University of Oslo

University of Oslo Faculty of Law Legal Studies
Research Paper Series
No. 2016-10

Beate Sjåfjell

Achieving Corporate Sustainability: What is the role of the shareholder?

Electronic copy available at: https://ssrn.com/abstract=2828573

Chapter 18
Achieving Corporate Sustainability: What Is the Role of the Shareholder?

*Beate Sjåfjell**

§18.01 WHY WE NEED TO DISCUSS CORPORATE SUSTAINABILITY AND THE SHAREHOLDER

The convergence of crises that we face as a global society, with its grand challenge of how to achieve social progress for all without destroying the very basis of our existence, emphasises the importance of discussing the role of business and finance. We cannot achieve environmental, social and economic sustainability of our societies without the contribution of business and finance. As opposed to the many difficult questions ahead, there is one thing we know for sure: 'business as usual' is a very certain path towards a very uncertain future. The positive achievements that have been made in reaching some of the Millennium Development Goals are bound to be undermined by the degradation of our natural environment including that which is the highly likely result of run-away climate change.[1] The achievement of the UN Sustainable Development Goals,[2] which may be said to epitomise the overarching goals of the

* The author gratefully acknowledges support from the project Sustainable Market Actors for Responsible Trade (SMART) (uio.no/smart), based at the University of Oslo, and which has received funding from the European Union's Horizon 2020 research and innovation programme under grant agreement No 693642. The author is also grateful to Hanne S. Birkmose for helpful comments, to Paige Morrow for insightful feedback to an early draft and to Ragnhild Lunner for invaluable research assistance. Contact e-mail: < b.k.sjafjell@jus.uio.no > .

1. About the UN Millennium Development Goals, *see* http://www.unmillenniumproject.org/goals/ (accessed 27 June 2016), and about the threat of climate change, *see* for example Thomson Reuters, *Climate Change Threatens Bangladesh's MDG Achievements – Experts*, http://news.trust.org//item/20130722163326-vjgux/ (accessed 27 June 2016).
2. *See* more about the UN Sustainable Development Goals at http://www.un.org/sustainabledevelopment/sustainable-development-goals/ (accessed 24 June 2016).

Electronic copy available at: https://ssrn.com/abstract=2828573

global society, is unlikely. A fundamental transition away from 'business as usual' and onto a sustainable path is necessary.

The dominant business form is the company,[3] and the role of shareholders, the investors in this business form, is therefore highly topical.[4] Concentrating in this chapter on the influence of the shareholders through the general meeting of European listed companies, we see that while the focus of the mainstream corporate governance debate for a long time has been on strengthening shareholder rights, an emerging and important debate is that on whether shareholders also have duties. This chapter contributes to that debate with a discussion of the potential role of shareholders in achieving corporate sustainability, including whether shareholders have or should have any duties to contribute towards such a goal.[5] Corporate sustainability is here defined as when businesses (or more broadly, economic actors) in aggregate create value in a manner that is: (a) *environmentally* sustainable in the sense that it ensures the long-term stability and resilience of the ecosystems that support human life, (b) *socially* sustainable in the sense that it facilitates the respect and promotion of human rights, and (c) *economically* sustainable in the sense that it satisfies the economic needs necessary for stable and resilient societies.

In the European Union (EU), we see a tentative recognition of the broader role of shareholders, especially as regards economic sustainability. The European Commission has in its reform package of April 2014 identified short-termism in companies as a contribution to the global financial crises, and takes as a starting point that shareholders may have supported 'managers' excessive short-term risk taking'.[6] Concentrating on listed companies, the Commission proposes measures to encourage long-term shareholder engagement, notably by proposing reform to the Shareholder Rights' Directive.[7] As I will argue in this chapter, this reflects a limited understanding of the influence of shareholders and of what kind of reforms are necessary, as the reality is rather that much of the short-termism arises out of pressure from shareholders and because of the economic incentives put into place for managers in the belief that these would align their interests with that of the shareholders.[8] Further, while a short-term perspective may be warranted in some business projects, the problem arises

3. The term 'company' encompasses both the private limited liability company (e.g., *aksjeselskap* in Norway, *GmbH* in Germany) and the public limited liability company (e.g., *allmennaksjeselskap* in Norway, *AG* in Germany). However, this chapter concentrates on the public limited liability company that has its shares listed on a stock exchange.
4. So is the role of other significant involved parties, notably the employees, but this chapter, like the book itself, focuses on the shareholders.
5. What may be denoted as shareholders' duties directly towards society, including the legal and moral duty of shareholders to themselves comply with applicable disclosure rules and tax law, will therefore not be discussed in this chapter. This is partly covered by other contributions to this book, including Karsten Engsig Sørensen's chapter on disclosure.
6. Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, COM/2014/0213 final – 2014/0121 (COD), Recital 2.
7. Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of the long-term shareholder engagement (...), COM(2014) 213 final.
8. *See infra* in s. §18.02.

Electronic copy available at: https://ssrn.com/abstract=2828573

when the blinkered short-termism of the shareholder primacy drive becomes pervasive in all of business and finance, irrespective of the individual project's natural life span. The trend towards short-termism is also emphasised by Barca and Becht already in 2001, with reference to the theory of the market for corporate control, which may be said efficiently to reallocate control of projects with short 'realization periods', but which may discourage long-term projects. Barca and Becht indicate that most projects requiring financing are of a long-term nature requiring long-term commitment, which gives rise to question regulation that promotes primarily funding of short-term projects.[9]

We also see a rising recognition of the significance of shareholders' role in promoting environmental and social aspects of sustainability, in part inspired by the debate on 'stewardship' originating in Europe with the UK Stewardship Code.[10] We see a reflection of this in the European Parliament's revisions to the Commission's proposal to changes in the Shareholders' Rights Directive, which suggest to broaden the scope to include societal issues. Similarly, the so-called non-financial reporting requirements introduced in 2014 aim to ensure that the largest listed companies disclose 'the impact of [their] activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters',[11] also with the view to facilitating responsible investment. These are examples that illustrate a growing EU interest in encouraging shareholders to contribute to long-term successful business, environmentally, socially and economically.[12]

Discussions of the relationship between shareholders, companies and broader societal interests are often undertaken under the umbrella of corporate social responsibility (CSR). There are numerous definitions of CSR. The European Commission's paradigm shift in its understanding of CSR took place when the Commission went from defining CSR as concept 'whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders *on a voluntary basis*' in 2001[13] to redefining CSR in 2011 as the '*the responsibility of*

9. Fabrizio Barca & Marco Becht (eds), *The Control of Corporate Europe*, 37-38 (Oxford University Press 2001). *See* for a criticism of the effects of attempting to promote a 'vibrant' market for corporate control through the EU takeover directive has on business and on the broader sustainability issues: Beate Sjåfjell, *Towards a Sustainable European Company Law*, Part V (Kluwer Law International 2009).
10. *See infra* in s. §18.04, and the contribution by Iris Chiu and Dionysia Katelouzou in this book.
11. Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC as amended by Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, Art. 19a.
12. Another example is the reform proposal for the IORP Directive: Proposal for a Directive of the European Parliament and of the Council on the activities and supervision of institutions for occupational retirement provision (recast), COM/2014/0167 final – 2014/0091 (COD), building on the White Paper on pensions, COM(2012) 55 final and the Green Paper on long-term financing of the European economy, COM(2013) 150 final.
13. COM(2001) 366 final (emphasis added). Although the Communication went on to speak of 'not only fulfilling legal expectation, but also going beyond compliance and investing "more"

Electronic copy available at: https://ssrn.com/abstract=2828573

enterprises for their impacts on society' and requiring an integration of 'social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy'.[14]

However, in spite of the EU Commission's paradigm shift in its redefinition of CSR in 2011, we have not seen a follow-up of this in any way other than very tentative and incremental progress over these last five years – including the non-financial reporting regime mentioned above.[15] A debate is needed on how to achieve the necessary fundamental transition from 'business as usual'. In spite of all good intentions from involved parties, the contributions from the CSR debate appear to be insufficient. To move away from that, it may be helpful to rephrase the question, as this chapter does, to how do we regulate for corporate sustainability.

Moving from a general CSR discussion to a focus on how to achieve corporate sustainability also positions the discourse more clearly within the fundamental recognition of the non-negotiable ecological limits that should form the space within which all economic and social development is to take place, which is embodied in the concept of planetary boundaries.[16] This is also reflected in the updated definition of sustainable development as an overarching societal goal as 'development that meets the needs of the present while safeguarding Earth's life-support system, on which the welfare of current and future generations depends'.[17]

In section §18.02, this chapter outlines the research findings that indicate a strong negative impact of shareholders, in aggregate, on corporate sustainability. Section §18.03 discusses the role of shareholders in the general meeting as a matter of law. After a short overview of the competence the controlling shareholder has in a general meeting, this focuses on the possibilities for and likelihood of shareholder influence in the general meeting being used to promote corporate sustainability. Section §18.03 concludes with a brief discussion of shareholder influence outside the general meeting. This is a trend that is encouraged by corporate governance codes and stewardship codes alike, without – as I will argue in this chapter – proper appreciation of the potential negative impacts of this approach. Section §18.04 discusses shareholders' emerging and potential duties towards corporate sustainability, including a brief discussion of the stewardship codes, while section §18.05 outlines tentative ideas on

into human capital, the environment and the relations with stakeholders' (paras 20-21), the definition of CSR as voluntary has been dominant.

