

False Promise ... Legal Whitewashing!

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Why provisions on directors' duties are unnecessary in a future EU Corporate Sustainability Due Diligence Directive (CSDDD)

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Introduction

In search of sustainable business transformation, the European Union (EU) plans to introduce mandatory corporate sustainability due diligence (also known as human rights and environmental due diligence (HREDD)) requirements for EU and foreign companies operating in the EU. The European Commission (EC) has detailed these requirements in a proposal published in February 2022 (Commission Proposal). On top of due diligence obligations imposed on corporations, the proposal regulates the directors' duty of care, requiring that they 'take into account' sustainability concerns in their deliberations (Article 25). How directors should achieve this is regulated by Article 26, which comprises a director's duty to monitor sustainability issues.

Generally, this is seen as a noteworthy development. At the same time, commentators are on par with one another that the lack of enforcement mechanisms of this duty at the European level risks weakening the provision altogether. I go beyond this. In my opinion, the regulation of directors' duties as proposed should not be supported even by those who deeply care about 'stakeholderism' – and it would be naïve to believe that two such provisions could be an answer to a corporate governance debate as polarised and stalemated as corporate purpose and sustainability. Before discussing this argument further, however, it is worth highlighting the divide within the EU itself on the matter at hand.

Unsettled issue

The provision of directors' duties in the Commission Proposal is perhaps one of the most contentious issues of the initiative within the EU circle and beyond. The EC finds it

‘necessary’ to regulate the conduct of directors concomitantly with HREDD requirements to ensure a ‘close link’ between the two obligations and to clarify and harmonise across Member States the sustainability expectations towards directors. The obligation the proposal lays down to achieve this dual objective is for directors, when pursuing the success of the company, to ‘take into account’ the consequences of their decisions for sustainability matters.

‘Take into account’ is a rather weak formulation as explained *infra*. The draft report of the rapporteur of the Committee on Legal Affairs of the European Parliament (EP) wishes to replace it with strong – and somehow legally enforceable – terms such as ‘integrate’ (amendment to recital 63) and ‘evaluate and address’ (amendment to Article 25). If adopted, this would be revolutionary and go beyond the current requirements of somewhat stakeholder-friendly jurisdictions such as France (civ code, Article 1833; com code art 225-35; 225-64).

The Council of the EU (CE), on the other hand, is against the inclusion of directors’ duties in a future CSDDD. The ‘General Approach’ of the CE (Council Proposal) published in November 2022 in reaction to the draft of the EC removes all provisions dealing with directors’ expectations (including those on variable remuneration) because of ‘strong concerns’ from Member States that regulating the duties of directors at the European level is ‘an inappropriate interference with national provisions regarding directors’ duty of care, and potentially undermining directors’ duty to act in the best interest of the company’ (paras. 26 & 31). What ‘inappropriate’ means in this context is unclear, but an EU-wide intervention in directors’ duties is surely not illegal. The CE covers this question in the proposed directive in the context of measures needed under Article 50 of the TFEU, one of the legal bases of the envisaged CSDDD. The CE explains that the provision does empower the EU lawmaker to adopt measures on directors’ duties.

But even though the director’s duty provision in the Commission Proposal has a legal basis, its added value is questionable, given that the HREDD requirements already include risk management and stakeholder engagement. This point, to which I subscribe, was raised by the Regulatory Scrutiny Board (RSB), an independent body of the EC that advises on the quality of the Commission’s impact assessment reports. One is allowed to hold a value judgement over this body, but I find its criticism warranted. I have reservations too, which I describe next.

Legal whitewashing

Taken in its entirety, the duty, set out in the Commission Proposal, is, first of all, nothing new or special, even for countries with strong shareholder primacy resonance. Second, the ‘take into account’ language of the EC has less legal (and enforceable) added value, and the EP’s alternative is too strong to rally support. Third, supporters of stakeholder welfare may find in the provision a ‘right’, but it is one without remedy – unenforceable.

Primo, since the Non-Financial Reporting Directive from 2014, directors in Europe have, at base, an obligation to report on how they consider sustainability issues in their decisions and, often, there is a clear link between the company’s obligations on these matters and a director’s duty. Some businesses (especially listed companies) have incrementally integrated these considerations as a response to internal or external pressures (such as national regulation, corporate governance codes, investors’ requirements, or the public). Requiring that directors take into account non-shareholder considerations in their deliberation is not new. Perhaps, the Commission Proposal has the merit of saying out loud what everyone else speaks quietly: bringing the topic into even more focus, introducing ‘legal’ obligations that go beyond reporting, with detailed descriptions of what is exactly expected of a director in this regard. Some Member States, too, have similar provisions under statutory or case law. The merit of a CSDDD would be to offer harmonisation on the topic (see Param Nayankumar Pandya). But there is nothing special about its intervention.

