AARHUS UNIVERSITY

Coversheet

This is the accepted manuscript (post-print version) of the article.

Contentwise, the post-print version is identical to the final published version, but there may be differences in typography and layout.

How to cite this publication

Please cite the final published version:

Möslein, F., & Sørensen, K. E. (2018). The Commission's Action Plan for Financing Sustainable Growth and Its Corporate Governance Implications. *European Company Law*, 15(6), 221-231.

Publication metadata

Title:	The Commission's Action Plan for Financing Sustainable Growth and Its Corporate Governance Implications
Author(s):	Möslein, F., & Sørensen, K. E.
Journal:	<i>European Company Law</i> , 15(6), 221-231
DOI/Link:	http://www.kluwerlawonline.com/document.php?id=EUCL2018032
Document version:	Accepted manuscript (post-print)

General Rights

Copyright and moral rights for the publications made accessible in the public portal are retained by the authors and/or other copyright owners and it is a condition of accessing publications that users recognize and abide by the legal requirements associated with these rights.

- Users may download and print one copy of any publication from the public portal for the purpose of private study or research.
- You may not further distribute the material or use it for any profit-making activity or commercial gain
- You may freely distribute the URL identifying the publication in the public portal

If you believe that this document breaches copyright please contact us providing details, and we will remove access to the work immediately and investigate your claim.

The Commission's Action Plan for Financing Sustainable Growth and its Corporate Governance Implications

By Professor Dr. Florian Mösslein, Philipps-University Marburg and Professor, Dr. jur., Karsten Engsig Sørensen, Aarhus University

With the adoption of the Action Plan 'Financing Sustainable Growth' that was published by the Commission in March 2018, the Commission is taking a range of steps towards encouraging listed companies to conduct their business in a more sustainable or long-term oriented manner. In fact, this is not a new policy, as similar policy goals were evident in the Directive on Non-financial Reporting (Directive 2014/95) and the revised Shareholder Rights Directive (Directive 2017/828). We show that many elements of the Action Plan are intended to have an impact on the governance of listed companies and even touch on core company law issues. After analysing those elements of the Action Plan that aim at affecting corporate governance in listed companies, we conclude that the Commission's new proposal is different in at least three respects from earlier initiatives with a similar aim: (1) its scope is broader, due to the Action Plan's focus on the financial market as a whole, (2) its regulatory instruments are more diverse and (3) its regulatory intensity is less soft.

1. Introduction

With the adoption of the Directive on Non-financial Reporting (Directive 2014/95) and the revised Shareholder Rights Directive (Directive 2017/828), the European Union (EU) took initial – subtle – steps towards encouraging listed companies to conduct their business in a more sustainable or long-term oriented manner.¹ This regulatory strategy can largely be qualified as 'soft regulation', with many instruments not being of a mandatory nature, but rather taking the form of simple nudging. With the adoption of the Action Plan 'Financing Sustainable Growth' that was published by the Commission in March 2018, the agenda of corporate sustainability will be pursued further. Regulatory intensity, however, is likely to increase. While the regulatory aim resembles that of the previous directives, the regulatory instruments proposed by the current Action Plan are more multifaceted and less 'soft'.

In accordance with its title, the Action Plan's primary focus is on financial markets. Therefore, it will have an impact on the various actors in European financial and capital markets. Concurrently, the Action Plan's explicit aim is "to reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth"; the reoriented flow of capital will effectively influence how listed companies are managed.² Since financial resources are among the crucial ingredients for business, companies will be offered (additional) incentives to make their businesses more sustainable, including by adjusting their corporate governance framework. To be more precise, the addressees of such incentives are not the companies themselves, but various corporate actors. After all, the former are legal, artificial persons whose behaviour is ultimately steered by human stakeholders. As a result, regulation needs to address key corporate actors such as management and shareholders, incentivizing them to engage in running their companies more

¹ Hereinafter 'sustainable'. As discussed in section 3, the terms 'sustainable' and 'long-term' are frequently used together and partly overlap.

² Action Plan, COM(2018) 97 p. 2.

sustainably.³ The Action Plan even includes proposals that qualify as core company law.⁴ Consequently, a thorough company law analysis is required. The focus of this paper will thus be on the Action Plan's relevance for listed companies and their corporate governance, rather than on its financial market implications.⁵

We will examine the aspects of the Action Plan that are most likely to affect the governance of listed companies. After focusing on the background of the Commission's proposals and the complex problem of developing a taxonomy for sustainability, we will analyse how the Commission intends to incentivize shareholders (investors) and management, setting the respective proposals within the context of earlier initiatives that work towards the same end. We will also briefly touch on how the Commission may attempt to encourage other stakeholders. Finally, we will discuss some wider implications of the Action Plan.

2. Background to the Action Plan

The Action Plan's declared starting point is the adoption of the Paris Agreement on climate change and the adoption of the UN 2030 Agenda for Sustainable Development in 2015.⁶ Both international documents have influenced the general European policy agenda, namely by flowing into many of the Commission's priorities for 2014-2020⁷ and by triggering the Commission's ongoing work on a Reflection Paper 'Towards a Sustainable Europe by 2030'.⁸ With respect to financial markets, the Commission appointed a High-Level Expert Group on sustainable finance at the end of 2016, which published its final report on 31st January 2018.⁹ The Commission responded frantically by adopting its Action Plan only two months later and by publishing the first three related proposals just two months after that, in May 2018.¹⁰ In addition, a consultation on the amendments of existing acts has already been carried out and a technical expert group on sustainable finance has been set up.¹¹ These timely steps comply with the very ambitious work plan and timetable set out in the Action Plan.¹²

More fundamentally, this rapid legislative activity relates to the (alleged) urgency of the subject matter. In dramatic fashion, the Action Plan refers to the "catastrophic and unpredictable consequences of climate change and resource depletion"¹³ and stresses the urgency of actions several times. Accordingly, "sustainability and the transition to a low-carbon, more resource-efficient and circular economy" constitute its primary policy goals.¹⁴ These goals have their constitutional roots in several provisions of EU treaties. In particular, Art. 3(3) Treaty on the Functioning of the European Union (TFEU) prescribes not only that the Union shall "establish an internal market", but also that it shall equally "work for the sustainable

³ For a comprehensive analysis of nudging in the realm of company law, see, e.g., Florian Möslin & Karsten Engsig Sørensen, *Nudging for Corporate Long-termism and Sustainability? Regulatory Instruments from a Comparative and Functional Perspective*, 24 Columbia Journal of European Law, 429 (2018).

⁴ For instance, it proposes actions that directly address how directors should incorporate sustainability in the governance of the listed company, see section 5 below.

⁵ The proposal is part of an even more comprehensive EU package to achieve the EU's climate and sustainable development, see references in COM(2018) 354 p. 4.

⁶ Action Plan, COM(2018) 97 p. 1, with further references in n. 1 et seq.

⁷ For a specific enumeration of the respective priorities, see, e.g., Action Plan, COM(2018) 97 p. 1, n. 4.

⁸ As announced in the Commission Work Programme 2018, COM(2017) 650, Annex 1, p. 2 (due in Q2, 2018).

⁹ The report is available at https://ec.europa.eu/info/publications/180131-sustainable-finance-report_en.

