

# Realising the potential of the board for corporate sustainability

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## 1. Introduction

The corporation is the dominant business form for large, capital-intensive business. Other forms for doing business, including new and old versions of social entrepreneurship, may contain the potential of being agents for change in the economy.<sup>1</sup> But if we do not at least also redefine the corporation, we risk that social entrepreneurship becomes a moral deflection device,<sup>2</sup> which even may reinforce the legal myth that corporations are duty-bound to maximise returns for shareholders.<sup>3</sup> As set out in the Introduction to this Handbook, the impact of the corporation on society and its potential for corporate sustainability is vital to our and future generations' survival.<sup>4</sup> Accordingly, this chapter focuses on the corporation, as the dominant form of doing business, and specifically on the role and core duties of the corporate board.

As a matter of corporate law, the corporate board has a crucial role in determining the strategy and the direction of the corporation, and supervising how this plays out.<sup>5</sup> As also the European Commission has observed, boards have a 'vital part to play in the development of responsible companies'.<sup>6</sup> However, the function of the corporate board is, generally speaking, constrained through the social norm of shareholder primacy with its narrow and short-termistic fixation on maximization of returns for shareholders, reinforced through the intermediary structures of capital

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<sup>1</sup> See C. Liao, 'Social enterprise law: friend or foe to corporate sustainability?', Ch. 46 in this volume; V. Pönkä, 'The cooperative as a platform for sustainable business operations', Ch. 48 in this volume.

<sup>2</sup> Even if they did become influential enough, there is a danger that they may be corporatized, as the argument is that cooperatives have been, although this trend may now be shifting, see H. Henry, 'Trends and Prospects of Cooperative Law', in D. Cracogna, A. Fici and H. Henry (eds.), *International Handbook of Cooperative Law* (Heidelberg: Springer, 2013), pp. 803-823.

<sup>3</sup> The debate in Canada in 2019 has emphasised both this danger and highlighted how promoting allegedly more socially responsible business can become a business venture in itself, see e.g. C. Liao, 'B.C. MLAs should recognize "benefit corporation" is an American branding exercise', *The Globe and Mail*, 21 Oct. 2018, [www.theglobeandmail.com/business/commentary/article-bc-mlas-should-recognize-benefit-corporation-is-an-american/](http://www.theglobeandmail.com/business/commentary/article-bc-mlas-should-recognize-benefit-corporation-is-an-american/).

<sup>4</sup> B. Sjøfjell and C.M. Bruner, 'Corporations and Sustainability', Ch. 1 in this volume.

<sup>5</sup> The 'board' is used in this chapter as a general term encompassing for example the German *Aufsichtsrat*, the British board of directors and the board or boards 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.

<sup>6</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, *A renewed EU strategy 2011-2014 for Corporate Social Responsibility*, COM(2011) 681 final, at 5-6; see also S. Watson, 'Moving beyond virtue signalling: Corporate sustainability for New Zealand', Ch. 13 in this volume.

markets.<sup>7</sup> Corporate boards are under increasing pressure between their perceived duty to maximize returns for investors (wrongfully perceived as a legal duty)<sup>8</sup> and society's expectations of corporate sustainability (often misleadingly perceived as only voluntary, Corporate Social Responsibility style).

Research identifying shareholder primacy as a barrier to the board integrating sustainability into its decision-making is summarised in Section 2. Emerging drivers for corporate sustainability are discussed in Section 3, using the regulatory ecology approach. This approach understands corporate decision-making to be constrained through the interaction of and between four modalities: law, social norms, markets and 'architecture' (including financial and legal technology).<sup>9</sup> The result is a picture of competing norms, where those promoting corporate sustainability are currently insufficient. Section 4 discusses possible ways forward, and notably how to strengthen the emerging drivers and dismantle the still strong barriers through changing the regulatory ecology to ensure that the potential for corporate sustainability is realised. Section 5 concludes with reflections on what hope there is for the implementation of necessary changes.

