Klausner (2004).

[111] According to Gelter (2012), p 96, we should consider four necessary requirements in the absence of which derivative suits could, with difficulty, be promoted in certain jurisdictions: (i) the absence of a minimum ownership threshold for eligibility; (ii) a favourable allocation of litigation risks to overcome minority shareholders' rational apathy; (iii) availability of information to potential plaintiffs; and (iv) the possibility to derivatively sue potential wrongdoers, which not only includes directors, but also controlling shareholders.

[112] Black et al. (2006); Spamann (2016), p 95.

[113] Sharfman (2017).

[114] See Kraakman et al. (2017), p 69.

corporate law already includes similar rules regarding corporate managers, asset managers (whether UCITS or AIFM) and institutional investors (insurance companies and pension funds) (SRD II). Moreover, it includes provisions aimed to stimulate the engagement of institutional investors in their portfolio companies, while others review the investment services regulation (MiFID II and implementing measures) taking sustainability factors and risks into account. Furthermore, EU company law aims to improve companies' social transparency and performance through legislation such as the Non-financial Reporting Directive (NFRD),[115] the Regulation on sustainability-related disclosures in the financial services sector (SFDR),[116] and the Regulation providing a common EU taxonomy for sustainable financial products.

In this paper we have argued that the EU has paid scant attention to the role of corporate governance codes and other soft law instruments of international origin. Moreover, we have shown that many issues already find an answer either in corporate governance codes or in international company law. Undoubtedly, the lack of homogeneity between the codes and their weak implementation and enforcement in practice may suggest that they are not entirely fit to respond to the need for sustainable corporate practices. However, the principles and guidelines issued by international organisations and standard setters (including the IMF, OECD, World Bank and United Nations) contribute to filling this gap and establishing new standards of corporate behaviour to reduce the negative impact of corporate activities on third parties. In a similar context, compliance with the international principles and standards is more common today, considering that companies respond to investors' growing attention to the ESG performance of their portfolio companies.

Moreover, we have shown that national company laws as to fiduciary duties are already aligned with the need for companies to maximise long-term shareholder wealth, also taking the interests of stakeholders into account, while short-termism does not appear to be promoted or tolerated by the same laws and their interpretation in practice. We have also rejected the thesis that corporate short-termism may be generated by the lack of enforcement of fiduciary duties and by the rarity of cases in which corporate directors have been found liable. Indeed, the business judgement rule rightly protects directors from the risk of being held liable by courts judging with the benefit of hindsight, always provided that directors have acted in good faith and were duly informed about the relevant circumstances.

Furthermore, we have argued that the broader context of EU company law should be thoroughly considered. Several reforms have been adopted by the EU legislature in recent years, such as the Non-Financial Disclosure Directive, the Taxonomy Regulation, the Sustainable Finance Disclosure Regulation and the Shareholder Rights Directive II, which address corporate short-termism and try to promote sustainability in the governance of firms. They offer better prospects for sustainable governance than the reform of directors' duties. Focusing on the full implementation and enforcement of the reforms already made would be a better choice for the EU than further amending company law in the direction examined throughout this paper.

[115] Directive 2014/95/EU on disclosure of non-financial and diversity information.

[116] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

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