¹⁰ Proposal for a regulation on the establishment of a framework to facilitate sustainable investment, COM(2018) 353; Proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341, COM(2018) 354; Proposal for a regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks, COM(2018) 355.

¹¹ For further information, see https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en.

¹² Action Plan, COM(2018) 97 p. 16 et seq.

¹³ Action Plan, COM(2018) 97 p. 1.

¹⁴ See again Action Plan, COM(2018) 97 p. 1.

development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment”.¹⁵ Therefore, in accordance with its financial markets focus, the Action Plan aims to increase investment in sustainable activities in order to “transform Europe’s economy into a greener, more resilient and circular system”.¹⁶

However, the target is not limited to reducing our environmental footprint on the planet. Concurrently, the Commission aims to address existing inequalities and stresses that the Action Plan “will also boost competitiveness by improving the efficiency of production processes and reducing the cost of accessing and managing resources”.¹⁷ It is clear that environmental, social and economic goals are not considered to contradict each other, but to complement each other. The same consideration becomes apparent in the title of the Action Plan, with its combination of the terms ‘sustainable’ and ‘growth’. Whether realistic or not, this reconciliatory approach has its legal origins in Art. 3(3) TFEU, which similarly juxtaposes these (and additional, manifold) different goals. From an economic perspective, this approach comes close to arguing the ‘business case’ by which sustainable performance correlates with better financial performance. If investors acknowledge this business case, the imminent gulf between shareholder value maximization and sustainable corporate behaviour would close, since the latter would simply contribute to the former. In that case, the benefits of pursuing a sustainability agenda would be obvious, including for profit-maximizing investors. The Commission argues for such a business case, not only in the present Action Plan, but also in previous, concordant initiatives.¹⁸ Even though there are some arguments in favour of this business case, it seems that empirical evidence is still lacking that supports its existence for companies in general.¹⁹ Moreover, based on findings from the natural sciences on non-negotiable planetary boundaries within which all human activity must be positioned to ensure a safe operating space for humanity, environmentally conscious legal scholars claim that a ‘business case’ approach to sustainability does not go far enough; instead, they advocate for a ‘strong sustainability’ approach.²⁰ The present Action Plan clearly follows a different path. Even though it is moving from purely voluntary corporate social responsibility standards to proper regulation, it mainly does so in the form of nudging and other soft regulatory approaches.²¹

3. Developing an EU sustainability taxonomy

The keyword of the Action Plan on Financing Sustainable Growth is, of course, the term ‘sustainability’. The word itself is already more than 200 years old, but has been revived in particular by the UN since its Conference on the Human Environment in 1972.²² In general, the term expresses the idea “that renewable

¹⁵ For a comprehensive analysis, see, e.g., Nicolas de Sadeleer, *EU Environmental Law and the Internal Market*, 15 et seqs. (2014).

¹⁶ Action Plan, COM(2018) 97 p. 2.

¹⁷ Action Plan, COM(2018) 97 p. 2.

¹⁸ Action Plan, COM(2018) 97 p. 3. Previous ‘business case’ references can be found in the impact assessment presented by the Commission in preparation for the Directive on Non-financial Reporting, see *Commission Staff Working Document Impact Assessment, Accompanying the Document Proposal for a Directive of the European Parliament and of the Council*, at 18, SWD (2013) 127 final (Apr. 16, 2013), with references to literature indicating such a correlation, as well as in the impact assessment presented for the revised Shareholder Rights Directive, see *Commission Staff Working Document Impact Assessment, Accompanying The Document Proposal for a Directive of the European Parliament and of the Council*, at 47, SWD (2014) 127 final (Apr. 9, 2014).

¹⁹ See, e.g., Philipp Schreck, *The Business Case for Corporate Social Responsibility: Understanding and Measuring Economic Impacts of Corporate Social Performance* (2009); Oliver Salzmann et al., *The Business Case for Corporate Sustainability: Literature Review and Research Options*, 23 EUR. MGMT. J. 1, 27 (2005).

²⁰ Cf. in particular Beate Sjafjell & Christopher Bruner, Introduction, in: ids. (eds.), *Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, (2019).

²¹ On these different patterns of regulatory intensity, see Florian Möslin & Karsten Engsig Sørensen, 24 *Columbia Journal of European Law*, 429, 476 et seqs. (2018); see also Iris Chiu, *An Institutional Theory of Corporate Regulation*, 71 *Current Legal Problems* (2018).

²² United Nations, *Report of the United Nations Conference on the Human Environment* (1973), in particular at p. 45.

resources shall only be used to the extent to which they will naturally be able to grow back”.²³ In a corporate context, the sustainability approach implies that the interests of different stakeholders in the company, including general societal interests, are taken into account. The approach thus contradicts with the traditional shareholder value paradigm, at least to the extent that shareholders do not entirely incorporate these other interests into their own preferences (as the ‘business case’ approach implicitly assumes).²⁴

3.1. From vagueness...

While sustainability is increasingly discussed among legal scholars, the term as such is only rarely used in legislation, at least in the realm of company law. In previous EU initiatives, there are a few references to sustainability, but usually without any precise definition. In particular, sustainability is mentioned several times in the preamble to the Directive on Non-financial Reporting. The closest approximation to a definition forms part of Recital 11, according to which the directive aims to “[manage] change towards a sustainable global economy by combining long-term profitability with social justice and environmental protection”.²⁵ However, this wording does not go far beyond evidencing the reconciliatory approach, in a very similar manner to Art. 3(3) TFEU and the title of the present Action Plan. In the revised Shareholder Rights Directive, the term ‘sustainability’ is also used several times, namely in Article 9a and in the preamble to the directive, but again, the term is not properly defined.

Apart from evidencing the reconciliatory approach, the approximate definition in the Directive on Non-Financial Reporting predominantly links sustainability and long-termism. The same link is established in the new Action Plan, which explicitly states that “sustainability and long-termism go hand in hand.”²⁶ Similarly to sustainability, however, ‘long-term’ is a term without specific meaning.²⁷ Apart from often being described as the opposite of ‘short-term’,²⁸ it is not clearly defined in any of the previous EU acts.²⁹ Nonetheless, the vagueness of this previous legislation did make some sense, since these initiatives at least implicitly accepted that sustainable performance is likely to differ from company to company, depending on their activities and their stakeholders. Therefore, the legislative intention was to be decidedly open, in order to leave the specification of sustainability aims to the companies themselves and to simply encourage them to “do their best”. In accordance with that intention, the regulatory intensity was necessarily limited to a soft law approach, with the mere aim of nudging companies in the general direction of sustainability.³⁰

3.2. ... to clarity?

With the Action Plan, the Commission adopts a new position. It advocates a “unified EU classification system – or taxonomy – [that] will provide clarity on which activities can be considered ‘sustainable’”.³¹ The need for such legislative specificity is not only due to the increase in regulatory intensity, but also has to do with the Action Plan’s financial market orientation. In financial markets, transparency is key, and if the flow of capital

²³ Gundula Deipenbrock, *Sustainability Rating – Approaching the Legal Perspective*, 9 Int’l & Comp. Corp. L.J. 18, 21 (2012).

²⁴ For an attempt to reconcile both concepts, see Judd Sneirson, *Green Is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance*, 94 Iowa L.R. 987 (2009); on the other hand, arguing that shareholder value thinking leads managers to focus myopically on short-term earnings, see Lynn Stout, *The Shareholder Value Myth* (2012).