14. COM(2011) 681 final, s. 3.1 (emphasis added).
15. For a critical perspective and further discussion, *see* Beate Sjåfjell & Linn Anker-Sørensen, *Directors' Duties and Corporate Social Responsibility (CSR)* in *Boards of Directors in European Companies* (Hanne Søndergaard Birkmose, Mette Neville & Karsten Engsig Sørensen eds, Kluwer Law International 2013).
16. Introduced by Johan Rockström et al., *Planetary Boundaries: Exploring the Safe Operating Space for Humanity*, 14 Ecol. Soc. Art. 32, www.ecologyandsociety.org/vol14/iss2/art32/ (accessed 27 June 2016); confirmed and updated in Will Steffen et al., *Planetary Boundaries: Guiding Human Development on a Changing Planet*, Science, www.sciencemag.org/content/347/6223/1259855.abstract (accessed 27 June 2016).
17. David Griggs et al, *Policy: Sustainable Development Goals for People and Planet*, 495 Nature 305, 306, http://www.nature.com/nature/journal/v495/n7441/full/495305a.html (accessed 27 June 2016).

Electronic copy available at: https://ssrn.com/abstract=2828573

how to reform the role of shareholders in company law as an intrinsic part of a tentative reform proposal. Section §18.06 concludes.

§18.02 WHAT IS THE IMPACT OF SHAREHOLDERS ON CORPORATE SUSTAINABILITY?

[A] Who or What Are the Shareholders?

A caveat for the discussion in this chapter is the nature of shareholders. Companies are a very heterogeneous group, and shareholders are even more so. Distinctions may be drawn between natural persons as shareholders, corporate shareholders and institutional investors, between minority and majority shareholders, controlling and non-controlling, domestic and foreign, between shareholders interested in the long-term development of the company and shareholders only concerned with maximising short-term returns (and all the variations on the spectrum between), and between traditional shareholders (where the economic and control rights are present) and synthetic shareholders (financial instruments, which do not necessarily control the underlying share – or which control the share but do not have the underlying economic risk).[18] Adding to this the opaque nature of shareholdings today, where we may have many layers between the actual beneficiary and the proxy advisor or nominee account holder voting in the general meeting, we often do not know who shareholders are (we have 'secret shareholders' as well as 'secret agents' for them), posing in itself an intrinsic challenge to any plans for influencing or regulating the shareholders.[19] Recognising also that this is just part of the corporate and financial complexity of control and power in business and finance, this chapter discusses shareholders' role in contributing to corporate sustainability in the context of shareholders' influence on companies, primarily through the general meeting. The discussion is informed by the explicit recognition that what may be denoted the new vote-buying era[20] challenges our traditional understandings of the role of shareholders and the overall influences of their decisions at the general meeting; a point to which I briefly return below in the concluding section.

With this important caveat, the next question is how shareholders are relevant in the corporate sustainability debate. Do shareholders, if we do generalise and try to draw out something on the impact of shareholders in aggregate, contribute to or work against the aim of corporate sustainability?

18. Linn Anker-Sørensen, *Financial Engineering as an Alternative, Invisible Veil for the Corporate Group*, University of Oslo Faculty of Law Research Paper No. 2016-01, http://ssrn.com/abstract=2729112 (accessed 22 May 2016).
19. *Ibid.*
20. *Ibid.*

Electronic copy available at: https://ssrn.com/abstract=2828573

[B] The Destructive Effect of the Shareholder Primacy Drive

Shareholders' contribution to corporate sustainability has the potential of being positive but is in practice and in aggregate extremely negative, as shown through the multi-jurisdictional comparative company law analysis undertaken in the Sustainable Companies Project (2010-2014).[21] As we will see below, the negative impact of the shareholders in aggregate takes the form of limiting in practice the scope of the boards and by extension of the managers of the companies to make long-term sustainable decisions.

The Sustainable Companies Project investigated the barriers to and possibilities for a deeper integration of environmental concerns into the decision-making in companies. We investigated core company law, through an extensive, comparative analysis of the purpose of the company as a matter of law, and the role and duties of the board as well as that of the general meeting. Because of the board's pivotal role according to company law in the strategy-setting and overarching monitoring of the management of the company,[22] we focused on the concept of the interests of the company to find the scope of the board's duty and discretion in its supervision and management of the company.[23] The regulation, or lack thereof, of corporate groups also formed part of our investigation. Further, we investigated accounting and auditing law, in a similar comparative approach, allowing us to delve deeply into the area of law where broader societal interests, through so-called non-financial or CSR reporting, has made inroads. While the focus of the Sustainable Companies Project was on environmental externalities, the results are to a great extent transferable to social externalities. Indeed, the reform proposal based on our work, summarised briefly below in section §18.05, takes that broader view.

In core company law, the possibilities for a shift away from business as usual and onto a sustainable path are larger than one might perhaps beforehand have expected. While the mainstream corporate governance debate tends to regard maximisation of shareholder profit as the sole purpose of companies, this is, as a matter of law, to a great extent incorrect, especially understood as society's purpose with companies in aggregate.[24] While company law in some jurisdictions adheres to shareholder value (the legal concept, which we distinguish from the social norm of shareholder primacy), the underlying rationale for facilitating the corporate form through legislation is always

21. More information about this project may be found at jus.uio.no/companies under Projects; Concluded.
22. The board is used in this chapter as a general term encompassing the German *Aufsichtsrat*, the British board of directors and the board as constituted in the Nordic countries. Trying to fit quite different systems, exemplified by the German two-tier variant and the one-tier system of the UK, into one picture of a board level and a management level requires some simplifications, as the German *Aufsichtsrat* and the UK board of directors are two quite different things, with the German *Vorstand* ('management board') having some similarities with the UK board that the *Aufsichtsrat* ('supervisory board') has not, and vice versa.
23. The analysis of the role of and duties of the general meeting in the Sustainable Companies Project is summarised in s. §18.03 *infra*, based on Beate Sjåfjell, et al., *Shareholder Primacy: The Main Barrier to Sustainable Companies*, in *Company Law and Sustainability* 79-147 (Beate Sjåfjell & Benjamin J. Richardson eds, Cambridge University Press 2015).
24. *See* Beate Sjåfjell et al., *supra* n. 23.

Electronic copy available at: https://ssrn.com/abstract=2828573

that it is thought to be beneficial for society through its contribution to economic development. No company law system insists on boards focusing only on returns for shareholders.[25] All jurisdictions expect boards to ensure legal compliance. We see examples of shareholder value jurisdictions like the United Kingdom (UK), expressly stipulating that broader societal concerns should be taken into account.[26] Generally company law across jurisdictions also allow boards to integrate environmental externalities beyond legal compliance, at least as far as the business case argument allows – that is as far as the case can be made that this is profitable for the company in the long run. Within the current system, company law on a comparative basis provides, perhaps, surprising latitude to the board and by extension the management to shape business in a sustainable manner.[27]

However, boards generally do not choose environmentally friendly, low-carbon options within the realm of the business case, let alone challenge the outer boundaries of the scope to pursue profit in a sustainable manner by going beyond the business case. This is because of the overriding social norm of shareholder primacy, which, supported by management remuneration incentives and other drivers, dictates that board and senior managers are the 'agents' of the shareholders and should maximise returns to shareholders as measured by the current share price.[28] This social norm, which is so pervasive that it has become a legal myth,[29] leads to an extremely narrow, short-term, focus on maximisation of returns.[30]

The barrier to corporate sustainability posed by the shareholder primacy norm is exacerbated by the chasm between company law's approach to corporate groups and the dominance and practice of such groups. While companies are 'creatures of national law',[31] corporate groups are international, making a holistic regulation of heterogeneous groups across national borders extremely difficult. The parent company's tight

25. In some jurisdictions environmental sustainability has begun tentatively to make inroads into the explicit duties of the board; *see* e.g., Andrew Johnston, *Reforming English Company Law to Promote Sustainable Companies*, 11 E. C. Law 63 (2014); Tineke Elisabeth Lambooij, *Corporate Social Responsibility: Legal and Semi-Legal Frameworks Supporting CSR: Developments 2000-2010 and Case Studies*, 107-146 (Wolters Kluwer 2010).
26. Charlotte Villiers, *Sustainable Companies: Barriers and Possibilities in UK Company Law*, 11 Int'l. Comp. Corp. L. J., 105 (2013), http://ssrn.com/abstract=2280350 (accessed 27 June 2016).
27. Beate Sjåfjell et al., *supra* n. 23. This is supported for the institutional investors by the report *Resource Efficiency and Fiduciary Duties of Investors*, Final Report, ENV.F.1/ETU/2014/0002, DG Environment, produced by Ernst & Young Cleantech and Sustainability Services (France) on behalf of the European Commission (hereinafter EY Report).
28. *Ibid.*
29. Along with that of shareholders owning companies, which they as a matter of company law clearly do not. For an eloquent dismantling of the myth, *see* Paddy Ireland, *Company Law and the Myth of Shareholder Ownership*, 62 M. L. R. 32 (1999), and Lorraine Talbot, *Critical Company Law* (2nd ed., Routledge 2015).
30. *See* Beate Sjåfjell & Linn Anker-Sørensen, *Directors' Duties and Corporate Social Responsibility (CSR)* in *Boards of Directors in European Companies* (Hanne Søndergaard Birkmose, Mette Neville & Karsten Engsig Sørensen eds, Kluwer Law International 2013).
31. As repeatedly emphasised by the Court of Justice of the European Union, *see Daily Mail*, Case 81/87 [1988] ECR 5483 para. 19: 'companies are creatures of the law' and 'exist only by virtue of [...] national legislation which determines their incorporation and functioning'; repeated *inter alia* in *Überseering*, Case C-208/00 [2002] ECR I-9919 para. 81.