A case can be made that a future CSDDD would provide a safe harbour for directors against shareholders' litigation when they heed sustainability issues. For some countries – at least – this would not be new. In France, for example, courts do not sentence directors for failing to maximise shareholder value when they took decisions in the overall company's interest (see this judgement). Even in countries like Germany, where directors can incur personal liability for their investments in sustainability matters when such investments have not resulted in a profit for the company, the Commission Proposal would not make much difference. The benchmark to assess a director's duty of care remains the company's interest as defined in respective national laws, and directors are not expected to pursue an investment that will not benefit the company but other constituents only (see *secundo* below). It is therefore unlikely that a duty of care provision in a future CSDDD would provide a defence to a director in such scenarios.

Secundo, the EC uses the infamous expression 'take into account' to link HREDD with a director's duty of care. If anything, this reflects a 'general concern' rather than a 'specific goal' that must be achieved (French Conseil d'Etat 2018, para. 102). It is a secondary obligation relevant to a director's duty in so far as such matters as the interests of employees, local communities, or the environment (would) affect the company's interests. In the Commission Proposal, when a course of action can result in some stakeholders' interests but not for the company's benefit, the director needs not pursue it as just mentioned. The EC Impact Assessment report accompanying the proposed directive is clear on that matter (p. 76): directors' duties do not go beyond the interest of the company and they do not require the directors to make, for example, environmental investments which are not in the (long-term) interest of the company (even if such investments would provide a general benefit).

In effect, the director's duty provision acts as a qualifier to the general HREDD requirement. I can, perhaps at my own risk, summarise the Commission's approach as imposing a sustainability obligation on companies, but directors need to enforce it only so long as doing so would benefit the company.

Furthermore, in countries such as France, criminal liability of directors carries more weight than, and is often preferred to, civil liability. Though, the expression 'take into account' is too general to warrant criminal liability in case of a breach. The alternative wordings that the EP tables ('integrate', 'assess and address') denote particular goals expected of directors and could make them directly accountable for sustainability matters. A similar approach (*tenir compte*) was once proposed by the French Parliament, but it was deemed 'stronger and stricter' and ultimately abandoned (see here and here). A somewhat lighter wording, 'considering' (*en considérant*), was censored by the French Conseil d'Etat, which preferred it to 'taking into account' (*en prenant en considération*) as the issue is more of a general preoccupation than a precise goal. Considering the fate of these legislative initiatives in France, it is quite unlikely that the EP's proposition will prevail on the EU level. 'Take into account' would be the compromise – if there is a compromise on this issue at all. In this case, the acclaimed introduction of said directors' duty in the proposal would bear little value.

Tertio, there is the enforceability of the duty. The Commission Proposal does not derogate from corporate law mechanisms that solely entrust shareholders and the company's representatives, with just a few caveats, with the right to bring proceedings in case of a director's breach of duty. But if the predictions of the EC in its impact assessment report are correct, this can lead to some unintended consequences. According to the EC, a future CSDDD would require directors to increasingly consider stakeholder interests in their decision-making. It goes on that this, in turn, would prompt more interest from shareholders, who would become more engaged with the company. If this is true, the director's duty provision will serve as a wake-up call to shareholders to eliminate competition to ensure that the interests of other stakeholders do not supersede theirs. If shareholders saw other stakeholders as competitors, as mentioned, it would be naïve to expect that they enforce a breach of the director's duty of care for failing to consider sustainability issues. We risk seeing more cases arguing that a director's decision on

sustainability was against the company's interests rather than the opposite.

Conclusions

It becomes largely unnecessary to add directors' duties in *this* directive. It is unclear how it helps supporters of stakeholder welfare other than shareholders. If care is not taken, the inclusion of the duties of directors in the planned directive can lead to corporate purpose and sustainability becoming a 'settled issue ... neglected question'. It would seduce us away from a profound re-imagination of the role of the corporation – particularly the role of its 'officers'—in society. This, I think, requires a robust approach to EU company law –as opposed to two add-on provisions in firm-wide legislation –revisiting the duties of directors with consequences on shareholders' rights, third-party standing, and public enforcement.

For now, the HREDD provisions, which require risk management and engagement with stakeholders, can be self-sufficient to change directors' duties in the desired direction. The corporate legal requirement also provides a safe harbour to directors against liability. The German Supply Chain Act 2021 teaches us this lesson. German commentators are confident that the law, by imposing a sustainability obligation on companies, creates – without a specific provision on directors' duties – a sustainability judgement rule that will shield directors from liability. A future CSDDD can still meet its primary objective – to prevent and mitigate adverse impacts on human rights and the environment – without the contentious yet 'abstruse' and unnecessary provisions on directors' duties.

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