²⁵ In more detail on this recital, see Jean Jacques du Plessis et al., *Principles of Contemporary Corporate Governance*, 318 (4th ed. 2018).

²⁶ See Action Plan, p. 3.

²⁷ Cf., e.g., Markus Roth, *Corporate Boards in Germany*, in: Paul Davies et al. (eds.), *Corporate Boards in European Law*, 353, 359 (2013).

²⁸ See also Action Plan, p. 4.

²⁹ In more detail, see Florian Möslin & Karsten Engsig Sørensen, 24 Columbia Journal of European Law, 429, 431 (2018).

³⁰ See again Florian Möslin & Karsten Engsig Sørensen, 24 Columbia Journal of European Law, 429, 431 (2018).

³¹ Action Plan, p. 4.

is to be reoriented towards sustainable investment, sustainability needs to be clearly identifiable for investors. Therefore, proposing an EU sustainability taxonomy counts among the first steps in implementing the Action Plan; in May 2018, the Commission proposed a regulation on the establishment of a framework to facilitate sustainable investment.³² Even though the proposal is just the first measure of what is explicitly described as a “step-by-step approach”,³³ it already indicates the general framework both in substantive and in methodological terms and it will certainly create future path dependencies. The respective criteria will not only have an impact on corporate disclosure and the marketing of financial products and corporate bonds,³⁴ but they are also likely to serve as a basis for the future labelling scheme for sustainable financial products that the Action Plan announces.³⁵

3.2.1. Environmental sustainability

With respect to the relevant yardstick, the taxonomy takes a much more specified approach than previous legislation. As indicated in the Action Plan, its focus is on “climate change mitigation and adaption activities and some environmental activities”.³⁶ Accordingly, Art. 5 of the regulation proposal on the establishment of a framework to facilitate sustainable investment specifies six environmental objectives: (1) climate change mitigation, (2) climate change adaptation, (3) sustainable use and protection of water and marine resources, (4) transition to a circular economy, waste prevention and recycling, (5) pollution prevention and control and (6) protection of healthy ecosystems. Among these objectives, a certain progression becomes apparent in Art. 18 of the same proposal, which provides three different dates for their respective application (with (1) and (2) ranking the highest, to be applied from 1st July 2020). More specific technical screening criteria will be defined by the Commission in future delegated acts.³⁷ Their establishment will be advised by a Platform on Sustainable Finance composed of representatives from relevant European institutions (such as the European Supervisory Authorities) and private stakeholders.³⁸ In addition, the Commission has set up a technical expert group,³⁹ which will review the criteria and their implementation on a regular basis.⁴⁰

In any event, the taxonomy’s focus is clearly on environmental issues, whereas social aspects of sustainability play a subordinate role. Social aspects are at least referred to in the provision on minimum safeguards that economic activities must comply with.⁴¹ In addition, the Commission aims to include additional forms of sustainability by announcing that in a second step, “the taxonomy will cover remaining environmental and social activities”.⁴² Whether and when this additional step will be taken, however, remains unclear. Both path dependencies and political pressures could ultimately prevent the Commission from doing so. As a result, the substantive focus would remain on environmental sustainability.

3.2.2. Economic activities

With respect to the subject matter, on the other hand, the proposal’s focus is on ‘economic activities’, not on companies or financial products. In order to qualify as sustainable, economic activities must substantially contribute to one or more of the objectives specified in Art. 5, according to the ‘white list’ in Arts. 6 to 11.

³² COM(2018) 353.

³³ Action Plan, p. 4; see also recitals 22, 33 and 35 of the Regulation Proposal.

³⁴ See Arts. 4(1) and (2) of the Regulation Proposal.

³⁵ Action Plan, p. 4 et seq.

³⁶ Action Plan, p. 4.

³⁷ See Arts. 6(2), 7(2), 8(2), 9(2), 10(2), 11(2), 14 and 16 of the Regulation Proposal.

³⁸ In detail, see Art. 15 of the Regulation Proposal.

³⁹ See Action Plan, p. 4 and the reference in n. 11 above.

⁴⁰ Art. 17 of the Regulation Proposal.

⁴¹ Art. 13 of the Regulation Proposal.

⁴² Action Plan, p. 4.

Moreover, they must not significantly harm any of these objectives, according to the ‘black list’ in Art. 12. In addition, the activity in question needs to be carried out in compliance with the minimum safeguards laid down in Art. 13, ensuring that fundamental rights and principles at work – as declared by the International Labour Organization –⁴³ are observed when the economic activity in question is carried out.

The key methodological question in this activity-centred approach is how the assessment of economic activities links to the qualification of companies or (their) financial products. Whereas under the reporting system for non-financial information companies still enjoy discretion to self-qualify their activities, they will be bound by the Regulation’s qualification in regard to their financial products or corporate bonds that are marketed as environmentally sustainable.⁴⁴ Moreover, the taxonomy’s focus is on the kind of economic activity, not on the manner in which this activity is performed. It aims to classify activities as sustainable or non-sustainable, obviously in a strictly binary – not gradual – manner.⁴⁵ While this approach has the clear advantage of being more objective and preventing companies from greenwashing, i.e., blurring the fact that their activities are fundamentally unsustainable,⁴⁶ it also reduces the incentives for companies in their respective economic sectors to act as sustainably as possible. More importantly, this approach even features a certain affinity towards planned economies, since it directs companies to pursue certain activities and to refrain from pursuing others.

Complex methodological problems may arise if companies (or issuers) conduct several different types of economic activities. In fact, companies often do so with the objective of diversifying their business portfolios, in order to become independent of specific, activity- or product-related market trends.⁴⁷ Some of these activities may be sustainable, while others are not. Since the taxonomy relates to activities, but ultimately seeks to address the marketing of financial products or corporate bonds, a weighting of companies’ different economic activities will be necessary. Art. 4(3) of the Regulation Proposal seems to suggest that the degree (“percentage”) of sustainability should be indicated, although it leaves the details to future delegated acts. One could, for instance, calculate the proportion of turnover that originates from sustainable activities. However, defining precise weighting factors could prove difficult and might well require sector-related differentiations. In any event, such weighting is likely to result in grading financial products into different degrees of sustainability (rather than maintaining the binary sustainable or non-sustainable differentiation as applied to economic activities).⁴⁸ In order to avoid downgrading, mixed companies might consider splitting their activities in order to raise money exclusively for the sustainable activities, for instance by issuing specific types of bonds. While traditional company law does not require capital raised by issuing bonds to be earmarked for specific activities, companies can choose to do so, for example by creating special purpose

⁴³ International Labour Organization, Declaration on Fundamental Principles and Rights at Work and its Follow-up, adopted by the International Labour Conference at its Eighty-sixth Session, (Geneva, 18 June 1998), available at <http://www.ilo.org/declaration/thedeclaration/textdeclaration/lang--en/index.htm>.

⁴⁴ See Art. 1(2)(a) of the Regulation Proposal.

⁴⁵ By differentiating between the environmental sustainability of an economic activity and “the degree of environmental sustainability of an investment”, Art. 1(1) of the Regulation Proposal clearly points in this sense. Cf. also the wording of Arts. 3 and 4(1) of the Regulation Proposal.