Electronic copy available at: https://ssrn.com/abstract=2828573

control of the group in practice is perversely matched by the limited legal possibilities for holding the parent company liable for subsidiaries' environmental and social transgressions.[32]

As touched upon in section §18.01, so-called non-financial reporting has become a regulatory tool of choice not only for the EU but also for national legislators worldwide, in a desire to influence companies and their investors to take corporate sustainability issues more into account. Inspired by ideas based on reflexive theory, the compromise solution between those wishing to regulate companies' environmental and social performance more strictly and those who do not, is asking companies to report on what they are doing.[33] In spite of good intentions and much hard work in this area, reporting requirements are strikingly insufficient in influencing companies and their investors. Much reporting remains left to voluntary and discretionary measures, leading to risks of corporate capture, lack of comparability, lack of consistency and uncertainty in benchmarking.[34] Notably, the new EU non-financial reporting requirements, while they may be perceived as an intermediary step towards the internalisation of social and environmental impacts, currently lack the scope and the necessary verification requirements to be a real game-changer.[35]

With the shareholder primacy drive thus left mainly unchecked, the resulting general practice of companies is detrimental to those affected by environmental degradation, violation of human rights and economic exploitation today and to the possibility for future generations to fulfil their own needs, as well as to companies themselves. It is also damaging to the interests of shareholders with more than a very short-term perspective on their investment, including institutional investors such as pension funds or sovereign wealth funds.

Accordingly, with the social norm of shareholder primacy identified as a main barrier to corporate sustainability, we see that shareholders on aggregate have a negative impact on society's overarching goals. This is not to say that all shareholders desire this outcome. To the contrary, a rising number of investors today allege to have a broader and more long-term focus, including pension funds, which per definition have a very long-term perspective. However, what may be referred to as socially responsible investing is still a fringe movement,[36] and institutional investors are generally caught up in a system where misguided efforts at promoting efficiency and maximising value have led to short-term return requirements that exacerbate the

32. Beate Sjåfjell et al., *supra* n. 23.
33. Charlotte Villiers & Jukka Mähönen, *Accounting, Auditing and Reporting: Supporting or Obstructing the Sustainable Companies Objective?*, 175-225 in Beate Sjåfjell and Benjamin J. Richardson (eds), *Company Law and Sustainability* (Cambridge University Press 2015).
34. *Ibid.*
35. Charlotte Villiers & Jukka Mähönen, *Article 11: Integrated Reporting or Non-Financial Reporting?*, in *The Greening of European Business under EU Law* 274-311 (Beate Sjåfjell & Anja WiesbrockRoutledge 2015).
36. Benjamin J. Richardson, *Financial Markets and Socially Responsible Investing*, in *Company Law and Sustainability* 226-273 (Beate Sjåfjell & Benjamin J. Richardson eds, Cambridge University Press 2015).

Electronic copy available at: https://ssrn.com/abstract=2828573

narrow, short-term effect of the shareholder primacy drive.[37] While many institutional investors appear to recognise that they in the long run will see detrimental effects of failing to properly consider broader issues, notably climate change, they are under increasing pressure to maximise returns for beneficiaries in a context of persistently low yields and interest rates.

This negative impact is partly within the scope of the law and partly as a result of violation of the law. The former, the negative impact that is within the scope of the law, is a result of the companies and the shareholders exploiting the scope the law gives them to maximise short-term returns through an externalisation of environmental and social concerns, by using loopholes and grey areas and taking advantage of the lack of international regulation of business. The negative impact as a result of violation of the law is an aspect that is often missed in the CSR debate, which speaks about what business and finance should do beyond the law, presupposing legal compliance that is not always present. Talking about what business and investors should do beyond the law serves as a deflection device away from the lack of legal compliance, which may serve to explain also the faith in more reporting requirements as a mechanism, rather than starting with proper supervision and enforcement of the rules and standards that already are in place. Of course, as this chapter also will indicate, there is not a sharp dichotomy between law and ethics, or between lawful and illegal – they are not separate issues but rather a gliding scale on the spectrum from clearly legal and legitimate to obviously illegal and illegitimate. With this in mind, this chapter moves on to discuss what the role of shareholders is under the law, what shareholders' broader moral obligations are or should be, and whether legal reform can contribute to mitigating the negative impact of the shareholder primacy drive.

§18.03 COMPANY LAW, THE GENERAL MEETING AND CORPORATE SUSTAINABILITY

[A] What Company Law Says About the General Meeting

The general meeting has certain duties according to European company law,[38] including the election of the board (or the majority of the board members) and the adoption of the annual accounts and management report.[39] Accordingly, while shareholders

37. In spite of for example the EY report, *supra* n. 12, confirming that institutional investors are allowed to take broader societal concerns.
38. This chapter draws on a limited number of examples from the national company law of EU Member States as well as Norway. The latter is through the European Economic Area Agreement in the position that it implements and applies company law like an EU Member State, with the difference that as a non-member Norway does not have a vote when EU secondary legislation (e.g., the Shareholder Rights Directive) is adopted. For a more extensive discussion with a broader comparative approach, *see* Beate Sjåfjell et al., *supra* n. 23, which this section draws on.
39. This chapter, focusing on European company law, presupposes that all listed companies have a general meeting, as well as a board, as mandatory organs. In the light of the Panama Papers revelations, it is interesting to note that some of the there implicated jurisdictions do not have a general meeting unless the board, on its own discretion, finds that this is useful; Linn

Electronic copy available at: https://ssrn.com/abstract=2828573

generally can choose to be passive ('rational apathy'), company law actually presupposes a minimum level of participation in terms of the decisions that company law requires of the general meeting for the company to be able to carry on with its business.[40]

Shareholders' powers through the general meeting go way beyond the specific issues that company law places on the general meeting's agenda. The extent of the power depends on the jurisdiction, their level of shareholding, the participation of other shareholders and other legal and corporate cultural factors (including for example whether there are staggered boards).[41]

Across jurisdictions the general meeting as a matter of company law has the potential for considerable influence on business, through their decisive power over the articles of association of the company, through electing and removing members of the board, and, in jurisdictions where this is possible, through direct instructions to the board.

[1] The Articles of Association

The general meeting can change the articles of association, also denoted the constitution of the company, and thereby the company's specific purpose. This can affect the scope of the board's discretion or obligation to promote sustainability in its promotion of the interests of the company.[42] Company law provides shareholders in general meeting with full control over the articles of association, and accordingly with broad scope for explicitly embedding sustainability in the articles of association of an individual company. Conversely, these possibilities are barriers to boards or managers wishing to shift the business towards sustainability where majority shareholders disagree with this course of action. Indeed, as we will see below and have already indicated, even the possibility of shareholders using the control mechanisms granted to them by company law may deter boards from carrying out the necessary shift from business as usual towards corporate sustainable.

[2] Appointing and Dismissing the Board

In many jurisdictions, the shareholders in a general meeting have the power to remove members of the board by simple majority. This may be done directly, as in the UK

Anker-Sørensen, *Formålsoppnåelse av NOKUS-regler på en internasjonal, fragmentert 'offshore' finansarena*, draft paper on file with current author.

40. The ongoing reform of the shareholders' rights directive and the stewardship codes, *see* s. §18.04 *below*, indicates a trend in the opposite direction, to require institutional investors to actively engage.
41. *See* Beate Sjåfjell et al. *supra* n. 23, 126-144, and the country reports in *Comparative Corporate Governance: A Functional and International Analysis* (Andreas M. Fleckner & Klaus J. Hopt eds, Cambridge University Press 2013).
42. For instance, the UK's Companies Act of 2006, s. 21. The company's directors will breach their duty to the company if they do not act in accordance with the company's constitution (s. 171(a)).

Electronic copy available at: https://ssrn.com/abstract=2828573

where the general meeting can remove directors by an ordinary resolution. Here, appointments to the board are made in accordance with the articles, and by default this is either by ordinary resolution of the shareholders in general meeting or by a decision of the directors. However, where the board appoints directors, they must retire at the next annual general meeting, although they may offer themselves for reappointment by the shareholders. The role of boards in practice in appointing directors in listed companies in these jurisdictions is reflected in the relevant corporate governance codes, which call for the establishment of a nomination committee consisting of a majority of independent non-executives to 'lead the process for board appointments' and 'make recommendations to the board'.[43] The control of the general meeting over appointment and dismissal of the board may also be indirect, as in Norway and Germany, where there for certain categories of companies may be a corporate assembly or supervisory board with shareholder- and employee-elected members, which appoints and dismisses the members of the board. The law here indirectly gives the general meeting the final say in that the general meeting appoints the majority of the members of the corporate assembly and supervisory board. Moreover, corporate governance codes encourage supervisory board to establish nomination committees. In Germany, that committee should consist exclusively of shareholder representatives who will propose candidates to the supervisory board for recommendation to the general meeting.[44] These powers and practices serve to enforce and exacerbate the misconception that members of the board are agents for shareholders as principals, with maximisation of shareholder returns as their main or only goal.

While these rights may in practice not be used in some companies, typically where the shareholders are dispersed and the cost of coordinating action to remove and replace the board serves as a deterrent,[45] the very existence of these rights will tend to make the board more responsive to shareholders' wishes. Those wishes might be expressed directly but informally through engagement and activism, or indirectly through share sales creating downwards pressure on the share price. Such informal dialogue, in the shadow of a legal right to remove directors, allows shareholders to press their demands even in those jurisdictions, discussed below, where the shareholders in general meeting are either prohibited by law from giving direct instructions or rarely do so in practice.

