Art. 25 of the Proposal for a Directive on Corporate Sustainability Due Diligence: Enlightened Shareholder Value or Pluralist Approach?

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ABSTRACT

On February 23 2022, the European Commission published the long-awaited Proposal for a Directive on Corporate Sustainability Due Diligence. Art. 25 of the Proposal also includes an attempt to harmonize "Directors' Duty of care". This Article contextualizes the approach adopted by the European Commission and it compares it to the UK "enlightened shareholder value" approach enshrined under S. 172 of the Companies Act 2006. The comparison allows to draw preliminary conclusions on the potential harmonizing effects of Art. 25 on the formulation and enforcement of directors' duties across the legal frameworks of the EU jurisdictions.

KEYWORDS

Corporate governance; Directors' duties; Duty of care; Shareholder Value; Sustainability; ESG; Due Diligence; Stakeholders; United Kingdom; Pluralist approach; Enforcement; Harmonization

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1. Introduction

On February 23 2022, the European Commission published a Proposal for a Directive on Corporate Sustainability Due Diligence,[1] in line with the EU's commitment towards the 2030 UN Sustainable Development Goals and with 2015 Paris Agreement targets, as also stressed in the European Green Deal.[2] Article 25 of the Proposal, titled "Directors' duty of care", states that "Member States shall ensure that, when fulfilling their duty to act in the best interest of the company, directors of companies [that fall in the scope of the Directive] take into account the consequences of their decisions for

[1] Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, 23 February 2022, COM(2022) 71 final.

[2] Communication from the Commission on the European Green Deal, 11 December 2019, COM(2019) 640 final, at 3, 5, 20.

sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term". Moreover, "Member States shall ensure that their laws, regulations and administrative provisions providing for a breach of directors' duties apply also to the provisions of this Article".

The Provision is very broadly formulated and it has a similar wording toS. 172 of the United Kingdom's Companies Act 2006. Yet the similarities are arguably only apparent. Besides, the challenges encountered in the formulation and enforcement of the UK provision offer some food for thought for the EU initiative, whose harmonizing effects risk being, at best, questionable. This Article aims at offering a brief but comprehensive overview of the background that led to the EU's proposed definition of directors' "duty of care". .. It later compares the controversial Art. 25 with S. 172 of the United Kingdom's Companies Act 2006, which also seeks to reconcile directors' duties with the interests of a wide series of stakeholders as well as with the long-term interest of the company. The comparison is carried out under the lens of the policy debate and scholarly tradition surrounding the codification of the UK provision. The Article later links the UK discussion to the EU preliminary works on "sustainable corporate governance" to outline similarities and differences in the respective approaches.. The final sections of the Article use the lessons learned from the UK experience to comment on the potential of the proposed Art. 25. In particular, they offer preliminary remarks on how the provision, as it currently stands, may alter the scope and enforcement of directors' duties across the legal frameworks of EU Member States.

2. The Sustainable Corporate Governance Initiative

Art. 25 fits squarely within the burgeoning discussion at EU level and across EU national jurisdictions on how to reconcile traditional company law rules with sustainability considerations.[3] The winding path that led to the current formulation of the provision began as the High-Level Expert Group on Sustainable Finance in its 2018's Final Report recommended to the Commission to "strengthen director duties related to sustainability".[4] Subsequently, the Commission undertook in the 2018's Action Plan on sustainable finance to consult with stakeholders in order to assess potential reforms to directors' duties,[5] and in the European Green Deal it stated that "[s]ustainability should be further embedded into the corporate governance framework, as many companies still focus too much on short-term financial performance compared to their long-term development and sustainability aspects".[6]

The 2020's "Study on directors' duties and sustainable corporate governance", prepared by Ernst & Young for the European Commission and heavily criticized by academic commentators for its flaws,[7]

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[3] On some of the early national and EU discussions see Corrado Malberti, *Company Law, Prudent Management and Corporate Sustainability*, 17(5) European Company Law 162 (2020).

[4] Final Report 2018 by the High-Level Expert Group on Sustainable Finance, at 40.

[5] Action Plan: Financing Sustainable Growth Communication from the Commission, 8 March 2018, COM(2018) 97 final, at 11.

[6] *Supra* n. 3, at 17.

[7] Mark J. Roe et al., *The European Commission's Sustainable Corporate Governance Report: A Critique*, 38 Yale J. on Regul. Bulletin 133 (2021). Florian Möslein & Karsten Engsig Sørensen, *Sustainable Corporate Governance: A Way Forward*, 18 Eur. Co. Law 7 (2021). The European Company Law Experts Group, *A Critique of the Study on Directors' Duties and Sustainable Corporate Governance Prepared by Ernst & Young for the European Commission*, Oxford

offered the basis for an Inception Impact Assessment of an initiative on Sustainable Corporate Governance[8] and for a related questionnaire-based public consultation, which ran between 26 October 2020 and 8 February 2021. The initiative was rejected by the Regulatory Scrutiny Board in May 2021 and then again in November 2021, following what Professor Hansen described as a "zombie" resurrection.[9] The regulation of directors' duties was finally incorporated in the Proposal for a Directive on Corporate Due Diligence, originally conceived as a separate legal instrument.[10] Therefore, Art. 25 is what remains of the original ambitious plan to harmonize directors' duties as a driver for sustainable corporate governance.