⁴⁶ See recital 9 of the Regulation Proposal and also Action Plan, p. 7 (with a definition in n. 26: “The use of marketing to portray an organisation’s products, activities or policies as environmentally friendly when they are not”). In general, see Frances Bowen, *After Greenwashing: Symbolic Corporate Environmentalism and Society* (2014).

⁴⁷ In more detail on underlying strategic considerations, see, e.g., Graham Kenny, *Diversification Strategy: How to Grow a Business by Diversifying Successfully* (2009).

⁴⁸ The requirement to identify “the percentage of holdings pertaining to companies carrying out environmentally sustainable activities” as well as “the share of investment funding environmentally sustainable economic activities as a percentage of all economic activities”, as provided for in Arts. 4(3)(a) and (b) of the Regulation Proposal, point in this direction.

vehicles.⁴⁹ By that token, the taxonomy may ultimately affect the business strategies of companies with mixed activities, namely by compelling them to separate their various economic activities into different companies under a group structure, similarly to the separation of activities in the banking and insurance businesses (so-called ‘ring-fencing’), and with all its consequential problems.⁵⁰

4. Incentivizing shareholders

Shareholders are a diverse group and may have different values.⁵¹ However, based on the assumption that at least some shareholders are disinclined to think sustainably, adjusting their focus may be possible if these shareholders are given an incentive to take this step. The last financial crisis is usually considered an argument for imposing such incentives, as it seems to confirm that a number of shareholders think in the short-term. For instance, the Commission’s 2011 Green Paper on Corporate Governance stated, “the corporate governance framework is built on the assumption that shareholders engage with companies and hold the management to account for its performance. However, there is evidence that the majority of shareholders are passive and are often only focused on short-term profits. It therefore seems useful to consider whether more shareholders can be encouraged to take an interest in sustainable returns and longer-term performance, and how to encourage them to be more active on corporate governance issues.”⁵²

The new Action Plan follows the same line of thinking. Most of the proposals seemingly build on the core idea of incentivizing shareholders. In accordance with the 2011 Green Paper, the ultimate aim is again for shareholders – duly incentivized – to use their influence to ensure that the management of listed companies acts sustainably. Therefore, the policy is closely linked to the efforts to enhance shareholder activism. However, it is debatable whether incentivizing shareholders in this way can change the way companies are governed. Nonetheless, it is a policy that the Commission has pursued for some years now and it appears that the Commission still believes it will work.⁵³

The current proposals either aim to incentivize shareholders in general or they target particular shareholders more specifically.

4.1. Incentivizing shareholders in general

The most prominent example of an effort to incentivize shareholders in general to invest sustainably is the duty for certain large undertakings to publish non-financial statements, as introduced by the Directive on Non-Financial Reporting. Shareholders are among the primary addressees of non-financial statements.⁵⁴ In the consultations that the Commission conducted before proposing this new regime, most respondents

⁴⁹ In general on this strategy (and its risks), see, e.g., Eilís Ferran and Look Chan Ho, *Principles of Corporate Finance Law*, 23 (2nd ed. 2014); Petri Mäntysaari, *The Law of Corporate Finance*, vol. 2, p. 354 et seq. (2010). Such vehicles were at the origin of Enron’s notorious collapse, cf. Steven L. Schwarcz, *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, University of Cincinnati Law Review 70, 1309 (2002).

⁵⁰ In detail, see, e.g., Steven L. Schwarcz, *Ring Fencing*, Southern California Law Review 87, 69 (2013); with respect to European banking regulation, see Jens-Hinrich Binder, *To ring-fence or not, and how?*, in: Horst Eidenmüller, Mathias Habersack and Lars Klöhn (eds.), *European Banking Regulation* (to be published in 2019, preprint available at <http://ssrn.com/abstract=2543860>); Florian Möslin, *Die Trennung von Wertpapier- und sonstigem Bankgeschäft: Trennbankensystem, ring-fencing und Volcker-Rule als Mittel zur Eindämmung systemischer Gefahren für das Finanzsystem*, ORDO Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft 64, 349 (2013).

⁵¹ See Lynn A. Stout, *New Thinking on Shareholder Primacy*, 2 ACCT., ECON. & L. 1, 5 (2012); Andrew Keay, *Shareholder Primacy in Corporate Law*, 7 EUR. COMPANY & FIN. L. REV. 369, 406 (2010).

⁵² See COM(2011) 164 p. 3.

⁵³ On the background and merits of this policy, see several of the contributions of Hanne S. Birkmose: *Shareholder’s duties*, Kluwer Law International (2017).

⁵⁴ Or ‘investors’; see Directive 2014/95/EU, rec. 3.

agreed that the previous disclosure regime made it difficult to benchmark non-financial performance. The Directive on Non-Financial Reporting tried to overcome this transparency problem by suggesting a (loose) format for reporting on non-financial information. The Commission tried to improve this format in 2017 by adopting the ‘Guidelines on non-financial reporting (methodology for reporting non-financial information)’.⁵⁵ Nonetheless, the Commission still appears to assume that the reporting framework is not working. While the present Action Plan states that the directive allows companies to report in a “flexible manner”, it claims that “an appropriate balance needs to be struck between flexibility and the standardization of disclosure necessary to generate the data needed for investment decisions.”⁵⁶ For the time being, the Commission does not propose any specific action, but suggests a fitness check of the rules on non-financial information. After a public consultation next year, the Commission will decide whether it will make further legislative proposals. In any event, the Commission will revise its 2017 Guidelines in order to provide further guidance on how to disclose climate-related information, which will build on the new taxonomy. In addition, the guidelines will also include other environmental and social factors. All of these steps acknowledge that the 2017 Guidelines are regarded as insufficient and too general in nature.

In addition, the Commission indicates the need to address the rules on financial reporting. It is concerned that the present framework might not be conducive to sustainable investment decision-making and that the International Financial Reporting Standards (IFRS) no. 9 may even discourage sustainable investment.⁵⁷ Therefore, the Commission has proposed more flexibility with respect to the endorsement of the IFRS; it will ask the European Financial Reporting Advisory Group to assess this question.⁵⁸ Nonetheless, this seems to be a rather limited exercise, far from the more progressive forms of integrated reporting that have otherwise been suggested.⁵⁹

Beyond financial reporting, the Action Plan suggests further proposals in order to inform shareholders about sustainable investment possibilities. First, it proposes a framework that facilitates benchmarks to reflect sustainability goals. The idea is to enable shareholders to effectively choose sustainable investments, inter alia, by reducing the risk of greenwashing.⁶⁰ However, the Commission’s proposal is limited to setting up minimum standards for low-carbon and positive carbon impact benchmarks.⁶¹ Second, the Action Plan intends to enhance information through labelling. While the regulation proposal on the taxonomy does not introduce such labelling schemes, it requires Member States to apply its criteria whenever national law allows products to be labelled as ‘environmentally sustainable’.⁶² In addition, the Commission intends to examine the introduction of an EU Ecolabel framework, which would apply the new taxonomy in order to create a voluntary EU-wide labelling system. Even the introduction of a labelling scheme for socially responsible

⁵⁵ See 2017 O.J. (C 215) 1.

⁵⁶ See Action Plan, p. 10.

⁵⁷ More specifically, the problem seems to be the treatment of fair value measurement for long-term investment portfolios of equity and equity-type instruments.