This right to appoint and dismiss the board certainly brings shareholder interests to the forefront and may be used to promote the interests of the company in a narrow or broad sense. However, for this right to be deployed to influence board decision-making in the direction of corporate sustainability, the majority of shareholders – or at

43. UK Corporate Governance Code B.2.1, https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx (accessed 27 June 2016).
44. Similarly, there has been a recent wave of resolutions demanding proxy access, especially in the USA, *see* 'Proxy access is no cure for US governance', Financial Times, 17 January 2016, http://www.ft.com/cms/s/0/4b9eb89a-bba2-11e5-b151-8e15c9a029fb.html# (accessed 24 June 2016).
45. In the Nordic countries and Continental Europe, controlling shareholders are, however, common.

Electronic copy available at: https://ssrn.com/abstract=2828573

least a well-co-ordinated group of blockholders – would have to back the policy, and even then, there would sometimes be considerable costs of collective action. In the absence of a clear statement of the purpose and interests of the company, these rights create a strong rhetorical suggestion that shareholders are the most important constituency, implicitly giving the social norm of shareholder primacy greater legitimacy.

[3] Other Decisions of the General Meeting Including Instructions to the Board

The general meeting may also influence the direction of the company by approving or rejecting proposals put before it concerning large investments and, of course, distributions to shareholders. In the EU, even minority shareholders have the right to submit a proposal before the general meeting.[46] In some states, majority shareholders in a general meeting can even issue legally binding instructions to the board, of a general or specific nature. However, the ability to instruct the board and thereby the company itself, varies greatly between jurisdictions.

In the Nordic countries, with its strictly hierarchical system,[47] the general meeting is the highest authority. Notably in Norway, a simple majority at the general meeting has a broad competence to instruct the board which extends to specific situations (though this must not go so far as to override the division of labour between the company organs).[48] In Finland, only a unanimous general meeting may make decisions on matters falling within the general competence of the board or the general manager,[49] unless regulated to the contrary in the articles of association.[50]

In a German AG, the general meeting's competence is strictly and exhaustively delimited in law, consisting mainly of rights to approve issuance of new shares, discuss strategy in meetings and to hold management to account by reference to the company's financial accounts. Apart from these express rights, the shareholders in general meeting have no direct say over management, although management (*Vorstand*) may voluntarily put issues before the general meeting.[51] The effect of this is to entrench the management of an AG not only against the supervisory board but also against the

46. *See* Directive 2007/36, Art. 6.
47. Jesper Lau Hansen, *A Scandinavian Approach to Corporate Governance*, 50 Sc. St. L., 125, 133 (2007).
48. Beate Sjåfjell, *Sustainable Companies: Possibilities and Barriers in Norwegian Company Law*, 11 Int'l. Comp. Corp. L. J. 1, http://ssrn.com/abstract=2311433 or http://dx.doi.org/10.2139/ssrn.2311433 (accessed 27 June 2016).
49. Otherwise, the general competence is strictly in the hands of the board, also in matters of great importance (e.g., major structural matters). Additionally, the Finnish law does not recognise the right to give instructions: Jukka Mähönen, *Sustainable Companies Mapping Paper on Company Law Issues: Finland*, a. 2.3.2 working paper on file with current author.
50. AktG, s. 119 II, *see* Gudula Deipenbrock, *The Management Board of a German Aktiengesellschaft, the Managing Directors of a German GmbH, the Unternehmensinteresse and the Goal of Sustainable Development of Companies: Some Fundamentals*, mapping paper, 6 (Sustainable Companies Project, 2010, on file with current author).
51. *Ibid.*

Electronic copy available at: https://ssrn.com/abstract=2828573

shareholders in general meeting. Poland adopts a similar approach, with the general meeting of public companies having no power to instruct the management board, although its power to remove the board means its wishes are likely to be listened to.[52] In the corporate groups that in Germany are defined as 'control groups', the management of controlled AGs are under a legal obligation to act in accordance with instructions given by the controlling company, regardless of its corporate form.[53]

It is common to limit the ability of shareholders to interfere in board and management decisions. In France, the general meeting can probably lawfully give instructions to the board, but cannot deprive it of its management power entirely,[54] while in Spain, the general meeting has a default power to give instructions to the board or subject particular management issues to prior authorisation.[55] In most common law countries, shareholder intervention is a theoretical possibility in law but rarely if ever occurs in practice. In Ireland, the shareholders can exercise 'all the functions of the company' by voting in the general meeting but they normally adopt articles (internal regulations) in a standard form which vests all management powers in the board of directors, but grants the shareholders a (rarely used) power to give directions to the board of directors.[56] Certain matters are reserved to the general meeting by the legislation. The approach in the UK is broadly similar: the company's constitution defines the relationship between the general meeting and board. The default rule vests management in the board, but does allow the general meeting to instruct the directors by a 75% majority.[57] In the absence of this provision in the articles, the shareholders have no power to instruct the directors.[58] Certain key decisions are reserved for the general meeting by legislation, but these do not touch upon the managerial prerogative. Exceptionally, individual shareholders might be able to litigate in the company's name by means of a derivative action, but any attempt by shareholders to bring a derivative action to challenge the directors' weighting of the various factors contained in section 172 of the Companies Act 2006 would face virtually insurmountable 'practical and legal hurdles'.[59]

---

52. Arkadiusz Radwan & Tomasz Regucki, *The Possibilities for and Barriers to Sustainable Companies in Polish Company Law*, 11 Int'l. Comp. Corp. L. J. 1, s. 2.2.2. (2012), http://ssrn.com/abstract=2159217 (accessed 27 June 2016).
53. René Reich-Graefe, *Changing Paradigms: The Liability of Corporate Groups in Germany*, 37 Conn. L. Rev. 789 (2005).
54. Pierre-Henri Conac, *France: The Permanent Reform of Corporate Governance*, 444, in Andreas M. Fleckner & Klaus J. Hopt, *supra* n. 41, at 475.
55. Elena Escrig Olmedo et al., *Sustainable Companies: Spanish Mapping Paper on Company Law Issues*, 17, University of Oslo Faculty of Law Research Paper No. 2012-36, http://ssrn.com/abstract=2181337 (accessed 27 June 2016).
56. Blanaid J. Clarke, *Irish Company Law Mapping Paper*, s. 2.2, University of Oslo Faculty of Law Research Paper No. 2012-35, http://ssrn.com/abstract=2178420 (accessed 27 June 2016).
57. *See* Article 4 of Model Articles for Public Companies. In theory, such a power could be included in the company's constitution or articles, but, given that it is rarely if ever used in the UK and Ireland, shareholders would be unlikely to do this.
58. *Automatic Self-Cleansing Filter Syndicate Co Ltd v. Cuninghame*, 2 Ch 34 (1906).
59. Charlotte Villiers, *supra* n. 26, at 30-32.

Electronic copy available at: https://ssrn.com/abstract=2828573

[B] Promoting Corporate Sustainability Through the General Meeting?

The section above indicates the competences and the powers of the shareholders through the general meeting. While the mainstream corporate governance debate has tended to focus on the rights of the shareholders and the shareholders' possibilities for protecting themselves against exploitation by self-interest-promoting boards and management, we have seen here that company law also invests the general meeting with responsibilities for important corporate decisions. Shareholders can on a general note, unless they on specific grounds are obligated to be active, decide to be passive recipients of possible distributions from the company. However, they may as a general meeting have decisions that they are bound to make – or they may decide to act on their own volition (within the scope company law gives the general meeting, with some variations across jurisdictions as we saw above).

Does company law draw up any duties for the general meeting to use its power in any particular way? Generally speaking, shareholders are not under any obligation to focus on anything and are at liberty to pursue their own financial goals, though institutional investors typically have fiduciary responsibility to their beneficiaries to act in their best interests.[60] As opposed to the board, which does not have a legitimate interest of its own and is given the duty of promoting the interests of the company, shareholders have a legitimate, company law protected right to act and vote so as to further their own legitimate self-interest related to that specific company.[61]

However, there are necessarily limits to this right and in a number of states company law contains general clauses stipulating that shareholders in the general meeting may not secure undue advantages for themselves or others at the expense of the company or other shareholders (this in addition to the principle of equality between shareholders).[62] As such, the concept of the 'interests of the company' as a matter of law serves to limit how far the majority can go in promoting their own interest, as do a variety of minority-protection rules across jurisdictions. Arguably, the purpose of the company and the interests of the company should form a guideline also for the general meeting,[63] informing any assessment of the legality of the general meeting's decisions. What this means will then vary across jurisdictions from the monistic shareholder value approach, where shareholder value comes first but where other interests are to

60. And, as clarified through the EY Report, *supra* n. 12, and supported by the research presented in Beate Sjåfjell et al, *supra* n. 23.
61. There is an interesting trend with shareholder activism being used to promote broader interests, such as awareness of climate change, *see* e.g., *Activist investors score victory at BP annual meeting*, Financial Times (online), http://on.ft.com/1CXenEU (accessed 25 June 2016) and *US shareholder votes on climate change hit record*, Financial Times (online), http://on.ft.com/1UFDqev (accessed 25 June 2016). This still remains a fringe activity. However, notably a group of 1,000 academics is attempting to strengthen this trend, which in the case of Exxon also has the backing of ISS, one of the of world's leading proxy advisers, which advise institutional investors on how to vote at general meetings, *see Academics back Exxon and Chevron climate openness vote*, Financial Times (online), http://on.ft.com/1WpAALt (accessed 25 June 2016).
62. About the principle of equality between the shareholders, *see* the contributions by Andreas Cahn and Pierre-Henri Conac in this book.
63. As we have argued that it does for the board, *see* Beate Sjåfjell et al., *supra* n. 23.