## 2. Shareholder primacy and the corporate board

Shareholder primacy is a systemically entrenched barrier for corporate sustainability. Denoting *shareholder primacy* as a barrier of such significance is a short form for a complex mix of perceived market signals and economic incentives, informed by path-dependent corporate governance assumptions and postulates from legal-economic theories.<sup>10</sup> Shareholder primacy should be distinguished from the legal norm denoted *shareholder value*, which we find notably in the UK.<sup>11</sup> That this distinction often is not made is symptomatic of the dominance of the shareholder primacy thinking, also in corporate law doctrine.<sup>12</sup>

Shareholder value is on the one end of the spectrum with a pluralistic approach to the interests of the company on the other, as we have seen in a multi-jurisdictional comparative analysis.<sup>13</sup> No corporate law system insists on boards focusing only on returns for shareholders, and certainly not requiring that returns be maximised. In addition to the obvious point that jurisdictions expect boards to ensure legal compliance, corporate law provides – across this spectrum – a large latitude to the board and by extension the management to shape business in a sustainable manner.<sup>14</sup> However, as is also evident from the state of unsustainability we are in, corporate boards in aggregate do not

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<sup>7</sup> B. Sjøfjell, A. Johnston, L. Anker-Sørensen and D. Millon, 'Shareholder Primacy: The Main Barrier to Sustainable Companies', in B. Sjøfjell and B.J. Richardson (eds.), *Company Law and Sustainability* (Cambridge: Cambridge University Press, 2015), pp. 79–147; C.M. Bruner, *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* (Cambridge: Cambridge University Press, 2013).

<sup>8</sup> As is illustrated by a number of the contributions in Part III of this volume.

<sup>9</sup> B. Sjøfjell and M.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>.

<sup>10</sup> Sjøfjell et al, 'Shareholder Primacy: The Main Barrier to Sustainable Companies', which Section 2 of this chapter draws heavily on.

<sup>11</sup> In earlier work, David Millon uses 'radical' and 'traditional' shareholder primacy to distinguish between the social norm and the legal norm; D. Millon, 'Radical Shareholder Primacy' (2013) 10 *University of St. Thomas Law Journal* 1013. On UK law, see A. Johnston, 'Market-led sustainability through information disclosure: the UK approach', Ch. 15 in this volume.

<sup>12</sup> B. Sjøfjell, et al., 'Shareholder Primacy: The Main Barrier to Sustainable Companies'.

<sup>13</sup> Ibid.

<sup>14</sup> Ibid. This is supported for the institutional investors e.g. 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. See also the two reports cited in n. 24 below.

predominantly choose sustainability-enhancing options even 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.<sup>15</sup>

The shareholder primacy drive combined with a lack of understanding of the scope the law gives the board, and by extension management, has given rise to legal myths inspired by law-and-economics postulates, dictating that the board and senior managers are the ‘agents’ of the shareholders and must maximize returns to shareholders as measured by the current share price.<sup>16</sup> The capital markets function to funnel and exacerbate the shareholder primacy drive, supported by securities regulation and stock exchange rules that have as their primary aim to protect investors, not the various other interest affected by corporate activity.<sup>17</sup> Corporate governance codes, often written by investor groups, instruments of the mainstream corporate governance movement, are informed by and promote the shareholder primacy drive – to the extent that they can be in direct contradiction to corporate law.<sup>18</sup> The normative impact of the shareholder primacy drive goes beyond the listed corporations, and is exacerbated by the chasm between corporate law’s approach to corporate groups and the dominance and practice of such groups,<sup>19</sup> and the extensive use of global value chains, and other non-equity modes of control,<sup>20</sup> allowing for an intensified externalisation of environmental, social and economic costs.