3. S. 172 Companies Act 2006:the forerunner to Art. 25?

The proposed Art. 25 specifies a list of consequences that directors must take into account while acting in the best interest of the company. Upon a first glance, the reader can establish an apparent similarity to S. 172 of the UK Companies Act 2006, the most notable comparative example of codification of directors' duties through a list of subordinate interests that directors must consider while promoting the success of the company.[11] The two provisions are formulated as follows:

Business Law Blog, 14 October 2020. *Response to the Study on Directors' Duties and Sustainable Corporate Governance by Nordic Company Law Scholars*, Nordic & European Company Law, LSN Research Paper Series No. 20-12. Alexander Bassen, Kerstin Lopatta & Wolf-Georg Ringe, *The EU Sustainable Corporate Governance Initiative – room for improvement*, Oxford Business Law Blog, 15 October 2021. Alex Edmans, *Diagnosis Before Treatment: The Use and Misuse of Evidence in Policymaking*, Oxford Business Law Blog, 30 October 2020. *See also* Jesse M. Fried & Charles C.Y. Wang, *Short-Termism, Shareholder Payouts, and Investment in the EU*, ECGI Law Working Paper No. 544/2020, 2.

[8] Inception impact assessment, Ares(2020)4034032. The feedback period closed on 8 October 2020.

[9] Jesper Lau Hansen, *Zombies v. Subsidiarity – Opening on 8 December 2021*, Oxford Business Law Blog, 28 October 2021.

[10] Jesper Lau Hansen, *Unsustainable Sustainability*, Oxford Business Law Blog, 8 March 2022. *See* the "Study on due diligence requirements through the supply chain" prepared for the European Commission by the British Institute of International and Comparative Law (BIICL), Civic Consulting and LSE in February 2020. *See also* the Ernst & Young Report, 77 and the European Parliament resolution of 17 December 2020 on sustainable corporate governance, 2021 O.J. (C 445) 94 ("whereas if due diligence obligations and directors' duties are to be covered by a single legislative instrument, they should be clearly separated in two different parts; whereas those obligations and duties are complementary but not interchangeable, nor is one subordinate to the other"). The Regulatory Scrutiny Board in its 2nd negative opinion in November 2021 stated that "[t]he report is not clear about why it is necessary to regulate directors' duties on top of due diligence requirements." Regulatory Scrutiny Board, Opinion on the Proposal on Sustainable Corporate Due Diligence, SEC(2022) 95, 26 November 2021, at 2.

[11] For comparative analyses drawing comparisons with S. 172 *see inter alia* Irene-Marie Esser & Johan Coetzee, *Codification of Directors' Duties*, 12 Juta's Bus. L. 26 (2004). Richard Annandale, *Sustainable Shareholder Value: A Period of Enlightenment for New Zealand*, 16 Waikato L. Rev. 291 (2008). Virginia Harper Ho, *Enlightened Shareholder Value: Corporate Governance beyond the Shareholder-Stakeholder Divide*, 36 J. Corp. L. 59, 77-80 (2010). Paul Redmond, *Directors' Duties and Corporate Social Responsiveness*, 35 U.N.S.W.L.J. 317, 336-338 (2012). Richard Williams, *Enlightened Shareholder Value in UK Company Law*, 35 U.N.S.W.L.J. 360, 361-362 (2012). Irene-Marie Esser & Piet Delport, *The Protection of Stakeholders: The South African Social and Ethics Committee and the United Kingdom's Enlightened Shareholder Value Approach*, Parts 1-2 50 De Jure 97 (2017). Katarzyna Chalaczkiewicz-Ladna, *Examples of Long-Term and Short-Term Decision-Making in the UK, Delaware and Germany – Gap-Filling Exercise in the Context of the Shareholder v. Stakeholder Debate and Share Ownership Structure of the Company*, 29(2) Eur. Bus. Law Rev. 237 (2018). Mihir Naniwadekar & Umakanth Varottil, *The Stakeholder Approach Towards Directors' Duties Under Indian Company Law: A Comparative Analysis*, NUS Working Paper 2016/006.

Art. 25(1) – Directors' duty of care	*S. 172(1) – Duty to promote the success of the company*
Member States shall ensure that, when fulfilling their duty to act in the best interest of the company, directors of companies referred to in Article 2(1) take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term.	*A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to – (a) the likely consequences of any decision in the long term, (b) the interests of the company's employees, (c) the need to foster the company's business relationships with suppliers, customers and others, (d) the impact of the company's operations on the community and the environment, (e) the desirability of the company maintaining a reputation for high standards of business conduct, and (f) the need to act fairly as between members of the company.*

The UK's S. 172 is the result of the codification of the common law duty of loyalty to act in the best interests of the company.[12] In particular, it consecrates the duty on directors to achieve the success of the company for the benefit of company's "members"[13] while adopting a longer-term horizon by taking the interests of wider constituencies, like employees, customers, and the community, into account.[14] According to the predominant interpretation, the provision would give rise to a hierarchy between the interests of shareholders as the "owners" of the company[15] and all the other constituencies – an approach which has been historically referred to as "Enlightened Shareholder Value" (hereinafter: ESV).[16] Thus, ESV represents an attempt to reorient the purpose of the board, but it only has a "weak" effect in light of the persisting focus on shareholders.[17]