Electronic copy available at: https://ssrn.com/abstract=2828573

be taken into account, to the pluralistic approach where a broad set of interests are not only legitimate interests but are even mandatory.[64]

In practice the general meeting will often through its decisions influence the understanding of the specific company's purpose and its interests. However, we can envisage that the interests of the company may in certain cases inform the drawing of the line between lawful decisions of the general meetings and those that are not, for example where a controlling shareholder wishes through the general meeting to exploit a corporate opportunity through another company in which she also has invested.

This is usually discussed as the shareholders' duty of loyalty, to the company and to the other shareholders. Many states impose a duty of loyalty on the general meeting of shareholders, requiring it not to act in a way that is incompatible with the interests of the company. Shareholders may face liability where they take decisions that give undue or unjustifiable advantages to one or more shareholders, or favour third parties at the expense of shareholders.[65] This duty of loyalty usually applies to the shareholders when they act in general meeting, but it may arguably be more intense and wide-ranging for majority or controlling shareholders than for minority shareholders.[66]

Since the scope of this concept varies in different jurisdictions, the requirements of any duty of loyalty imposed on shareholders might be expected to vary depending on whether a particular country adopts a pluralist version or a narrower, shareholder value one. However, in most cases, this fiduciary duty operates primarily or exclusively as a means of protecting minority shareholders, reflecting the conventional concern of company law with conflicts between majority and minority shareholders. In Germany, the Federal Court of Justice has established a duty of loyalty of majority shareholders towards the company and its minority shareholders.[67] This effectively prohibits the majority shareholders from using their voting rights in a manner that could harm the interest of the company as a whole. This is also the case in the Nordic region, although for example in Norway the lack of court cases where the interests of the company as a separate entity are at stake has opened up scope for arguments that company law only protects the minority shareholders from majority abuse.[68] In France, the duty appears to be less far-reaching, with the courts finding an 'abuse of majority' where a majority shareholder votes against *l'intérêt social* in pursuit of the shareholder's own personal

64. For the full analysis of this, *see* Beate Sjåfjell et al., *supra* n. 23.
65. For example Beate Sjåfjell, *supra* n. 48.
66. *See* e.g., the Portuguese Code of Commercial Companies (Còdigo das Sociedades Comerciais, 1986), Art. 83, where this point is illustrated by Jorge M. Coutinho de Abreu, *Portugal: Synopsis on Corporate Governance*, 788-821 in Andreas M. Fleckner & Klaus J. Hopt, *supra* n. 41.
67. Hanno Merkt, *Germany: Internal and External Corporate Governance*, 521, 545 in Andreas M. Fleckner & Klaus J. Hopt, *supra* n. 41. *See also* the contribution by Andreas Cahn in this book.
68. Beate Sjåfjell; and *see* for Sweden, Finland and Denmark: Jan Bertil Andersson & Frida Segenmark, *Sustainable Companies: Barriers and Possibilities in Swedish Company Law*, 9-10, University of Oslo Faculty of Law Research Paper No. 2013-09, http://ssrn.com/abstract=224 8584 (accessed 27 June 2016); Jukka Mähönen, 23, *supra* n. 49; Karin Buhmann et al., *Mapping of Danish Law Related to Companies' Impact on Environment and Climate Change*, 12-13, Nordic & European Company Law Working Paper No. 10-36, http://ssrn.com/abstract=2257750 (accessed 27 June 2016).

Electronic copy available at: https://ssrn.com/abstract=2828573

interest; however, this remedy, which is widely used in France, only operates to protect the interests of minority shareholders.[69]

Common law countries do not impose a general fiduciary duty on shareholders to act in the interests of the company, but some may impose a fiduciary duty on the general meeting in certain exceptional circumstances, such as when it is changing the constitution, or making other changes, which might adversely impact minority shareholders. However, it is certainly arguable that, if a company has a constitution which allows the general meeting to take management decisions, or if the general meeting exercises its power to instruct the board, it should act in the interests of the company (as defined in the law of the particular common law jurisdiction).[70] Other jurisdictions, like Switzerland, apparently do not impose fiduciary duties on shareholders at any level.[71]

Promoting the interests of the company may arguably only take place within the boundaries of the law – it can never be within the legitimate interests of the company to exploit lack of detection or enforcement of violation of the law, in the company's home state or in the host states in the case of international business. Consequently, the general meeting can also not knowingly promote violation of the law by making corporate decisions on such a basis. Accordingly, the general meeting cannot adopt the annual accounts if they know that they do not comply with the law, nor accept distributions on such a basis. It may similarly be argued that the general meeting should consider current and future board members' ability and willingness to ensure legal compliance in the company, such that a pattern of lack of legal compliance in a company should call for replacing the board. This is at the core of the monitoring role that the general meeting is meant to have and which forms part of the theoretical justification for shareholders having decisive rights in the company.[72]

These arguments give rise to further questions of whether and to what extent the general meeting has a duty to follow up on any suspicions of violations of the law, for example based on media reports about the company. Arguably the general meeting has such a duty – most likely with variations across jurisdictions – and if not, should have such a duty. This could take the form of requiring further documentation from the board or the auditor before adopting annual accounts or accepting distributions from the company.

A related question is whether shareholders can vote to accept the board's proposal for distributions if they know or have reason to suspect that profits have been created in violation of ethical codes that the company has given recognition to, for example through signing up to Global Compact. In light of the Panama Papers revelations the general meeting should arguably also according to the circumstances, where this is put to the general meeting to decide on, request further documentation

69. Pierre-Henri Conac, *supra* n. 54.
70. Beate Sjåfjell et al., 135-137, *supra* n. 23.
71. Peter V. Kunz, *Switzerland: The System of Corporate Governance*, 868, 887-888, in Andreas M. Fleckner & Klaus J Hopt, *supra* n. 41.
72. Beate Sjåfjell, s. 4.3, *supra* n. 9.

Electronic copy available at: https://ssrn.com/abstract=2828573

before accepting a corporate restructuring for 'tax optimisation'.[73] There is not a clear line between law and (mere) ethics, as we will discuss further in section §18.04 below. To the extent that the argument can be made that the company has signed up to ethical codes, these should form part of the legitimate purpose and interests of the company, also for the general meeting.

However, this does not give a much of a general company law basis for drawing up firm duties for the general meeting in terms of promoting corporate sustainability, although we may anticipate interesting future developments in this field, as ethical guidelines become more prevalent and increasingly recognised in and integrated into accounting law, corporate governance codes and stewardship codes. As the role and duties of the board of the company, with its pivotal role in promoting the interests of the company, develops, this will arguably also have a knock-on effect on the role and duties of the general meeting. Indeed, there are also indications that not only the role of the majority or controlling shareholders is under development: the Norwegian National Contact Point (NCP) set up to promote and oversee compliance with the OECD Guidelines for Multinational Enterprises, has found that the OECD Guidelines also apply to the financial sector including to minority investors, notably the Norwegian Pension Fund Global.[74] As stated by the Norwegian NCP these cases raise questions about what type of due diligence can be expected of a minority shareholder, and questions of principle concerning application of the OECD Guidelines in relation to financial institutions. A process is ongoing in the OECD to specify expectations of the financial sector, including of minority shareholders.[75]

The consequences of the general meeting's decisions being in conflict with the legitimate interests of the company will also vary across jurisdictions, and this chapter does not give scope to investigate these variations. The consequences of being seen to be in conflict with ethical guidelines, such as the OECD guidelines, would normally not be judicial but may have reputational impacts and could exceptionally also form a separate basis for legal recourse based for example on contractual arguments, where a contractual party has emphasised the company's recognition of ethical guidelines when entering into a contract.

The academic discussion about the imposition of a broader set of fiduciary duties for the shareholders, as in duties to ensure the achievement of the societal purpose of

73. About the Panama Papers, *see* e.g., *What are the Panama Papers? A guide to history's biggest data leak*, The Guardian, http://www.theguardian.com/news/2016/apr/03/what-you-need-to-know-about-the-panama-papers (accessed 25 June 2016); and *see* e.g., this marketing of 'tax optimisation': BRIS Group, '*The difference between tax planning and tax optimisation*', http://bris-group.com/difference-tax-planning-tax-optimisation/ (accessed 25 June 2016).

74. *See* the case concerning *Human rights breaches related to manufacturing of iron in India*, OECD Responsible Business Conduct Database of 9 October 2012, http://mneguidelines.oecd.org/database/instances/no0009.htm (accessed 25 June 2016). In spite of strong objections from the Norwegian Government after the first case, the Norwegian NCP has upheld its position in new cases, *see NCP Norway concludes two new specific instances regarding NBIM*, http://nettsteder.regjeringen.no/ansvarlignaringsliv-en/2015/07/02/ncp-norway-concludes-two-new-specific-instances/ (accessed 25 June 2016).

75. *Ibid.*

Electronic copy available at: https://ssrn.com/abstract=2828573

companies, has just begun.[76] Overall, to the extent that a fiduciary duty is imposed on shareholders, it seems to offer little or nothing in terms of furthering corporate sustainability. Principally it is in practice a means of protecting minority shareholders and may even act as a restraint on majority shareholders wishing to shift the company onto a path of corporate sustainable. Indeed, the purpose of the specific company may in itself be in conflict with corporate sustainability, so that even if shareholders promote the interests of the company, this does not necessarily mean that they promote corporate sustainability. And even when shareholders directly influence the company to violate legal obligations to protect broader societal interests, such as the environment, the shield of limited liability tends to protect the shareholder.[77]

[C] Shareholder Influence Outside the General Meeting

Shareholders can influence the company in a number of ways outside the general meeting. This may be so prevalent that this, combined with opaque structures of corporate and financial complexity, may tend to render the general meeting irrelevant. It therefore deserves a brief discussion in this chapter focusing on the impact of the shareholders through the general meetings. I will concentrate here on shareholder dialogue.