The legislative response to this corporate unsustainability has mainly taken the shape of reporting requirements,<sup>21</sup> combined with persistent belief that markets will self-correct through pressure from investors and corrections to share price where there is misconduct or failure to disclose material information.<sup>22</sup> 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.<sup>23</sup>

The resulting general practice of corporations is detrimental to those affected by environmental degradation, violation of human rights and economic exploitation today and to the possibility for

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<sup>15</sup> The lack of cases challenging the boundaries for how far corporate boards can go in promoting long-term sustainability in their decision-making, is a striking feature in the multijurisdictional comparative analysis presented in Sjøfjell, et al., ‘Shareholder Primacy: The Main Barrier to Sustainable Companies’.

<sup>16</sup> Along with that of shareholders owning corporations, which they as a matter of corporate law clearly do not; e.g. P. Ireland ‘Company Law and the Myth of Shareholder Ownership’ (1999) 62 no. 1 *Modern Law Review* 32-57; L. Talbot, *Critical Company Law* (Abingdon: Routledge, 2nd ed., 2015).

<sup>17</sup> J. Cullen and J. Mähönen, ‘Taming unsustainable finance: the perils of modern risk management’, Ch. 8 in this volume; C.M. Bruner, ‘Corporate Governance Reform in a Time of Crisis’ (2011) 36 no. 2 *Journal of Corporation Law* 309.

<sup>18</sup> J. Mähönen and G. Johnsen, ‘Law, culture and sustainability: corporate governance in the Nordic countries’, Ch. 16 in this volume; B. Sjøfjell, ‘When the Solution Becomes the Problem: The Triple Failure of Corporate Governance Codes’, in J.J. du Plessis and C.K. Low (eds.), *Corporate Governance Codes for the 21st Century*, (Cham, Switzerland: Springer, 2017), pp. 23–55.

<sup>19</sup> B. Clarke and L. Anker-Sørensen, ‘The EU as a potential norm creator for sustainable corporate groups’, Ch. 14 in this volume.

<sup>20</sup> J. Salminen, ‘Sustainability and the move from corporate governance to governance through contract’, Ch. 5 in this volume; Ch. 14.

<sup>21</sup> I. Chiu, ‘Disclosure regulation and sustainability: legalisation and governance implications’, Ch. 37 in this volume; O. Songi and A. Dias, ‘Sustainability reporting in Africa: A comparative study of Egypt, Equatorial Guinea, Kenya, Nigeria, Botswana and South Africa’, Ch. 38 in this volume; see also the multijurisdictional comparative analysis in C. Villiers and J. Mähönen, ‘Accounting, Auditing and Reporting: Supporting or Obstructing the Sustainable Companies Objective?’, in B. Sjøfjell and B.J. Richardson (eds.), *Company Law and Sustainability* (Cambridge: Cambridge University Press, 2015), pp. 175–225.

<sup>22</sup> Ch. 8.

<sup>23</sup> Villiers and Mähönen, ‘Accounting, Auditing and Reporting’.

future generations to fulfil their own needs. It is also damaging to the interests of corporations and of shareholders with more than a very short-term perspective on their investment, including institutional investors such as pension funds and sovereign wealth funds, and the ordinary people saving for the future through these structures. Yet, while many institutional investors appear to recognise that they in the long run will see detrimental effects of failing to properly consider broader issues, they are under increasing pressure in a context of persistently low yields and interest rates, in many cases to the extent that it is perceived as a duty to maximise returns for their beneficiaries.<sup>24</sup>

### 3. Emerging drivers for integrating sustainability in corporate boards

#### 3.1 Sifting through the noise

There is much sustainability talk from business, with the adoption of the UN Sustainable Development Goals giving further impetus to the range of declarations of intent to contribute to sustainability. There is a lack of coherent and stringent regulation of sustainability reporting and generally no requirements for external verification of sustainability claims.<sup>25</sup> The result is a considerable amount of ‘noise’ to be sifted through to see that much of what is shared through colourful websites and promotion material, is at worst green-washing, blue-washing, and more recently SDG washing,<sup>26</sup> and at best well-intended initiatives that are insufficient to mitigate the unsustainability of ‘business as usual’. However, the rise of sustainability declarations from business also forms a backdrop against which to analyse the emerging drivers for change, where the evolving language of business may indicate a gradual shift in social norms.