[12] *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286; for an analysis of the case *see* Jean Du Plessis, *Directors' Duty to Act in the Best Interests of the Corporation: 'Hard Cases Make Bad Law'*, 34 Aust. J. Corp. Law 3, 19 (2019).
[13] S. 172 refers to "the benefit" of "members as a whole" and not directly to "shareholder value" to encompass companies that do not issue shares, and non-profits, as pointed out by Andrew R. Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2012) 110. Paul L. Davies, *Shareholder value, company law, and securities markets law: a British view*, in *Capital Markets and Company Law* 261 (Klaus J. Hopt & Eddy Wymeersch eds., Oxford University Press 2003).
[14] As proposed by the Company Law Review, *Modern Company Law for a Competitive Economy: Developing the Framework* (2000), at para 2.11-2.19
[15] *See, inter alia*, Stephen M. Bainbridge, *In Defense Of The Shareholder Wealth Maximization Norm: A Reply To Professor Green*, 50 Wash. & Lee L. Rev. 1423 (1993). Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 South. Calif. Law Rev. 1189 (2002). Judd F. Sneirson, *The History of Shareholder Primacy, from Adam Smith through the Rise of Financialism*, in *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* 73 (Beate Sjåfjell & Christopher M. Bruner eds., Cambridge University Press 2019).
[16] In line with Company Law Review, *supra* n. 16; on the "enlightened shareholder value" see, *inter alia*, extensively Keay, *supra* n. 15; Andrew Keay, *Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach*, 29 Sydney L. Rev. 577, 590 (2007).
[17] As pointed out by Jaap Winter, *Towards a Duty of Societal Responsibility of the Board*, 17(5) European Company Law 192, 195-196 (2020). *See also* Jaap Winter, *Addressing the Crisis of the Modern Corporation: The Duty of Societal Responsibility of the Board*, in *Festschrift für Christine Windbichler zum 70. Geburtstag am 8. Dezember 2020* 1191 (Gregor Bachmann, Stefan Grundmann, Anja Mengel & Kaspar Krolop eds., De Gruyter 2021).

However, the policy and scholarly discussion prior to the introduction of the section also contemplated a different regulatory option.[18] The Company Law Review Steering Group, appointed by the UK Government's Department of Trade and Industry ahead of the codification of directors' duties, also identified a "Pluralist" approach as a potential alternative avenue. Drawing from stakeholder theories,[19] this approach would involve the need to balance all the interests of different stakeholders in their own rights.[20] In its final report "Modern Company Law for a Competitive Economy", the Steering Group outlined the main drawbacks of this approach, which would "impose a distributive economic role on directors in allocating the benefits and burdens of management of the company's resources; that this role would be uncontrolled if left to directors in the form of a power or discretion; and that a similarly broad role would be imposed on the judges if the new arrangement took the form of an enforceable obligation conferring rights on all the interested parties to argue for their interests in court".[21] In light of the shortcomings and of the substantial changes to common law required to codify directors' duties as pluralistic, the Review Group rejected this approach. Conversely, the Committee acknowledged that ESV would not represent a reform, but rather a clarification, of already existing directors' duties under common law.[22] It concluded that, while the objectives of UK companies should be to "maximize overall competitiveness and wealth and welfare for all",[23] the means to run them should promote competitiveness and accountability: ESV would thus be more in line with these goals.[24]

4. Art. 25(1), *quo vadis*?

[18] More extensively on the theoretical and policy discussion underlying the current formulation of S. 172, Thomas Clarke, *The Impact of Financialisation on International Corporate Governance: The Role of Agency Theory and Maximising Shareholder Value*, 8 Law Financ. Mark. Rev. 39, 42-48 (2014).
[19] On this point *see* Andrew Keay, *Risk, Shareholder Pressure and Short-Termism in Financial Institutions: Does Enlightened Shareholder Value Offer a Panacea*, 5 Law Financ. Mark. Rev. 435, 439 (2011).
[20] For a conceptualisation of stakeholderism, *see* Andrew Keay, *Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado about Little?*, 22 Eur. Bus. Law Rev. 1, 6-8 (2011). Andrew Keay & Hao Zhang, *An Analysis of Enlightened Shareholder Value in Light of Ex Post Opportunism and Incomplete Law*, 8 Eur. Co. Financial Law Rev. 445, 449 (2011). R. Edward Freeman, *The Politics of Stakeholder Theory: Some Future Directions*, 4 Bus Ethics Q. 409, 415-419 (1994). Gavin Kelly & John Parkinson, *The Conceptual Foundations of the Company: a Pluralist Approach*, 2 C.F.I.L.R.174 (1998). Lee Roach, *The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach*, Company Lawyer 12 (2000). For a comparison of ESV and Pluralist approaches, *see* John Parkinson, *Inclusive Company Law*, in *The Reform of United Kingdom Company Law* 43 (John De Lacy ed., Routledge-Cavendish 2002). Andrew Keay, *Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach*, 29 Sydney L. Rev. 577, 590 (2007). Sarah Worthington, *Reforming Directors' Duties*, 64 Mod. L. Rev. 439 (2001).
[21] Company Law Review, *supra* n. 16, at para 2.12.
[22] *Ibid.*, at para 2.19. *See* Shuangge Wen & Jingchen Zhao, *Exploring the Rationale of Enlightened Shareholder Value in the Realm of UK Company Law – The Path Dependence Perspective*, 14 Int'l Trade & Bus. L. Rev. 153, 172 (2011)
[23] Company Law Review, *supra* n. 16, at para 2.21.
[24] *Ibid.*, at para 2.21-2.22. *See also* the House of Commons Trade and Industry Committee, *The White Paper on Modernising Company Law*, Sixth Report of Session (2002-03), at 7: "The pluralist approach to defining directors' duties would require a more fundamental change in company law. Where the ESV approach would have directors consider the impact on other stakeholders of their attempts to produce shareholder value, the pluralist approach would force directors to consider the interests of stakeholders in their own right. Shareholders would become merely one of a number of parties whose interests the directors would weigh against each other when making decisions. The Review Group ultimately rejected the pluralist approach".