The concept of shareholder dialogue is not recognised by company law but is given some legitimacy by its inclusion in corporate governance codes and it is encouraged in stewardship codes.[78] It typically consists of informal, private meetings between select shareholders and the chair of the board or the chief executive officer. Such meetings are non-transparent and significant channels for shareholder influence. Although this also gives scope for influence by minority (institutional) investors, active majority shareholders will naturally have the most clout. Depending on the inclination of the most active shareholders, the board and management of the company may be guided by signalling from shareholders, which is quite detached from the decision-making framework envisaged by company law. This may reduce company law to a formal structure with which companies must comply, but which has little or no impact on corporate decision-making. The legitimacy of such dialogue is highly questionable, especially when it is used as the only channel for shareholder influence beyond appointment of the board.[79] It speaks strongly to the dominance of the corporate

76. Iman Anabtawi & Lynn A. Stout, *Fiduciary Duties for Activist Shareholders*, 60 Stan. L. Rev. 1255 (2008).
77. *See* further on this issue and especially as regards parent companies, Beate Sjåfjell et al, s. 4.3, *supra* n. 23, on shareholder sanctions and liabilities.
78. Iris H-Y Chiu & Dionysia Katelouzou's contribution to this book.
79. This is the case for example in the controversies surrounding the Norwegian state's refusal to enter into any discussion of whether it should use its power as majority shareholder to instruct Statoil to withdraw from Canadian oil sand projects, *see* Beate Sjåfjell, s. 1.3, *supra* n. 48; with a new energy in the debate after recent corruption scandals regarding the Norwegian State-controlled companies and the Panama Papers' highlighting of the Norwegian State-controlled bank's involvement in the setting up of tax haven structures through its subsidiary in Luxembourg.

Electronic copy available at: https://ssrn.com/abstract=2828573

governance movement that such a practice, which arguably is against the fundamental principles of company law, has become so firmly established.

Shareholder involvement in corporate governance – both formal and informal – tends to be viewed in the common law world as a solution to the short-term focus of board and senior management's decision-making under the shareholder primacy model. Notably, in the UK, institutional shareholder 'involvement' is encouraged through the 'Stewardship Code', which aims 'to promote the long term success of companies in such a way that the ultimate providers of capital also prosper'.[80] Pension funds and other institutional investors may hold out the prospect of more socially responsible decision-making, given their longer-term time horizons. However, it should also be noted that those same funds have to earn sufficient returns to meet their obligations to existing beneficiaries at a time when central banks have locked down long-term interest rates.[81] Moreover, to the extent that the activism is being carried out by hedge funds, it may have the effect of reinforcing the short-term financial focus of shareholder primacy, curtailing board and management discretion.[82]

In the context of the corporate group, the parent company as shareholder of the subsidiaries may find communicating directly with the chair of the board or the manager of the subsidiaries more efficient. Members of the boards of subsidiaries may typically be employees of the parent company, rendering the idea of promoting an independent company interest as opposed to a group interest or parent company interest an academic exercise for which there is little space in everyday business life.

What boundaries, if any, are there for the influence of the shareholders outside the general meeting? Shareholders who are bound by other norms to act socially responsible and ensure that the company in which they have shares do the same, are arguably bound by this also in the shareholder dialogue. This is relevant for institutional investors and for the state as majority shareholder, as the argument has been made in Norway. In practice, the question is to a great extent moot as we most often cannot find out what takes place in these dialogue meetings – which serves further to illustrate the illegitimacy of exercising shareholder influence mainly in this manner.[83]

80. Kay, *The Kay Review of UK Equity Markets and Long-Term Decision-Making*, 53 which emphasises that 'engagement goes beyond merely voting', https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf (2012). For a critical analysis, *see* Lorraine Talbot, *Why Shareholders Shouldn't Vote: A Marxist-progressive Critique of Shareholder Empowerment*, 76 M. L. R. 791 (2013).

81. *See* David Millon, *Shareholder Social Responsibility*, 36 Seattle U. L. Rev. 911 (2013).

82. Gospel and Pendleton report that activist hedge funds sometimes purchase a stake in a company 'with the prior intention of securing changes' and typically aim 'to secure returns from activism within a year or so'; Howard Gospel & Andrew Pendleton, *Financialization, New Investment Funds, and Labour*, in *Financialization, New Investment Funds, and Labour: An International Comparison* 1, 13-18 (Howard Gospel, Andrew Pendleton & Sigurt Vitols eds, Oxford University Press 2014). *See also US activist hedge funds form UK bridgehead for charge into Europe*, Financial Times, http://on.ft.com/1j3Nlae (accessed 27 June 2016).

83. That some shareholders exceptionally use the shareholder dialogue to promote sustainability issues does not change that the practice itself – of closed, non-transparent meetings with select shareholders – is illegitimate, nor that the shareholder influence in aggregate is detrimental.

Electronic copy available at: https://ssrn.com/abstract=2828573

§18.04 SHAREHOLDERS' EMERGING AND POTENTIAL DUTIES

As discussed in Iris Chiu and Dionysia Katelouzou's contribution to this book, stewardship codes have developed internationally, inspired by the UK stewardship code, with the aim of improving investors' governance. Chiu and Katelouzou see the reform proposal of the Shareholder Rights Directive as a step towards firming up the stewardship voluntary approach and moving towards shareholder duties through its disclosure duties, although also the directive is based on comply or explain. The proposed Directive encourages 'shareholder engagement' including the 'monitoring' of investee companies alone or cooperating with other shareholders on matters 'including strategy, financial and non-financial performance, risk, capital structure, human resources, social and environmental impact and corporate governance'.[84]

Similarly, the reform proposal of the IORP Directive, with the aim of strengthening 'the capacity of IORPs to invest in assets with a long-term economic profile and support the financing of sustainable growth in the real economy', asks that the pension funds should, as part of their risk management system, 'include new or emerging risks, such as risks related to climate change, resource use or the environment'.[85] The beneficiaries are sought included as stakeholders, with the reform proposal setting out that the pension funds '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'.[86]

The attempt of stewardship codes, and also the proposed reform of the Shareholder Rights Directive and the IORP Directive, aimed at the shareholders, to mitigate the negative impacts of the narrow and short-term shareholder primacy drive may be compared to the tentative introduction, aimed at the companies, of CSR into corporate governance codes for listed companies.[87] They suffer from the same limitations of not confronting shareholder primacy but rather expecting through incremental improvements to transform 'business as usual' into something environmentally, socially and economically sustainable.

84. Shareholder Rights Directive, Amendments adopted by the European Parliament on 8 July 2015 on the proposal for a directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement (COM(2014)0213 – C7-0147/2014 – 2014/0121(COD)), Art. 2 h. The reform proposal of the IORP Directive goes in the same direction.
85. IORP Directive reform proposal, *supra* n. 12, preamble and Art. 29.
86. *Ibid.*, Art. 55.
87. Daniel Gergely Szabó & Karsten Engsig Sørensen, *Integrating Corporate Social Responsibility in Corporate Governance Codes in the EU*, 24 E. B. L. R. 781 (2013), available at SSRN, http://ssrn.com/abstract=2081611 (accessed 25 June 2016). For a discussion of this, *see also* Beate Sjåfjell, *When the Solution Becomes the Problem: The Triple Failure of Corporate Governance Codes*, working paper presented at conference 'Reflections on Voluntary Corporate Governance Codes: Is it now time to move on from a "soft law" approach to a "hard law" approach?', Hong Kong, 25-26 April 2016 (forthcoming on SSRN), where also some exceptional positive developments, notably the South African and Dutch corporate governance codes, are discussed.

Electronic copy available at: https://ssrn.com/abstract=2828573

These efforts appear totally insufficient in light of the strongly entrenched shareholder primacy drive, with its narrow, short-term effect supported by the quarterly requirements for returns imposed on institutional investors. Also, apparently the Commission's proposal to foster long-term, engaged shareholding is based on their analysis of jurisdictions where there already exist patient investors (usually either families or foundations) who are strongly involved in the companies and steer according to a long-term business strategy. The Commission appears to have overlooked cultural factors, which cannot be easily or quickly reproduced through pan-European regulation. Nor can it be said that these investors, although arguably long-term in the traditional economic and also social sense, have a sufficiently broad perspective to fully encompass all three dimensions of corporate sustainability.

There are also significant ethical guidelines with far-reaching impacts on the corporate sustainability discourse, aimed at the companies and with direct or knock-on relevance for the shareholders, such as the OECD Guidelines for Multinational Enterprises with their unprecedented system of National Contact Points, and the UN Guiding Principles on Business and Human Rights, which are sought implemented in national action plans.[88] Together with Global Compact and other guidelines, principles and initiatives such as Integrated Reporting, they have informed the debate on corporate social responsibility and accountability, and have made their inroads into reporting rules in accounting law as well as into corporate governance codes.[89] This is not either in any way sufficient to mitigate the shareholder primacy drive, but it serves to stimulate the interesting ongoing discussion on where we are at any given point in time on the gliding scale from ethics to law. Is also serves to inform the necessary debate on how to regulate for corporate sustainability.

We have also seen that courts can step in where legislators hesitate, and stipulate duties notably for parent companies through groundbreaking decisions.[90] The decisions of the Norwegian OECD National Contact Point, while not having direct legal significance, also identifies duties of the minority shareholder in complying with the OECD guidelines, which illustrates the dynamic nature of the gliding scale from clear hard-law obligations to ethical obligations – what appears today to be a (mere) ethical obligation may tomorrow be recognised as a legal duty.