⁵⁸ See Action 9(5) of the Action Plan.

⁵⁹ For an account of the different proposals, see Lynne Dallas, *Short-termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265, 324 (2012).

⁶⁰ The Commission suggests that more transparency on the methodologies and features of benchmarks should be required to make it easier for users to evaluate their quality, as well as possibly harmonizing benchmarks for low-carbon issuers, see Action 5. Also, the Commission will look into how market research providers and sustainability rating agencies consider sustainability factors and the Commission suggests that these actors should also take action in this area if they conclude there is a need, see Action 6.

⁶¹ See the proposed regulation amending Regulation 2016/1011, COM(2018) 355.

⁶² See Art. 4 of the proposal.

financial products is considered.⁶³ This idea has been suggested earlier.⁶⁴ A limited version of such a labelling scheme already exists; Regulation 346/2013 on European Social Entrepreneurship Funds (Regulation 346/2013) entitles funds to use the designation 'EuSEF' provided that a number of conditions are fulfilled, primarily that 70 per cent of the assets must be invested as 'qualifying investments'.⁶⁵ The undertakings that the EUSEF-fund invests in need to provide either 1) services or goods to vulnerable, marginalized, disadvantaged, or excluded persons, 2) employ a method of production that embodies its social objective, or 3) facilitate financial support exclusively to social undertakings. Altogether, the EuSEF label is designed to attract socially responsible investors. The labelling scheme that the Action Plan considers would operate similarly but is likely have a broader impact, since its standards will probably be less specific than those required by Regulation 346/2013.

Additionally, the Action Plan aims to ensure that investors who receive investment advice simultaneously receive information about sustainable investments. To that end, the Commission has proposed a regulation that requires different forms of disclosure. First, the proposal mandates investment firms and insurance intermediaries that provide insurance advice with regard to insurance-based investment products to disclose their written policies on the integration of sustainability risks in their advice on their websites.⁶⁶ Furthermore, the same advisors are required to pre-contractually disclose certain information to the investor: first, the procedures and conditions applied to integrate sustainability risks into investment and insurance advice; second, the extent to which sustainability risks have an impact on the returns on the product advice; and third, information on how the remuneration policies used by the advising firm are consistent with the integration of sustainability risks.⁶⁷ These proposals will add to the already heavy load of information that investors receive when being advised, and one may question whether this will have the desired effect. A more effective solution would be simply to require advisors to include sustainability considerations in their advising. In fact, the Action Plan announces that the integration of environmental, social and governance (ESG) considerations in the advisory process will be required by future provisions, to be adopted as delegated acts.⁶⁸ Similar moves have already been made by the European Securities and Markets Authority (ESMA). Inspired by the Action Plan, its recently published 'Guidelines on certain aspects of the MiFID II suitability requirements' suggest as good practice that advisors ask about their clients' preferences (such as ESG factors) and take these preferences into account.⁶⁹

All of these initiatives aim to ensure the availability of relevant information and suitable advice for investors who intend to make sustainable investments. They are all based on the assumption that investors will react positively to this information, i.e., direct their investments into sustainable companies. While one can assume that investors who are already dedicated to investing responsibly will make use of the additional disclosure on sustainability,⁷⁰ it is less certain whether other – not yet committed – investors will be incentivized to act

⁶³ See Action Plan, p. 5.

⁶⁴ The idea of introducing such labels was already suggested in the consultation conducted in 2016, see *Commission Summary of the Responses to the Public Consultation on Long-term and Sustainable Investment*, at p. 23 (Oct. 2016), http://ec.europa.eu/information_society/newsroom/image/document/2016-44/feedback_final_pc_30068_en_19173.pdf.

⁶⁵ Parliament and Council Regulation 346/2013/EU, On European Social Entrepreneurship Funds, Art. 3(1)(b)(i), 2013 O.J. (L 115) 18.

⁶⁶ See the proposal COM(2018) 354, Art. 3.

⁶⁷ See Art. 4(2) of the proposal.

⁶⁸ See Action 4 of the Action Plan and COM(2018) 354 p. 9. In May and June 2018, the Commission was seeking feedback on amendments to delegated acts under MiFID II and the Insurance Distribution Directive, but at the time of writing none of these seem to have been adopted by the Commission.

⁶⁹ See the Guidelines para. 28. The Guidelines were published on 28th May 2018 and are available at <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-final-guidelines-mifid-ii-suitability-requirements>.

⁷⁰ This growth in the number of investors committed to some sort of social screening is documented, for instance, in the reports prepared by the Forum for Sustainable and Responsible Investments; see, e.g., US SIF, 2014 REPORT ON SUSTAINABLE, RESPONSIBLE AND

more responsibly when receiving this information. The Action Plans builds on the assumption that the provision of information raises the level of awareness among investors.⁷¹ Reporting might in fact have some educational effects, which will eventually result in more shareholders taking sustainability concerns into account.⁷² It is noteworthy that the Commission has not taken up the High-Level Expert Group's proposals with respect to financial education and financial literacy, even though they seem likely to enhance the possible educational effects of the new rules.⁷³

Investors' awareness of sustainability can be transmitted to the governance of listed companies in two different ways. On the one hand, management may tend to conduct business more sustainably in order to attract a growing number of investors with a sustainability focus. On the other hand, individual investors can influence business policies more directly by making use of their shareholder voice at general meetings. With its efforts to promote shareholder activism, the Commission assumes that investors will act accordingly, but this assumption is debatable. While there is some evidence that shareholders are more active in relation to sustainability issues,⁷⁴ the overall effects of efforts to enhance shareholder activism remain to be seen. The level of shareholder activism is likely to depend on a variety of determinants such as respective ownership structures.⁷⁵

4.2. Targeting specific shareholders

Another way of incentivizing shareholders is to target specific shareholders with a special position and/or subject to special regulation. For instance, specific shareholders may be required to disclose their position on sustainable investment, thereby encouraging them to reflect on the issue. This approach was followed by the revised Shareholder Rights Directive, requiring institutional investors and asset managers to develop an engagement policy, which, inter alia, should address how they "monitor investment investee companies on relevant matters, including strategy, financial and non-financial performance and risk, capital structure, social and environmental impact and corporate governance".⁷⁶ In the absence of such a policy, these shareholders must provide a "clear and reasoned explanation why they have chosen not to comply".⁷⁷ On a comply-or-explain basis, institutional investors are also required to prepare an investment strategy that should address "how the main elements of their equity investment strategy are consistent with the profile and duration of their liability, in particular long-term liabilities, and how they contribute to the medium to long-term performance of their assets".⁷⁸ These requirements aim to encourage managers of institutional investors and

IMPACT INVESTING TRENDS (2014), http://www.ussif.org/Files/Publications/SIF_Trends_14.F.ES.pdf. For the growth in the amount of assets, which is covered by the Principles for Responsible Investment (PRI), see PRINCIPLES FOR RESPONSIBLE INVESTMENT 5 (2016), <https://www.unpri.org/download?ac=1534>; for an examination of this development, see RORY SULLIVAN, VALUING CORPORATE RESPONSIBILITY: HOW DO INVESTORS REALLY USE CORPORATE RESPONSIBILITY INFORMATION? (2011).