The preliminary works leading to the adoption of Art. 25 are a useful reference point to link the provision to the ESV approach or to the Pluralist approach. First of all, the indirect references to S. 172 date back to the Final Report of the High-Level Expert Group on Sustainable Finance in 2018, that recommended to the Commission "to enhance director duties and corporate governance by explicitly incorporating sustainability, … [t]o act in a way the director considers in good faith is most likely to promote the success *of the company for the benefit of its owners* and other stakeholders".[25] By contrast, S. 172 refers to the "success *of the company for the benefit of its members as a whole*", thus giving priority to shareholders' interests alone. The Final Report recommended a similar open-ended list of secondary interests, using similar wording to S. 172 ("the likely consequences of any decision in the longer term", "the interests of the company's employees", "the need to foster the company's business relationships with suppliers, customers and others").[26]

Conversely, the Ernst & Young's Report heavily drew from the Sustainable Companies Project and the SMART Project, led by Professor Sjåfjell of the University of Oslo and concluded respectively in 2014 and 2020, as well as from the "Statement on Corporate Governance for Sustainability" signed by several academics.[27] These projects reached the conclusion that directors' duties under the *existing* national legal frameworks across the EU are due to the company as a legal entity and not to the shareholders. "Shareholder primacy" would not be a result of a legal obligation, but rather of a "social norm", whereby directors favor the short-term maximization of shareholder value due to the pressures by financial markets, activist shareholders, the threat of takeovers and stock-based compensation schemes.[28] Therefore, it would not derive from the law of directors' duties, but rather from an erroneous interpretation thereof. The Ernst & Young's Report fully subscribed to this view,[29] and advocated for EU intervention to overcome current misconceptions and errors.[30] The Final Report of the SMART Project placed the UK's approach on the end of the spectrum and the Pluralist approach on the other one, and argued that provisions like S. 172, which allow directors to consider the interests of other constituencies as secondary, would be insufficient to address the shareholder primacy. Therefore, they advocated for EU rules clarifying that the board should promote the interests *of the*

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[25] Final Report 2018, *supra* n. 6, at 40.
[26] *Ibid*.
[27] Ernst & Young's Report, at 9, 23, 52, 54, 56, 57, 60.
[28] Beate Sjåfjell et al., *Shareholder primacy: the main barrier to sustainable companies*, in *Company Law and Sustainability: Legal Barriers and Opportunities* 79 (Beate Sjåfjell & Benjamin J. Richardson eds., Cambridge University Press 2015). Beate Sjåfjell et al., *Supporting the Transition to Sustainability: SMART Reform Proposals*, University of Oslo Faculty of Law Legal Studies Research Paper Series No. 2019-63, 7, 10-11. The Statement on "Corporate Governance for Sustainability" is available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3502101> (accessed 7 April 2022).
[29] Ernst & Young's Report, at vi, 32, 42. In this regard, Claus Richter, Steen Thomsen & Lars Ohnemus, *A Response From the Copenhagen Business School*, Oxford Business Law Blog, 26 October 2020 noted that "[t]he report states that the company has only its own interests, which are separated from all other interests. This is very problematic. First, it rests on the perception of the company as a self-driving autonomous entity, operated without regard to founders, shareholders, or other stakeholders". Similarly, the Nordic Company Law Scholars, *supra* n. 9, 8 noted that "the notion of a company interest is mostly applied in company law in a negative and limiting way. ... is invoked to limit the exercise of this discretion to prevent directors from pursuing interests that are not subject to any legitimate legal relationship with the company ... A failure to understand this negative application of the notion of company interest or purpose in company law may lead some observers to advocate that a company should make an inventory of interests or purposes that are generally viewed as favourable and declare these to be its core values, interest or purpose".
[30] Ernst & Young's Report, at vii, 47.

company, something that is already well-established in EU company law,[31] yet is constrained by social norms.[32] Importantly, the participants to the SMART Project did not propose a definition of the concept of company's interest at EU level, which inevitably varies across jurisdictions and cannot be enshrined in legislation.[33] Rather, they encouraged a reformulation of the duties to operationalize the actions of directors.[34]

The Ernst & Young's Report, echoing the SMART Proposals, also recommended linking directors' duties to the long-term interest of the company. Yet, it reached a different, and rather confusing, conclusion: the Report mentioned in different parts that directors should fulfil this duty by "considering" or taking the interests of other entities "into account".[35] This wording also seems to suggest a hierarchy where the interests of other constituencies are secondary, as in S. 172, but where the company as an entity, and not the benefit of shareholders, is primary. However, the Report incoherently recommended the adoption of a Directive requiring directors to "balance" the long-term interests of the company, employees, customers, local and global environment, as well as the society at large:[36] it thus seemed to endorse a pure Pluralist approach. At the same time, it acknowledged that, as emerged during the interviews conducted in the preparation of the Report, the balance of different interests may allow directors to pick the right stakeholders for every decision on the basis of their information. This may simply reinforce shareholder primacy since the other entities do not appoint the board and it might also exacerbate principal-agent problems.[37] Several scholars commenting on the Study raised similar concerns in relation to the proposed "balancing" exercise.[38]