§18.05 CREATING SUSTAINABLE VALUE WITHIN THE PLANETARY BOUNDARIES

In previous contributions, I have presented a tentative proposal to reform company law, with the aim of contributing to shifting companies from the unsustainable

88. For the OECD guidelines, *see* http://www.oecd.org/corporate/mne/ (accessed 27 June 2016); for the UN Guiding Principles, *see* https://business-humanrights.org/en/un-guiding-principles-on-business-and-human-rights-1 (accessed 27 June 2016).
89. On Integrated Reporting, *see* http://integratedreporting.org/ (accessed 27 June 2016).
90. Linn Anker-Sørensen, *Parental Liability for Externalities of Subsidiaries: Domestic and Extraterritorial Approaches*, University of Oslo Faculty of Law Research Paper No. 2014-36 (2014); Nordic & European Company Law Working Paper No. 14-06, available at http://ssrn.com/abstract=2506508 or http://dx.doi.org/10.2139/ssrn.2506508 (accessed 27 June 2016).

Electronic copy available at: https://ssrn.com/abstract=2828573

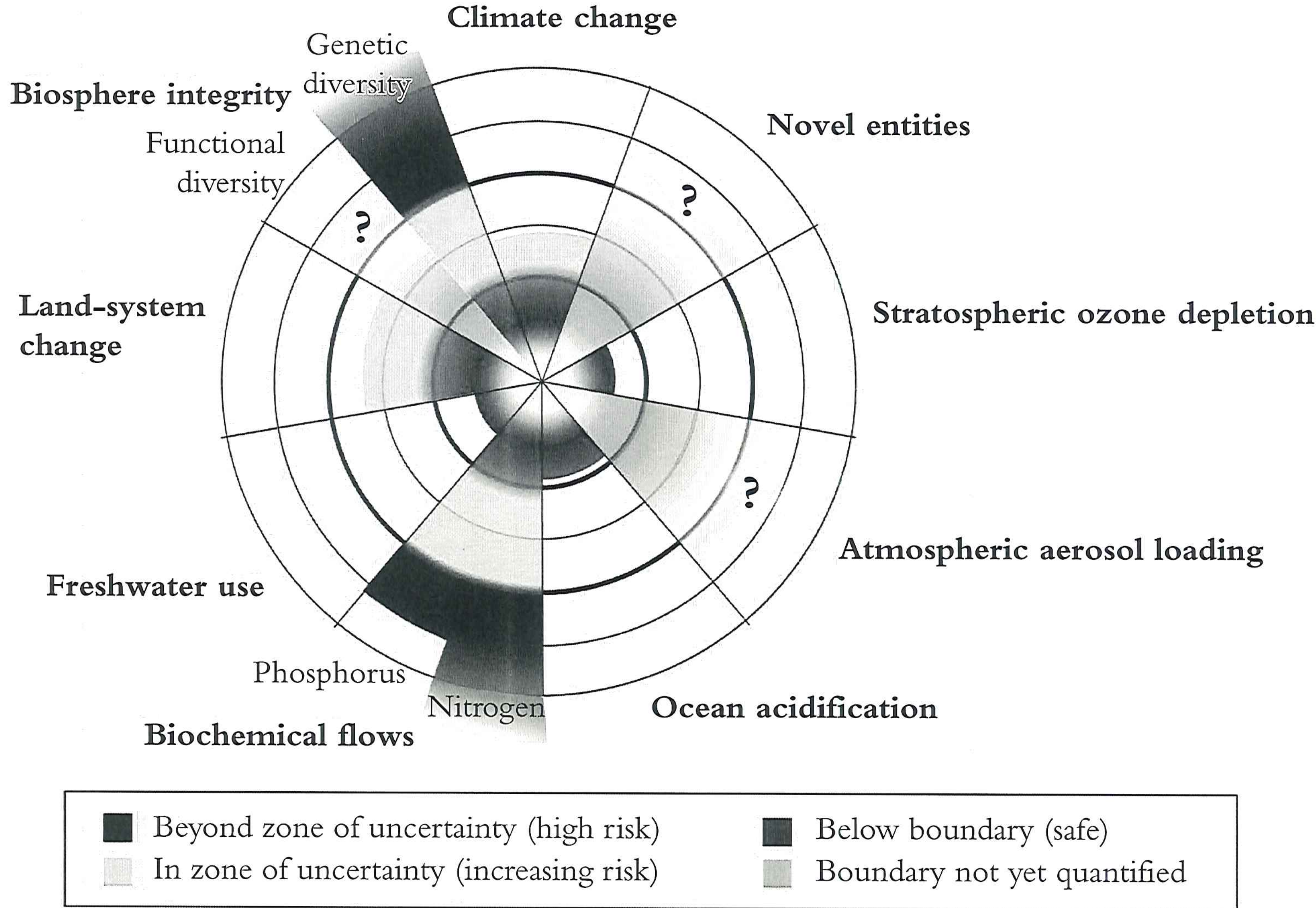
'business as usual' and over onto a path of corporate sustainability. This idea for a reform proposal was in its first version presented together with Jukka Mähönen on the Nordic level, and thereafter, informed by inspiring discussions in the Sustainable Companies team, as a potential EU law proposal.[91] The main content of this tentative reform proposal has been to redefine the purpose of the company and the role and duties of the board. After recapitulating the main content of this reform proposal, I will below briefly discuss how the role of the general meeting and the duties of the shareholders could be integrated into such a reform.

The reform proposal is informed by the knowledge that if we are to achieve a safe operating space for humanity, we cannot continue with incremental improvements; neither can we focus on whichever environmental or social challenges are given the most attention at any one time. The concept of planetary boundaries,[92] state-of-the-art natural science,[93] embodies this fundamental recognition of the non-negotiable ecological limits and should form the space within which all economic and social development is to take place. This concept should therefore be a key issue in a redefined purpose of companies as a matter of company law.

It is estimated that humanity has already transgressed four of the nine planetary boundaries shown in Figure 1 including climate change, biosphere integrity, biogeochemical flows and land-system integrity.[94] The conceptual framework for planetary boundaries proposes a strongly precautionary approach, by 'setting the discrete boundary value at the lower and more conservative bound of the uncertainty range'.[95]

91. Beate Sjåfjell & Jukka Mähönen, *Upgrading the Nordic Corporate Governance Model for Sustainable Companies*, 11 E. C. L. 58 (2014), available at http://ssrn.com/abstract=2471495 (accessed 27 June 2016), and Beate Sjåfjell, *Corporate Governance for Sustainability: The Necessary Reform of EU Company Law*, 97-117 in Beate Sjåfjell & Anja Wiesbrock, *supra* n. 35.
92. *See* Johan Rockström et al., *supra* n. 16.
93. An example of its use is Bjørn Nykvist et al., *National Environmental Performance on Planetary Boundaries: A Study for the Swedish Environmental Protection Agency*, Report 6576 (Swedish Environmental Protection Agency 2013), available at http://www.naturvardsverket.se/Documents/publikationer6400/978-91-620-6576-8.pdf (accessed 30 June 2016).
94. The other five being global freshwater use, ocean acidification, atmospheric aerosol loading, stratospheric ozone depletion, and cycling of phosphorus and nitrogen. *See* Will Steffen et al., *supra* n. 16.
95. Johan Rockström et al., *supra* n. 16.

Electronic copy available at: https://ssrn.com/abstract=2828573



Electronic copy available at: https://ssrn.com/abstract=2828573

To integrate this into company law, the purpose of companies should be redefined, for example in an EU company law directive, as:

> The purpose of a company is to create sustainable value within the planetary boundaries while respecting the interests of its investors and other involved parties.

The fundamental key issues here are the purpose of creating 'sustainable value' and the space within which value can be created; that is, 'within the planetary boundaries'. The concept of 'within the planetary boundaries' clearly signals that these are non-negotiable boundaries where the room for trade-offs is limited.[96] At the same time, to develop this idea into a proper legislative proposal, the concept of sustainable value must be given content in, e.g., the directive's explanatory notes. The basic idea is that 'sustainable value' is long-term and inclusive and stands in opposition to short-term pursuit of shareholder returns. Protection and promotion of the interest of the shareholders, other investors and other involved parties, including employees, creditors and other contractual parties, is encompassed through the formulation that sustainable value is to be sought 'while respecting the interest of its investors and other involved parties'.[97] Broader societal impact can also be included in the concepts of 'sustainable value' and 'other involved parties' depending on how this is defined in explanatory notes and implemented, interpreted and put into practice. Yet the ultimate goal remains to achieve not only a safe operating space for humanity but a safe and *just* space for humanity.[98]

To operationalise this redefined purpose it must be integrated into the duties of the board[99] and companies should be required to draw up a long-term, life-cycle based sustainable business plan. As the European Commission has observed, boards have a 'vital part to play in the development of responsible companies'[100] and businesses should:

> have in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders, with the aim of: maximising the creation of shared value for their owners/shareholders and for their other stakeholders and

96. This distinguishes the proposal from the much debated 'enlightened shareholder value' in the UK Companies Act, *see* e.g., Andrew Johnston, 63-66, *supra* n. 25 and emphasises the non-negotiable ecological limits as opposed to what is done in the traditional pluralistic approach of Continental-European law. *See also* Tineke Elisabeth Lambooij, 107-146, *supra* n. 25.
97. Using 'investors' rather than 'shareholders' recognises the complex structures of finance through, *inter alia*, debt, equity or grants.
98. *See* Kate Raworth at http://www.kateraworth.com/doughnut/ (accessed 27 June 2016).
99. The duties of the board are arguably the best place in the regulatory ecology of the companies. On the significance of boards *see* e.g., Beate Sjåfjell & Linn Anker-Sørensen, *supra* n. 15. For a further discussion of the concept of regulatory ecology, *see* Beate Sjåfjell & Mark B. Taylor, *Planetary Boundaries and Company Law: Towards a Regulatory Ecology of Corporate Sustainability*, University of Oslo Faculty of Law Research Paper No. 2015-11, available at http://ssrn.com/abstract=2610583 (Accessed 26 May 2015).
100. COM(2011) 681 final, 5.