⁷¹ See the impact assessment prepared by the Commission in *Commission Staff Working Document Impact Assessment Accompanying the Document Proposal for a Directive of the European Parliament and of the Council*, at 18, SWD (2013) 127 final (Apr. 16, 2013).

⁷² Regarding the educational effect of disclosure, see Howard Beales et al., *The Efficient Regulation of Consumer Information*, XXIV J.L. & ECON. 491, 531 (1981) (in relation to consumers); Niamh Moloney, *Confidence and Competence the Conundrum of EC Capital Markets Law*, 4 J. CORP. L. STUD. 1, 33 (2004) (in relation to investors).

⁷³ More precisely, the experts recommend that EU support Member States in developing national strategies for financial education with a strong sustainability component, including incorporating a financial literacy component into school curricula, see EU High-level Expert Group on Sustainable Finance Report, p. 49.

⁷⁴ For instance, there is empirical evidence indicating that shareholders in the Netherlands are interested in pushing sustainability issues by asking questions and making interventions at general meetings, see Anne Lafarre & Christoph Van der Elst, *Shareholder Sustainability Activism in the Netherlands*, ECGI Working Paper No. 396/2018, available at <https://ssrn.com/abstract=3156614>.

⁷⁵ Christoph van der Elst, *Revisiting Shareholder Activism at AGMs: Voting Determinants of Large and Small Shareholders*, ECGI Working Paper No. 311/2011, available at SSRN: <http://ssrn.com/abstract=1886865>.

⁷⁶ See Directive 2017/828/EU, Art. 3(g)(1)(a).

⁷⁷ See Directive 2017/828/EU, Art. 3(g)(1).

⁷⁸ See *id.* Art. 3(h)(1).

asset managers to undertake more long-term engagement in their investee companies.⁷⁹ After all, this directive was enacted against the backdrop of the financial crisis, which exposed how shareholders, in many cases, supported managers' excessive short-term risk-taking.⁸⁰

However, the effects of the directive on shareholder engagement seem doubtful, and even more so in regard to its effects on long-term and sustainable engagement.⁸¹ The precondition for any influence on the management of institutional investors and asset managers is that the reports are taken into account at all. While asset managers are likely to respond to reactions of institutional investors, the latter will only react if their beneficiaries ask for more sustainable investments. Beneficiaries will only do so if the reports make them reflect on their investment strategies, for instance because the long-term perspective saves costs and potentially results in better returns.⁸² To a certain extent, this underlying presumption is debatable, as beneficiaries may not read the information or may not care enough about it.⁸³

Nonetheless, the Action Plan follows the same approach by further incentivizing beneficiaries of different investors. The Commission has already adopted a proposal requiring certain financial market participants (including UCITS management companies, AIFMs, insurance undertakings and IORPs) to engage in a range of disclosure measures related to ESG considerations.⁸⁴ The proposal is very detailed, so only a few elements can be highlighted here. The financial market participants are required to publish written policies on the integration of sustainability risks in investments decisions. These policies need to be published on their websites and should be up-to-date at all times. Moreover, when the institutions receive new beneficiaries, a range of information should be provided pre-contractually. These requirements mirror the obligations that have been outlined for advisors.⁸⁵ Additional requirements apply if financial market participants offer sustainable investment products, such as economic activities that contribute to environmental objectives as defined in the taxonomy.⁸⁶ In that case, the proposal requires both pre-contractual disclosure of various types of information, such as the designated indexes, as well as disclosure in the form of periodical reports, for example on the sustainability-related impact of financial instruments.⁸⁷ Altogether, the proposal seeks sustainability disclosure that is more focused on ESG considerations and more widely disseminated, so that beneficiaries are more likely to notice the information. The Commission clearly intends to overcome some of the deficiencies of the previous disclosure regimes with respect to the debatable impact of the information required.

⁷⁹ There are other similar initiatives, which seem to have the same aim. See, e.g., *Commission Proposal for a Directive of the European Parliament and of the Council on the Activities and Supervision of Institutions for Occupational Retirement Provision*, at Art. 55, COM(2014) 167 final (Mar. 27, 2014) according to which the "institution shall ensure that prospective members are informed about all the features of the scheme and any investment options including information on how environmental, climate, social and corporate governance issues are considered in the investment approach".

⁸⁰ See Directive 2017/828/EU, rec. 2.

⁸¹ For a critical assessment of the effect of such transparency, see Iris H.-Y. Chiu, *Reviving Shareholders Stewardship: Critically Examining the Impact of Corporate Transparency Reforms in the UK*, 38 DEL. J. CORP. L. 983 (2014).

⁸² See *Commission Staff Working Document Impact Assessment Accompanying the Document Proposal for a Directive of the European Parliament and of the Council*, at 47, SWD (2014) 127 final (Apr. 9, 2014).

⁸³ The responses to the consultation conducted by the Commission in 2016 indicate that to what extent beneficiaries are interested in ESG matters varies considerably. See *Commission Summary of the Responses to the Public Consultation on Long-term and Sustainable Investment*, at 18 (Oct. 2016), http://ec.europa.eu/information_society/newsroom/image/document/2016-44/feedback_final_pc_30068_en_19173.pdf; see also the conclusion drawn by Scott Hirst, *Social Responsibility Resolutions*, 43 J. Corp. L. 217 (2018)), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2773367, indicating that institutional investors often do not vote according to the preferences of their beneficiaries.

⁸⁴ See COM(2018) 354.

⁸⁵ See section 4.1. above and Art. 4(1) of the proposal.

⁸⁶ For a more extensive definition, see Art. 2(o) of the proposal.

⁸⁷ See Arts. 5 and 7 of the proposal.

In contrast, the main regulatory innovation consists of the proposal to explicitly require institutional investors and asset managers to integrate sustainability considerations in their investment decision-making processes.⁸⁸ A previous consultation suggested that managers of such institutions may be subject to duties that could prevent them from integrating ESG considerations into their investment decisions,⁸⁹ but this assumption was rejected by other reports both at the national and the European level.⁹⁰ The Action Plan now goes a crucial step further by proposing to impose a (positive) duty to integrate ESG considerations into investment management decisions.⁹¹ This step would indeed be radical. It runs counter to the general perception that there is no duty requiring managers to integrate these considerations.⁹² While there have been similar attempts to introduce these kinds of duties before, they have never affected such a broad range of investors. For example, Regulation 346/2013 states that EuSEF managers must observe several duties in relation to investee companies; one of these duties is to conduct the EuSEF's business activities in such a way as to promote the positive social impact of the investee company. While this duty also relates to promoting non-financial goals, its imposition seems much more obvious (and legitimate); at the very least, the EuSEF received its funds precisely for that particular purpose. In contrast, the present proposal reaches much further, not only because it concerns a much broader range of institutions, but also because it does not relate to any specific purposes of respective investors. Accordingly, the duty appears to be much more intrusive, so it will be interesting to see how this proposal is received.

5. Incentivizing directors

Given their responsibility and competence to run the company and oversee its business activities, directors play a pivotal role in corporate conduct. Their decisions translate directly into corporate behaviour and every single management decision has a potential impact on workers, customers or the environment. From this perspective, directors seem to be the ideal target group for regulatory interventions designed to encourage sustainable corporate behaviour.⁹³ However, directors do not enjoy unfettered discretion when making business decisions, but instead act as their company's agents.⁹⁴ Ultimately, they depend on shareholders and investors who control them both internally, by exerting their voting rights, and externally, by their (dis)investment decisions.⁹⁵ If regulations succeed in incentivizing shareholders to act more sustainably, based on the assumptions that have been discussed, they will therefore also incentivize directors to act accordingly. However, given that these incentives depend on the effectiveness of the shareholder-related 'transmission belt', they operate indirectly and their regulatory effects are consequently uncertain.