Later, the Impact Assessment on the Initiative on Sustainable Corporate Governance seemed to drive away from the criticized Pluralist nuance of the Ernst & Young's Report. While it favored the

[31] *See* for instance Albert F. Verdam, *The Obligation of Dutch Company Directors to Be Guided by "the Interests of the Company" Compared to the Concept of "Enlightened Shareholders Value" in the English Companies Act*, 11 Eur. Co. Law 157 (2014).
[32] Beate Sjåfjell et al., *Securing the Future of European Business: SMART Reform Proposals*, Nordic & European Company Law, LSN Research Paper Series No. 20-08, 33, 35.
[33] For instance, it may give more or fewer emphasis to economic considerations or to the interests of third parties, *see ibid.*, at 58.
[34] *Ibid.*, at 57, 58.
[35] Ernst & Young's Report, at vi, 75.
[36] *Ibid.*, at viii. Emphasis added.
[37] *Ibid.*, at 77. *See also* the Commission Staff Working Document, *Impact Assessment Report, Accompanying the document Proposal*, 23 February 2022, SWD(2022) 42 final, at 76-77.
[38] Mark J. Roe et al., *supra* n. 9, at 146. Florian Möslein & Karsten Engsig Sørensen, *supra* n. 9, at 9. Vanessa Knapp, *Sustainable Corporate Governance: A Way Forward?*, 2 Eur. Co. Financial Law Rev. 218, 224 (2021): "The proposal seems to assume, without evidence to support this, that balancing the interests of stakeholders with those of shareholders will necessarily lead to a change in the social norm of shareholder primacy and/or will lead to directors taking a longer-term view. There is no explanation of how directors are to determine a "proper" balance between the various interests". Claus Richter, Steen Thomsen & Lars Ohnemus, *A Response From the Copenhagen Business School*, Oxford Business Law Blog, 26 October 2020: "Equal consideration of the interests of all stakeholders should not be the ultimate objective for businesses, particularly considering that the interests of stakeholders are often contradictory." *See also* the Regulatory Scrutiny Board Opinion, Proposal for a Directive of the European Parliament and of the Council on Sustainable Corporate Due Diligence and amending Directive (EU) 2019/1937, SEC(2022) 95, 26 November 2021, at 3: "The description of the directors' duties should clarify how directors need to incorporate conflicting interests of stakeholders and sustainability aspects. It should clarify whether or not there is a long-term interest of the company that could supersede particular interests of stakeholders or beneficiaries or particular sustainability considerations".

clarification of directors' duties as owed towards the company, it proposed an EU initiative integrating the duty to take all stakeholders' interests within the duty of care.[39]

However, the confusion between the two different approaches re-emerged in the Public Consultation for the Sustainable Corporate Governance Initiative held between 26 October 2020 and 8 February 2021. While Question 1 enquired whether companies and their directors should "take account" of broader interests, Question 8 again referred to "balancing" and mentioned the duty of care. The majority of the respondents supported the latter option, although 53.9% of the companies that participated expressed their disagreement.[40]

In its resolution of 17 December 2020 on sustainable corporate governance, the European Parliament stated that company directors have a legal and statutory duty to act in the interest of their company.[41] Due to its long-standing narrow interpretation, it suggested the reform of directors' duty of care to integrate long-term interests and sustainability risks, impacts, opportunities and dependencies into their company's overall strategy. It also specifically opposed the interpretation of the duties towards their company as referred only to short-term profit maximization by way of shares and not to sustainability concerns, and thereby called the European Commission to issue a specific legislative proposal "to ensure that directors' duties cannot be misconstrued as amounting solely to the short-term maximization of shareholder value, but must instead include the long-term interest of the company and wider societal interests, as well as that of employees and other relevant stakeholders".[42]

In the final text of the Proposal, Recital 63 states that "[i]n all Member States' national laws, directors owe a duty of care to the company", and Art. 25(1) of the Proposal clarifies "how directors are expected to comply with the duty of care to act in the best interest of the company".[43] Eventually, the Proposal concluded in favor of retaining the "taking-into-account" approach for the definition of the general fiduciary duties – and also dropped "further reaching specific directors' duties" considered in the Impact Assessment.[44] Therefore, the Commission considered the inclusion of a list of secondary interests, similar to the one in S. 172, as a sufficient antidote to shareholder primacy's "social norm". At the same time, the EU Commission's formulation places the company *as an entity* on top of the pyramid of priorities. This reference suggests a different intention than the one underlying S. 172: in particular, it seems to drive away from shareholder primacy and from ESV and lean towards a pluralistic approach. However, the provision remarkably falls short from defining what the company's interest it, exacerbating issues already raised after the introduction of S. 172.[45]