Electronic copy available at: https://ssrn.com/abstract=2828573

society at large; and identifying, preventing and mitigating their possible adverse impacts.[101]

The OECD Guidelines for Multinational Enterprises also support the formulation of such duties.[102]

Therefore, at the EU level, directors' duties should be reformulated as follows:

> The board of the company is to ensure the life-cycle based creation of sustainable value. To this end, the board shall adopt and regularly revise a long-term business plan for the company, based on a life-cycle assessment of the company's main areas of business.

A mandatory table of contents of the sustainable business plan should be drawn up as an annex to the directive to encourage proper compliance and comparability between companies. Guidelines, endorsed by the European Commission, should set out how the relevant and sufficient key performance indicators (KPIs) are to be selected according to the sector and concrete business plan of the company.

The operationalisation of the board's duty to ensure life-cycle based creation of sustainable value is the sustainable business plan, which should contain the long-term plan for the company.[103] The sustainable business plan should outline how the company will achieve life-cycle based value creation within the planetary boundaries. A requirement for such a sustainable business plan, designed thoughtfully, would involve a standardisation of a process that companies wishing to achieve long-term sustainable value would need to do anyway. The standardisation would contribute to lowering costs and establishing a level playing field.

This proposal, with its life-cycle focus on the products and services that businesses offer, fits well with the integrated product policy of the EU where the life-cycle perspective is identified as the leading principle[104] as it does with the public procurement reform, where life-cycle costing is an important approach to including broader concerns.[105] A full life-cycle analysis to identify and mitigate negative environmental and social impacts would have to be undertaken for any products the company sells or services it offers, either by the company itself or by the manufacturer/supplier.[106] This

101. COM(2011) 681 final, 6.
102. OECD, *OECD Guidelines for Multinational Enterprises* (2011), 42-46, available at http://www.oecd.org/corporate/mne/48004323.pdf (accessed 27 June 2016), at 42-46.
103. A tentative indication is that long-term here would be 15-30 years (or the full time span of the company if it has a shorter time horizon).
104. *See* Eléonore Maitre Ekern, *Towards an Integrated Product Regulatory Framework Based on Life Cycle Thinking*, 144-162 in Beate Sjåfjell & Anja Wiesbrock, *supra* n. 35. *See also* the European Commission's Joint Research Centre's establishment of the European Platform on Life Cycle Assessment (EPLCA), http://eplca.jrc.ec.europa.eu/ and the identification in the EC's 2003 Communication of life cycle assessments as being the 'best framework for assessing the potential environmental impacts of products'. *See* European Commission, *Integrated Product Policy*, COM(2003) 302 final.
105. *See* Dacian C. Dragos & Bogdana Neamtu, *Life-cycle Costing for Sustainable Public Procurement in the European Union*, 114-137 in Beate Sjåfjell & Anja Wiesbrock, *supra* n. 36.
106. This would entail a cradle-to-cradle perspective of a product, including every phase from the sourcing of the materials used in the production through to the production, marketing and selling of the product, to the user phase and finally to the recycling or waste management of the product, in order to identify all environmental and social impacts.

Electronic copy available at: https://ssrn.com/abstract=2828573

would be a way of dealing with the pulverisation of responsibility for environmental and social impacts that we see today through multinational groups of companies and international supply chains. Any European company would need to draw up its own life-cycle based business plan or substantiate that this was included, for example, within a parent company's sustainable business plan.[107]

The sustainable business plan should further include milestones or objectives to be achieved along the way and KPIs for impacts that are relevant, quantifiable and that can be reported on annually by a company. The long-term plan should be broken down into shorter time segments,[108] requiring a company, at these regular intervals, to undertake a full assessment of its sustainable business plan and consider necessary revisions.

As an intrinsic part of such a reform, the role and duties of the general meeting should also be included. The aim of including the role and duties of the general meeting would be to ensure that the general meeting promotes the redefined purpose of the company, and conversely, that the shareholders do not exert direct or implicit pressure on the board to undermine the reform.

A comprehensive legal reform should include a general clause to stipulate that the general meeting in all its decisions is to promote the overarching purpose of the company; that is to create sustainable value within the planetary boundaries while respecting the interests of its investors and other involved parties. It could specifically state that the general meeting's decisions concerning the board (and by extension the management of the company), should support the board in its duty to ensure the life-cycle based creation of sustainable value.

The general meeting's duty to adopt the annual accounts should specifically mention reporting according to the sustainable business plan, as a contribution towards treating the hitherto denoted non-financial reporting as seriously as financial reporting is treated today.

The general clause that several jurisdictions have, setting out the general meeting must not make decisions that go unfairly to the detriment of the company or of other shareholders, could be envisaged included in an EU directive, to make it generally applicable. It should there be broadened to state that the general meeting cannot make decisions that unfairly compromise the company's ability to create sustainable value within the planetary boundaries.

Private enforcement should be considered, through making it possible to challenge decisions of general meetings on the grounds of their unsustainability, for example if a distribution, or a merger and acquisition decision, endangers the company's long-term sustainability as envisaged in the sustainable business plan.

The ideas presented above are, as is apparent, quite tentative. It does seem safe to conclude, however, that a meaningful regulatory reform for corporate sustainability, where the role and duties of the board should be central, would need also to include the

107. An issue for further research will be how to ensure that such a reform is not circumvented through companies in third countries selling their products to European purchasers.
108. For example, these periods could be 15 years in length, but broken down into three or five year segments.

Electronic copy available at: https://ssrn.com/abstract=2828573

role of the general meeting and of shareholders more generally, as does the pervasive issue of the corporate groups. As a small step forward in mitigating the problem with 'secret' shareholders, and inspired by the Finnish companies act, shareholder transparency should be a prerequisite for voting at the general meeting.[109]

Also, regulation to make transparent and limit the shareholders' influence on the company outside of the general meeting should be considered. That this is now regarded as good corporate governance and recommended also in the stewardship codes is symptomatic of the systemic nature of the problems with our current corporate governance system.

§18.06 A NECESSARY AND SYSTEMIC DEBATE

The limitations to regulating shareholders for corporate sustainability are clear, with shifting shareholders, synthetic shareholders, unknown shareholders and 'secret' agents.[110] Nevertheless, we cannot leave the situation as it is. With the shareholder primacy drive as a pervasive social norm strengthened through economic incentives and the power shareholders through the general meeting usually have over boards (to replace them at will), has had serious negative impacts on corporations and on corporate sustainability. Combining this state of affairs with an overly strong emphasis on shareholders rights' in relation to the company, and mainly discussing shareholders' duties in other contexts, notably between shareholders,[111] strongly suggests that a new approach is required.[112]

Clearly, we are only just at the starting point of a debate that is complex and necessary to have on a systemic level. Resistance may be expected from strong economic forces wishing to keep status quo as well as from path-dependent legislators.

This book provides a basis for the further development of a coherent systemic analysis as regards shareholders' rights and obligations under European law. Analysing the role of shareholders is a significant part of a systemic analysis, which must encompass the interaction of the market actors: businesses, investors, consumers and the public sector in its many roles as market actor (shareholder, investor, public procurer). A systemic analysis requires that we position our analysis within the planetary boundaries and with the aim of securing humanity's social foundation within

109. This as opposed to the minimum dividend rule in the Finnish Companies Act, which should be abolished and not copied.
110. Linn Anker-Sørensen, *supra* n. 18.
111. Examples here are both the enactment of the Takeover Directive, Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (Text with EEA relevance), and the enactment of and the European Commission's proposal to reform the Shareholder Rights' Directive (in spite of the more progressive reform proposals from the European Parliament), *supra* n. 84.
112. That the EY Report, *supra* n. 12, discourages regulation ('This study does not *see* a need for legal changes in relation to fiduciary duty, but instead take action to engage, enable and encourage the entire investment community in the practical aspects of taking environmental and resource efficiency issues into consideration in their investment decision process') illustrates, in my opinion, how using auditing firms, law firms and consultancies for policy work will tend to reinforce status quo.

Electronic copy available at: https://ssrn.com/abstract=2828573

the environmental ceiling. While this chapter has focused on European law, a comprehensive systemic analysis must also relate to international law and recognise and understand the interaction between European policy-makers and market actors and those of other parts of the world. The international research project Sustainable Market Actors for Responsible Trade (SMART, 2016-2020) aims to conduct such a systemic analysis, with the invaluable support of its growing global network.[113]

We know that 'business as usual' is not an alternative. So, lest we end up fiddling while the world burns, we should use our positions as business scholars to contribute to the necessary rethinking of the regulation of business and finance, including shareholders. We have the knowledge to recognise the problem and the resources to deal with it. If we are successful, we will leave behind a fairer and better world for humanity. What greater academic aim could there be?

113. For more information on this H2020-funded project, *see* uio.no/smart. Interested scholars are invited to become members of the Sustainable Market Actors Network, *see* jus.uio.no/companies under Networks.

Electronic copy available at: https://ssrn.com/abstract=2828573