Legislators have a choice of different regulatory strategies in order to encourage managerial decisions that take sustainability considerations into account. They can either follow a substantive approach and try to

⁸⁸ See Action 7 of the Action Plan.

⁸⁹ It was indicated in the 2016 consultation undertaken by the Commission that this problem existed, see *Commission Summary of the Responses to the Public Consultation on Long-term and Sustainable Investment*, at 25 (Oct. 2016).

⁹⁰ A good example here is the report prepared by the UK Law Commission in 2014, which concluded that while the pursuit of a financial return should be the predominant concern of such managers (pension trustees), the law permits them to make investment decisions based on non-financial factors, provided that 1) they have good reason to think that scheme members share the concern and 2) there is no risk of significant financial detriment to the fund. See the Law Commission, *Fiduciary Duties of Investment Intermediaries* (June 30, 2014), http://www.lawcom.gov.uk/app/uploads/2015/03/lc350_fiduciary_duties.pdf. A report prepared for the Commission in 2015 came to a similar conclusion. See Ernst & Young, *Resource Efficiency and Fiduciary Duties of Investors*, 56 et seq. (2015), http://ec.europa.eu/environment/enveco/resource_efficiency/pdf/FiduciaryDuties.pdf.

⁹¹ See Action 7 of the Action Plan.

⁹² See the Ernst & Young report, *ibid*, and Rory Sullivan et al., *Fiduciary Duty in the 21st Century* (2015), <http://unepinquiry.org/wp-content/uploads/2015/09/Fiduciary-duty-21st-century.pdf>.

⁹³ In more detail, see Florian Möslin & Karsten Engsig Sørensen, 24 *Columbia Journal of European Law*, 429, 434.

⁹⁴ See again Florian Möslin & Karsten Engsig Sørensen, 24 *Columbia Journal of European Law*, 429, 434.

⁹⁵ See above, at section 4.1.

establish direct incentives for directors to act responsibly, or they can try to constrain irresponsible behaviour. Legislation of this kind often includes a combination of carrots, e.g., remuneration incentives and sticks, e.g., constraints on directors' duties, to ensure that corporate directors comply with long-term interests and sustainability by making respective managerial behaviour more attractive than its alternatives.⁹⁶ Legislators can also follow a procedural, subtler approach, in particular by mandating that certain decision-making procedures be followed. With respect to long-termism and sustainability, disclosure requirements – similar to those of investment managers – are supposedly the most widespread procedural instrument in conventional company law.⁹⁷ A third regulatory strategy would be to introduce structural rules aimed at modifying the structure and composition of decision-making bodies such as the board, in order to encourage more sustainable corporate behaviour.⁹⁸

In its (brief) section on corporate governance, the Action Plan proposes both procedural and substantive rules with a view to “fostering sustainable corporate governance and attenuating short-termism in capital markets”.⁹⁹ The Commission considers it a requirement for corporate boards to develop and disclose a sustainability strategy. Similarly to the proposals regarding institutional investors and asset managers,¹⁰⁰ this proposal would go far beyond the conventional disclosure obligations provided for in the Directive on Non-financial Reporting. The current proposal would not only require the disclosure of pre-existing strategies on a comply-or-explain basis, but would also obligate corporate boards to develop sustainability strategies in the first place. While the regulatory intention is obviously to prevent managers from closing their eyes to sustainability concerns, it seems questionable whether and how such a legal obligation could be effectively enforced. For the time being, this proposal is at a very early stage, since the Action Plan itself indicates that much more analytical and consultative work is required before any concrete regulatory proposal can be presented. The same is true for the more substantive proposal to “clarify the rules according to which directors are expected to act in the company’s long-term interest”.¹⁰¹ In fact, this proposal touches the very core of company law as it concerns one of the most heavily disputed questions: in whose interests directors are supposed to act.¹⁰² For good reasons, the internal governance of companies, directors’ duties and the question of for whom managers are trustees have not been harmonized; the proposal for a Fifth Company Law Directive was withdrawn long ago¹⁰³ because the comparative legal differences have proven to be insurmountable.¹⁰⁴ Against this backdrop, the discussion of the possible need to clarify the rules with regard to long-term interest may well be highly explosive. Even though it is relatively hidden in the current, financial-market oriented Action Plan, company lawyers should urgently take note of this important legislative development.

⁹⁶ For an extensive account, see Florian Möslin & Karsten Engsig Sørensen, 24 *Columbia Journal of European Law*, 429, 435-446. For similar wording with respect to sustainability reporting, see KPMG et al., *Carrots & Sticks – Global Trends in Sustainability Reporting, Regulation and Policy* (4th ed. 2016), available at <https://home.kpmg.com/xx/en/home/insights/2016/05/carrots-and-sticks-global-trends-in-sustainability-reporting-regulation-and-policy.html>; from a different perspective see Christoph Kumpan, *Carrot and Stick – The EU’s Response to New Securities Trading Systems*, *Eur. Co. & Fin. L. Rev.* 383 (2006); in general see Ian Ayres, *Carrots and Sticks – Unlock the Power of Incentives to Get Things Done* (2010).

⁹⁷ Extensively, see Florian Möslin & Karsten Engsig Sørensen, 24 *Columbia Journal of European Law*, 429, 446-453.

⁹⁸ Florian Möslin & Karsten Engsig Sørensen, 24 *Columbia Journal of European Law*, 429, 453-455.

⁹⁹ Action 10, at p. 11 of the Action Plan.

¹⁰⁰ See above, at section 4.2.

¹⁰¹ See again Action 10, at p. 11 of the Action Plan.

¹⁰² See, e.g., with regard to UK law, *Modern Company Law – For a Competitive Economy – The Strategic Framework – A Consultation Document from the Company Law Review Steering Group*, 33 (2/1999); from a comparative perspective, see Klaus J. Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation*, *AJCL* 59, 1, at 28-30 (2011).

¹⁰³ COM(2001) 763 final/2 (DG Internal Market).

¹⁰⁴ For an extensive account, see Stefan Grundmann, *European Company Law*, §§ 12 and 14, 247-276 and 318-352 (2nd ed. 2012).

6. Incentivizing other stakeholders

In addition to shareholders and directors, there are other stakeholders who might have the potential to foster corporate sustainability. Stakeholders such as employees, creditors, consumers and trading partners have a potential interest in the company¹⁰⁵ and it is often assumed that non-financial reporting is relevant to them.¹⁰⁶ However, even if such stakeholders have preferences for the long-term sustainability of the company, their interests might not be strong enough to raise their voices; even if this is the case, their position does not necessarily enable them to influence the governance of the company.¹⁰⁷

Among all of these stakeholders, employees might have the strongest interest in the company's performance. As their employment is not necessarily of a temporary nature, their primary concern is likely to be the continuing, long-term existence of the company. Their preferences, however, do not necessarily coincide with the long-term interests of shareholders. While both are likely to favour the company's prosperity in the long run, they may well disagree as to whether profits should be distributed or reinvested (or perhaps even used for an increase in salaries). Nevertheless, if long-term and sustainable performance should benefit all stakeholders, employees' interests are relevant even if they are different from those of shareholders. While the recently amended United Kingdom corporate governance code proposes greater engagement with the workforce,¹⁰⁸ the current Action Plan does not increase employees' influence in the governance of listed companies. Employees' interests are only taken into account in a single respect as the taxonomy on sustainability may help to ensure employees some minimum safeguards.