5. Harmonizing effects of Art. 25 on the scope of directors' duties

[39] Impact Assessment, at 2, 3.
[40] Summary Report of the Public Consultation, at 6.
[41] European Parliament resolution, *supra* n. 12, at para. Q.
[42] *Ibid.*, at para. 18, 19, 21.
[43] Proposal, at 16. *See* the *Impact Assessment Report, Accompanying the document Proposal*, *supra* n. 38, at 7: "Directors' duties are misinterpreted as requiring short-term financial value maximisation instead of creating long-term value"; "Directors' duty to act in the interest of the company is often unclear". *See also ibid.*, at 9, 21, 24.
[44] *Ibid.*, at 22.
[45] See Lorraine Talbot, *Operationalizing Sustainability in Company Law Reform through a Labour-Centred Approach: A UK Perspective*, 11 Eur. Co. Law 94 (2014), who emphasized the ambiguity of the reference to the "best interests of the company" and proposed replacing it with "labours' interest".

The above analysis has highlighted the predominant interpretation of S. 172 as a codification of already existing principles developed by case law, despite contrary views arguing that it would represent an innovation.[46] Similarly, the recitals to the Commission's Proposal refer to the harmonization of directors' duties as a clarificatory exercise. Yet, it is in practice difficult to argue that Art. 25 does not reform national provisions on the matter.[47] Therefore, after having examined the genesis of the provision and the theoretical discussion leading to its formulation, it is also essential to reflect on its potential effects on Member States if Art. 25 were to be adopted in its current formulation.

Under EU law, "harmonization" encapsulates both the process and the final outcome of bringing already existing rules into accordance. Yet, it may also have a "Preventive" effect, leading to the introduction of new rules previously not previously contemplated by national legal frameworks.[48] In both circumstances harmonization measures would have to comply with the principles of subsidiarity and proportionality under the EU Treaties.[49] In other words, they must be in line with EU objectives and pertain to areas where retaining national provisions would be inadequate for these aims. Any EU measure should not go beyond what is necessary for the stated objective.[50] As regards Art. 25, the Ernst & Young's Report has confirmed that the choice of the Directive as a harmonization tool would ensure the uniform formulation of duties in a more effective way than voluntary initiatives could achieve. At the same time, it would also leave some degree of flexibility at national level in the implementation phase. Similarly, the impact assessment has claimed that retaining national provisions would not be as effective due to the global reach of sustainability issues.[51] The Nordic Company Law Scholars had also reached similar conclusions.[52]

There are arguably several challenges to the harmonizing effect of this provision.

First, the scope of the provision may considerably restrict its applicability. Admittedly, the notion of directors is broadly defined and includes different limited liability company forms, one and two-tier board systems, and also entities which functionally and not formally serve a managerial position like the CFO, the deputy CFO, and "other persons performing similar functions" identified by each

[46] *See* Collins C. Ajibo, *A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory*, 2 Birkbeck L. Rev 37, 49 (2014). Richard Williams, *Enlightened Shareholder Value in UK Company Law*, 35 U.N.S.W.L.J. 360 (2012). Roman Tomasic, *Company Law Modernisation and Corporate Governance in the United Kingdom*, 1 VULJ 43 (2013). Some scholars argued that the codification actually misinterpreted the previous directors' duties under the common law: Jonathan Mukwiri, *Myth of Shareholder Primacy in English Law*, 24 Eur. Bus. Law Rev. 217 (2013). Daniel Attenborough, *Misreading the directors' fiduciary duty of good faith*, 20 J. Corp. Law Stud. 73 (2020).

[47] Proposal, at 16: "Directors' duties also include the clarification of how directors are expected to comply with the duty of care to act in the best interest of the company". *Ibid.*, at 22: "the directors' general duty of care for the company, which is present in the company law of all Member States, is also being clarified providing that when fulfilling their duty to act in the best interest of the company, directors should take into account the sustainability matters of the proposal for a corporate sustainability reporting Directive, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term horizons". *Ibid.*, at 26: "Article 25 clarifies directors' duty of care".

[48] Eva J. Lohse, *The meaning of harmonisation in the context of European union law – a process in need of definition*, in *Theory and Practice of Harmonisation* 284, 291 (Mads Andenas & Camilla Baasch Andersen eds., Edward Elgar Publishing 2012).

[49] Art. 5 of the Consolidated version of the Treaty on European Union, 2012 O.J. (C 326) 13.

[50] *See also*, on "preventive" harmonisation, Case C-377/98 *Netherlands v Parliament and Council* [2001] ECR I-7079, para. 15; similarly, Case C-376/98 *Germany v Parliament and Council* [2000] ECR I-7079, at para. 6.

[51] Impact Assessment, at para 2.

[52] Nordic Company Law Scholars, *supra* n. 9, at 23.

Member State.[53] It is also important to note that it may also apply to "supervisory bodies", which are distinct from the board of directors in two-tier systems.[54] According to Art. 2 of the Proposal, it can also be applicable to companies incorporated under a third country legislation, provided they have certain links with the EU. Nevertheless, the Directive only applies to entities with "more than 500 employees on average and had a net worldwide turnover of more than EUR 150 million in the last financial year" or to entities with "more than 250 employees on average and had a net worldwide turnover of more than EUR 40 million", provided that at least 50% of this net turnover is generated in high-risk sectors like textiles, agriculture, forestry, and others.[55] It is clear that the employees' threshold would cut off a considerable size of the market from the scope of the application of Art. 25.[56] It may also be in practice difficult for Member States to implement the provision in a way that creates a differentiated regime for directors' duties of larger-sized companies and for companies in high-risk sectors than for other types of companies, falling outside the literal scope of the Directive.

