

# Company law: the corporate board and mandatory sustainability due diligence

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## Company law is no holy cow

Mandatory sustainability due diligence should not be disconnected from company law. Such a disconnect reinforces the treatment of company law as a holy cow in the regulatory field, which cannot be touched while all other areas of law around the company is gradually seeing changes to promote corporate sustainability.

To leave company law out of the equation would make it more difficult to include the core role of the corporate board in due diligence. Rather, due diligence should be seen as an integral aspect of reformed duties for the corporate board, to ensure that companies mitigate the risks of unsustainability – for the sake of the company itself and for society. Any true improvement in this area needs to directly and explicitly include the role of the corporate board.

Otherwise we risk repeating the mistake committed through decades of various initiatives based on ideas of reflexive theory, where different forms of sustainability reporting (CSR reporting; non-financial reporting, etc.) have intended to influence the decision-making of the board without regulating directly. Experience has shown that this has had limited effect and is insufficient to close the gap between what boards see as their duty and what the company is asked to do.

## The legal myth of shareholder primacy

Company law itself obviously does not say that companies should be governed in a way

that undermines the possibilities for a sustainable future by exploiting people, destroying the environment and undermining the economic bases for resilient societies. Yet, this is what is happening today.

One reason is the still very strong social norm of shareholder primacy. I use this term, drawing on multijurisdictional comparative analysis in several projects, as a short form for a range of complex interactions between economic incentives and financial market expectations of companies. This social norm has become so strong that it has become a legal myth. Therefore, many think that companies are the property of shareholders, and that the duty of the board is to maximise returns for shareholders. The result is an extreme externalisation of the responsibility for social, environmental and economic harm committed by companies through their global value chains.

As long as that social norm is left unchallenged, any kind of norm sets around the company, any expectations of what they should report on, any kind of standards or guidelines or principles, which increasingly and more strongly are arguing that the company should internalise the interests of society and environment, will have limited effect.

To close the gap between what boards and senior management think is their main job and societal expectations of business transitioning towards sustainability, we need to include the role of the corporate board. As Stephen Turner explains, it has to be hard law. We have to show, finally, that sustainability is as important as the financial governance of the company: that we take people and the environment as seriously as we for decades have been taking financial issues.

### **From human rights due diligence to sustainability due diligence**

Mandatory sustainability due diligence, as hard law regulation of the duties of the board, will be a key tool for corporate governance, for risk management for the company itself – and for society. We owe thanks to the UN Guiding Principles for Business and Human rights (UNGPs), for informing much of the debate on mandatory due diligence. With that backdrop, it is natural that much of discussion has been and still is about human rights due diligence.

Yet, protection of human rights and securing company respect for human rights will have limited effect if we don't work more broadly to secure sustainability. The grand challenge of our time is to secure the social foundations for humanity now and for the future within planetary boundaries. And these are interconnected issues: it's not possible to pick out one part to say 'let's mitigate climate change first and then look at biodiversity and water and land use' and also it's not possible to say 'let's protect human rights first and then protect the very basis of our existence'. So it has to be *sustainability* due diligence and it has to be mandatory.

### **A level playing field and legal certainty**

Sustainability due diligence as hard-core company law responds to the call for a level playing field from businesses that are trying to contribute to the transition to sustainability. It also provides legal certainty for all involved and for those affected within and outside of the company.

What companies meet today in their globalised activities is a very fragmented and chaotic picture of some national sector-based rules on due diligence, some reporting requirements, increasing societal expectations, and guidelines and principles in various forms. Without a level playing field consisting of mandatory rules and enforcement, it may even be irrational for a company to do a full due diligence and be open about what they

find, because they may then look worse than their competitors who are still getting away with greenwashing, blue washing or SDG washing (the latter referring to the UN Sustainable Development Goals).

For all these reasons we need sustainability due diligence as a key part both of a corporate duty and a duty for the corporate board to ensure that the company creates sustainable value within the limits of our planet.

### **Corporate duty and a duty of the corporate board**

Setting out mandatory sustainability due diligence as a *corporate duty* is important because it places the onus on the legal entity that has a potentially everlasting life. This opens up for public and private enforcement in various ways. However, just having a corporate duty has very strong limitations. Notably, we will then not manage to close this gap between what companies are expected to do and even mandated to do, and what corporate boards, and by extension senior management, see as their duty to do in their governance of the company.

For that reason, to actually operationalise this and to give legal certainty to those on boards and in senior management, this should also be very clearly spelled out as a *duty for the corporate board*. This would entail, as is the norm in company law, that it is a duty for the board as a collective organ, with potential liability individually for the members of the corporate board.

Contrary to what some may wish to claim, this is not opening up for totally new possibilities for companies and members of their boards to be sued. Rather it would be a contribution to bringing into more foreseeable forms the international trend of lawsuits against companies for environmental and human rights harms, which illustrate the growing lack of acceptance of the status quo of corporate *unsustainability*. While it is crucial that due diligence does not act as a safe harbour or devolve into box-ticking exercise, proper compliance with a mandatory sustainability due diligence regime will serve as a potential defence for the company and its board.

### **Situating mandatory due diligence in a thoughtfully formulated reform**

A duty for the corporate board to undertake mandatory sustainability due diligence should be a part of a well thought-through legal reform.

It should be spelled out explicitly for the board that its duty is to promote the interest of the company. This is what company law, usually implicitly, requires across jurisdictions. However, because of the social norm of shareholder primacy, which has developed into this myth that board members are agents for the shareholders and should maximise their returns, it would be a valuable clarification to put into company law that the duty is to promote the interest of the company.

To promote the transition of business towards a sustainable future, this should be formulated so that it sets out that the board shall promote the interests of the company in a way that creates sustainable value within planetary boundaries. Further, it should be stipulated that this means setting a sustainable value creation strategy for the whole business of the company, encompassing its global value chains, assessing the business model of the company and adjusting or changing it where and when necessary. Sustainability due diligence should be included as a clearly spelled out mechanism for the board to be able to do its job.

### **Clicking into place a missing piece of corporate sustainability**

Reforming company law means putting into place a missing piece in the jigsaw puzzle of corporate sustainability. The success of the EU's Sustainable Finance Initiative relies on investors, fund managers and banks being able to reliably assess the sustainability of their clients, their investments or project plans. This is not possible without reliable and relevant information from companies. This is recognised in the EU Commission's preparation of the reform of the so-called Non-Financial Reporting Directive – now more appropriately named in the proposal as a Corporate Sustainability Reporting Directive. Although this major step towards corporate sustainability reporting is positive, it needs the connection with hard-core company law to realise its potential.

Without company law, it is not only sustainable finance that risks failing. The entire EU Green Deal, with its various initiatives, aiming to influence production and consumption so that they become more sustainable, cannot realise its potential unless we connect the other pieces with the rules governing the key decision makers in companies. Ultimately, it is about securing a sustainable future for us all.

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