Instead, and in accordance with its financial focus, the Action Plan proposes incentivizing other stakeholders: the banks. As a source of companies' external finance, banks can in fact assume two different roles, depending on whether they become creditors (granting loans or holding corporate bonds) or shareholders (investing in equity). With its references to external finance and to banks' assets, the Action Plan seems to include both.¹⁰⁹ In order to incentivize banks to act more sustainably, the Commission proposes exploring the feasibility of including risks associated with climate and other environmental factors in banks' risk management systems and the potential calibration of banks' capital requirements.¹¹⁰ While its details still need to be explored, this proposal aims to incentivize banks to finance sustainable companies in order to reduce these companies' costs of finance, thereby creating another incentive for listed companies to act more sustainably. However, the Action Plan has not considered another, further-reaching proposal of the High-level Expert Group. With its aim of adjusting the 'fit and proper' rules in order to assess the board members' ability and willingness to address sustainability concerns, this proposal would have had

¹⁰⁵ According to rec. 14 of the revised Shareholder Rights Directive, *supra* note 62, "greater involvement of all stakeholders, in particular employees, in corporate governance is an important factor in ensuring a more long-term approach by listed companies that need to be encouraged and taken into account".

¹⁰⁶ See, e.g., Parliament and Council Directive 2014/95/EU, rec. 4, 2014 O.J. (L 330) 1, which, apart from shareholders, mentions other stakeholders as addressees of non-financial reports.

¹⁰⁷ See OECD, G20/OECD PRINCIPLES OF CORPORATE GOVERNANCE § IV (Sept. 2015), <https://www.oecd-ilibrary.org/docserver/9789264236882-en.pdf?expires=1530585840&id=id&accname=guest&checksum=5DA75AB1D067F30B49D9E7364B1917D8>, which encourages cooperation with stakeholders in different ways, such as by granting them redress for the violation of rights and encouraging employee participation.

¹⁰⁸ See the UK Corporate Governance Code published in July 2018 by the Financial Reporting Council, Provision 5.

¹⁰⁹ See Action Plan, p. 9.

¹¹⁰ See Action 8 of the Action Plan. According to the Commission, it is estimated that at least half of the assets of banks in the Euro zone are currently exposed to climate change-related risks.

considerable impact on the profile of board members and, more generally, the internal governance of banks.¹¹¹

7. Conclusions and outlook

Altogether, the Action Plan continues the approach of incentivizing sustainable corporate behaviour, similarly to previous steps such as the Directive on Non-financial Reporting and the revised Shareholder Rights Directive. However, the Action Plan is different in at least three respects: (1) its scope is broader, due to its focus on financial market as a whole, (2) its regulatory instruments are more diverse and (3) its regulatory intensity is less soft. While still taking the previous reconciliatory approach, which tries to align sustainability and economic growth, the urgency of preventing climate change has contributed not only to accelerating the legislative process, but also to creating a more nuanced regulatory strategy. First, the development of a sustainability taxonomy aims to provide clarity on the traditionally vague notion of sustainability by focusing on specific environmental objectives in particular. By evaluating economic activities (rather than companies or financial products), the taxonomy is likely to foster corporate ring-fencing; however, consequential problems will arise. Second, the Action Plan aims to incentivize shareholders by introducing additional information duties not only with regard to reporting, but also through labelling and an EU Ecolabel framework. Additional information obligations will be imposed on investment advisers in order to ensure that investors receive sufficient information on sustainability issues. Specific shareholders, such as institutional investors, will be subjected to further information obligations and a far-reaching requirement to integrate sustainability considerations in their investment decision-making processes. All of these obligations aim to influence investment flows in order to eventually have an impact on corporate behaviour. Third, and in addition to this indirect impact, the Action Plan tries to incentivize corporate managers more directly by requiring a sustainability strategy and considering a modification of the rules according to which directors are expected to act in the company's long-term interest. The latter proposal has the potential to fundamentally change core company law. Finally, among all other stakeholders, the Action Plan focuses on banks and attempts to influence their financing decisions by proposing steps to include risks associated with climate and other environmental factors in their risk management systems.

From a company law perspective, the Action Plan may well provoke fears of another sustainability-related "revolution through the back door".¹¹² While similar concerns had once been expressed with respect to non-financial disclosure, the current proposals are much more comprehensive and go to the very core of company law. In regard to existential threats, fundamental modifications of the corporate governance framework might be inevitable, but they merit and indeed require a broad discussion among company law scholars. In this discussion, one important consideration should relate to the tailoring of the regulatory scope.¹¹³ Since the Action Plan's focus is on capital and financial markets, its proposals primarily concern listed companies. However, there might be potential spillover to non-listed companies due to, for example, banks' modified financing strategies. In order to avoid potential discriminatory effects between different forms and types of companies – which might in turn give rise to avoidance strategies by businesses – one may also consider the

¹¹¹ See p. 39 of the report of the High-Level Expert Group.

¹¹² Peter Hommelhoff, *Nichtfinanzielle Ziele in Unternehmen von öffentlichem Interesse – Die Revolution übers Bilanzrecht*, Festschrift for Kübler, 291 (2015); see also Peter Hommelhoff, *Aktuelle Impulse aus dem europäischen Unternehmensrecht: Eine Herausforderung für Deutschland*, Neue Zeitschrift für Gesellschaftsrecht 1329, 1330 (2015); Peter Hommelhoff, *Nichtfinanzielle Unternehmensziele im Unionsrecht – Zwanzig Bemerkungen zum Kommissionsvorschlag für die Novellierung der 4. und 7. Bilanzrichtlinie vom April 2013*, Festschrift für Hoyningen-Huene 137, 140 (2014), groundbreaking change. Should the highlighted text be italicized?

¹¹³ More extensively (but more generally) on the respective challenges, see Florian Möslin & Karsten Engsig Sørensen, 24 Columbia Journal of European Law, 429, 482-486.

alternative approach of more generally tailored company law rules, which also apply to non-listed companies. Moreover, the Action Plan's proposals should be seen in the context of other sustainability-related rules, proposals and developments, such as (1) the Directive on Non-financial Reporting and the revised Shareholder Rights Directive, (2) the current plans of the European Parliament for a Statute for Social and Solidarity-Based Enterprises and (3) the advance of social entrepreneurship, associated with the introduction of new company forms such as benefit corporations and new corporate certification schemes such as Certified B Corporations. While the present paper only touches on the first issue, the other two point in very similar – though slightly different – directions, both in substance and with respect to regulatory instruments. For example, the existing corporate certification schemes and the labelling scheme for sustainable financial products as proposed by the Action Plan potentially overlap and interact. All of these regulatory interactions must be taken into account in future debates about the current Action Plan on Financing Sustainable Growth. There is still a great deal of work to be done in company law scholarship.