Second, the provision on the general fiduciary duty of care of directors is included within a Directive on Sustainability Due Diligence, and therefore it is inevitably framed as instrumental to the latter. Indeed, the Proposal also introduces other obligations on directors and it points out to the "close link with the due diligence obligations", making the harmonization of directors' duties "necessary for the due diligence to be effective".[57] There is also a link to the expected changes to sustainability reporting requirements.[58] Even the Regulatory Scrutiny Board specifically asked why it was necessary to regulate directors' duties separately,[59] and the Commission responded that the current formulation of the Article only retains the elements of directors' duties that would be necessary to fulfil due diligence obligations.[60] However, the extent to which the general directors' duties are in fact instrumental to the specific due diligence obligations is difficult to assess. Therefore, the primary objective of Art. 25, if read within its context, is arguably to require directors to take into account sustainability matters and the interest of the company *as part of their due diligence exercise*.[61] Broader interpretations may be more in line with the Commission's overall intent to promote more sustainable governance practices, but they would not necessarily be required by the Directive.

Third, a remarkable obstacle to the harmonizing effect to the provision would be the possible conflicting implementation options. In particular, the proposed Directive does not give a precise meaning to the notion of company's interest.[62] More importantly, if the Provision was eventually adopted, it could allow Member States to formulate directors' duties both under a ESV-oriented and

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[53] Proposal, Art. 3(o). *See also* the *Impact Assessment Report, Accompanying the document Proposal, supra* n. 38, at iii.

[54] Proposal, Art 3(i). *See* e.g. Art. 2409-octies of the Italian Civil Code.

[55] Proposal, Art. 2.

[56] Johannes Weichbrodt, James Ford & Libby Reynolds, *EU Publishes Draft Corporate Sustainability Due Diligence Directive*, HLS Forum of Corporate Governance, 15 March 2022: "It appears that around 13,000 EU companies and 4,000 non-EU companies would fall within the above criteria".

[57] Proposal, at 16. *See also ibid.*, at 10.

[58] Proposal, at 22 and Recital 63.

[59] Regulatory Scrutiny Board 2nd negative Opinion, *supra* n. 12, at 2.

[60] Commission Staff Working Document, *Follow-up to the second opinion of the Regulatory Scrutiny Board Accompanying the document Proposal*, 23 February 2022, SWD(2022) 39 final, at 46.

[61] *See* Proposal, at 22 and Recital 63.

[62] On the heterogeneity of the definition of company's interest in different EU jurisdictions, *see* the *Impact Assessment Report, Accompanying the document Proposal, supra* n. 38, at 36-37, and the Commission Staff Working Document, *Impact Assessment Report, Annexes, Accompanying the document Proposal*, 28 March 2022, SWD(2022) 42 final, at 153-154.

under a pluralist-oriented approach. In other words, one Member State could arguably still be in line with the Directive by identifying the interest of the company with that of shareholders, as in S. 172, as long as it mandated directors to take into account the other interests. Conversely, it could also identify the company's interest as pluralistic and require directors to balance different interests. If the United Kingdom had still been a Member of the European Union, for instance, the British lawmaker could have implemented the Article without changing the first part of S. 172(1), where it draws an equation between the company's interest and shareholders' benefit, but by adding the subordinated interests of the EU provision not already included in the non-exhaustive list of S. 172. Rather, another provision may have required adjustments due to the reference in Art. 25 to a standard of "care". While S. 172 regulates a standard of "loyalty",[63] it is S. 174 that codifies directors' duty to exercise "reasonable care, skills and diligence".[64] As a consequence, had the UK still been a member of the EU, it would probably have had to reform S. 174 to clarify that directors shall promote the company's interest and, in so doing, they should take the other interests under S. 172 into account.

6. Art. 25(2) and the enforcement of directors' duties

Several scholars have identified the lack of enforcement mechanisms for stakeholders as the main weakness of S. 172:[65] shareholders, and not the other stakeholders, are the "proper claimants"[66] empowered to bring a derivative claim for breach of directors' duties. While other entities like creditors could have a judicial remedy under limited circumstances,[67] other constituencies like employees and civil society could not. Correspondingly, there has only been one (unsuccessful) claim under S. 172 for environmental reasons, yet brought by an NGO in its capacity as a shareholder.[68] The NGO Client Earth has recently threatened Shell to bring a claim grounded on the same provision.[69] The duty is also

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[63] As also clarified in the preparatory works, *see* Company Law Review, at para 2.19, 2.21-2.22.

[64] Guido Ferrarini, Michele Siri & Shanshan Zhu, *The EU Sustainable Governance Consultation and the Missing Link to Soft Law*, ECGI Law Working Paper No. 576/2021, 19 rightly pointed out that "the reference to the duty of care is not entirely appropriate, given that the duty of loyalty is primarily at play when the directors are required to act in the company's interest".

[65] Martin Gelter & Neshat Safari, *British Home Stores collapse: the case for an employee derivative claim*, 19 J. Corp. Law Stud. 43 (2019). Andrew Keay, *Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach'* 29(4) Sydney L. Rev. 577 (2007). Collins C. Ajibo, *A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory*, 2 Birkbeck L. Rev. 37 (2014). Andrew Keay & Hao Zhang, *An Analysis of Enlightened Shareholder Value in Light of Ex Post Opportunism and Incomplete Law*, 8 Eur. Co. Financial Law Rev. 445, 470-474 (2011). Shuangge Wen & Jingchen Zhao, *Exploring the Rationale of Enlightened Shareholder Value in the Realm of UK Company Law - The Path Dependence Perspective*, 14 Int'l Trade & Bus. L. Rev. 153, 159 (2011). Andrew Keay, *Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach*, 29 Sydney L. Rev. 577, 606 (2007). Rosel Tan, *Protecting the Silent Stakeholder: Giving the Environment a Voice within Company Law*, 2018 Bristol L. Rev 27 (2018).

[66] *Foss v Harbottle* (1843) 67 ER 189, (1843) 2 Hare 461.

[67] S. 172(3) states that "[t]he duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company". *See also* S. 214 of the Insolvency Act of 1986 as summarised in Andrew Keay, *The Shifting of Directors' Duties in the Vicinity of Insolvency* 24(2) Int. Insolv. Rev. 140, 143 (2015).

[68] *R (on the application of People & Planet) v HM Treasury* [2009] EWHC 3020.

[69] *See* ClientEarth, *ClientEarth shareholder litigation against Shell's Board FAQs*, March 2022, <https://www.clientearth.org/media/puojyzvy/clientearth-shareholder-litigation-against-shell-s-board-faqs.pdf>, (accessed 3 April 2022). David Gibbs-Kneller, *No Real Prospect for Success: ClientEarth's Derivative Litigation Against the Directors of Shell*, Oxford Business Law Blog, 8 April 2022.

predominantly interpreted as subjective, i.e. courts have predominantly reviewed directors' decisions where they have failed to act in good faith.[70] As a result, commentators have argued that courts are only likely to scrutinize a breach of S. 172 if another constituency has been completely disregarded.[71] Notably, the Ernst & Young's Report emphasized the lack of remedies available to stakeholders across EU jurisdictions when directors breach their duty of care.[72] The Report evaluated giving to stakeholders stronger enforcement mechanisms – including the right to enforce directors' duty to act in the interest of the company for failure to consider sustainability risks and the social impact of companies' operations and value chains.[73] According to the evaluated regulatory option, the claimants were supposed to prove (*i*) a directors' breach of their duty, (*ii*) the damage suffered, and (*iii*) a causal link. The Report posited that the provision would have not only facilitated litigation, but also put pressure on boards to take these interests into account in their daily management activities.[74] In their response to the consultation, the majority of companies have expressed their concerns towards the expansion of enforcement mechanisms.[75] Even academic commentators, including the Nordic Company Law scholars have criticized this proposal due to the incompatibility with national legal frameworks and to the perils of extending legal standing to such a large plethora of stakeholders.[76]
The current wording of the second paragraph of Art. 25 suggests an attempt to reconcile these concerns through a very moderate formulation, requiring Member States to "ensure that their laws, regulations and administrative provisions providing for a breach of directors' duties apply also to the provisions of this Article". If the provision were adopted in its current formulation, it should compel Member States to have judicial remedies in place for cases when directors fail to consider sustainability risks. However, it does not require the introduction of *new* remedies specifically designed for stakeholders. This vague formulation may thus give rise to the same enforcement issues and lack of proceedings observed after the introduction of S. 172. It is true that the design of uniform remedies for stakeholders at EU level may not be in line with general company law and national principles. Yet, it remains that the current wording of the Proposal will have very little effect on the law of Member States concerning the enforcement of directors' duties. Due to its limited harmonizing impact, the practical function of Art. 25(2) is unclear.

7. Conclusions

The Proposed Art. 25 places emphasis on the notion of the "interest of the company" and it mandates a list of subjects that shall be considered by directors in the pursuit thereof. Therefore, despite the apparent similarities between Art. 25 and S. 172, the proposed EU provision seems to deviate from the

[70] *Re Smith & Fawcett Ltd.* [1942] Ch 304.
[71] Joan Loughrey, Andrew Keay & Luca Cerioni, *Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance*, 8(1) J. Corp. Law Stud. 79, 94 (2008).
[72] Ernst & Young's Report, at 147, 148, 152.
[73] *Ibid.*, at 152.
[74] *Ibid.*, at 153; *see also* the Consultation Document Proposal for an Initiative on Sustainable Corporate Governance, Questions 11, 12, 13, 13a.
[75] Summary Report of the Public Consultation, at 6.
[76] Mark J. Roe et al., *supra* n. 9, at 152. Guido Ferrarini, Michele Siri & Shanshan Zhu, *supra* n. 65, at 24. Vanessa Knapp, *supra* n. 35, at 228. Florian Möslein & Karsten Engsig Sørensen, *supra* n. 9, at 12. Nordic Company Law Scholars, *supra* n. 9, at 16.

UK's "Enlightened" conception of directors' duties and to adopt a more pluralistic approach to the definition of directors' duties. Yet its formulation is too vague and it fails to clarify what the interest of the company is. Therefore, its potential to harmonize national laws on directors' duties, and the related enforcement mechanisms, is low. The provision stands out as the last legacy of a long-standing attempt to bring about a remarkable change to corporate practices, but its results are likely to remain largely symbolic.