In light of the negative impact of financial markets’ drive for continuing strong and even rising returns, changes in investor behaviour and the regulatory framework for finance are called for to reduce the short-term and narrow pressure on maximising returns. However, also amongst investors, the extent of sustainability talk and engagement with the SDGs creates a filter of noise through which the identification of actual emerging drivers for sustainability may be difficult. There is a danger that through all the talk about sustainability, one clear message is still delivered to the boards and managers of listed companies: maximize returns.<sup>27</sup> In selecting corporations to invest in, the information corporations make available will naturally form the basis. The lack of reliable, relevant, verified and comparable information complicates the process of sustainable investing, although obviously, investor demand for such corporate information is a potential driver for change. So-called ESG (Environmental, Social and Governance) ratings, based at least partly on information from the

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<sup>24</sup> C.M. Bruner, ‘Center-Left Politics and Corporate Governance: What Is the ‘Progressive’ Agenda?’ (2018) 2 *Brigham Young University Law Review* 304-307; D. Millon, ‘Shareholder Social Responsibility’ (2013) 36 *Seattle University Law Review* 911. The report Freshfields Bruckhaus Deringer, *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment* (London: Freshfields Bruckhaus Deringer, 2005), [www.unepfi.org/fileadmin/documents/freshfields\\_legal\\_resp\\_20051123.pdf](http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf), commissioned by the UNEP Finance Initiative, concluded that integrating ESG considerations into investment analysis so as to ‘more reliably predict financial performance’ is ‘clearly permissible and is arguably required in all jurisdictions’, *ibid* at p. 13. A 2015 report, clearly underestimating the tenacity of the shareholder primacy drive, aimed at ending ‘the debate about whether fiduciary duty is a legitimate barrier to investors integrating environmental, social and governance (ESG) issues into their investment processes’, see R. Sullivan, W. Martindale, El. Feller and A. Bordon, *Fiduciary Duty in the 21<sup>st</sup> century* (2015), [www.unpri.org/download?ac=1378](http://www.unpri.org/download?ac=1378), at 9.

<sup>25</sup> B. Sjøfjell, J. Mähönen, A. Johnston and J. Cullen, ‘Obstacles to Sustainable Global Business. Towards EU Policy Coherence for Sustainable Development’, *University of Oslo Faculty of Law Research Paper* No. 2019-02, available at <https://ssrn.com/abstract=3354401>.

<sup>26</sup> E.g. A. Fishman, ‘Responsible Business Report Finds High Risk of “SDG Washing”’, *SDG Knowledge Hub*, 29 May 2018, <http://sdg.iisd.org/news/responsible-business-report-finds-high-risk-of-sdg-washing/>.

<sup>27</sup> Ch. 8; B. Sjøfjell, H. Rapp Nilsen and B.J. Richardson, ‘Investing in Sustainability or Feeding on Stranded Assets: The Norwegian Government Pension Fund Global’ (2017) 52 (4) *Wake Forest Law Review* 949-979.

corporations, and the assessment the rating agencies undertake do not seem to take a research-based sustainability concept as their starting point.<sup>28</sup>

### 3.2 Regulatory initiatives for sustainability

While transnational business still to a great extent lacks a comprehensive and enforceable regulatory framework promoting corporate sustainability, international initiatives such as notably the OECD Guidelines for Multinational Enterprises (OECD Guidelines) and the UN Guiding Principles for Business and Human Rights (UNGPs) have attempted to fill the gaps.<sup>29</sup> These international norms, may be seen as facilitating a gradual change in the societal perception of the role of the business – and of business perception of its relationship with society. The UNGPs have played a major role in the development of due diligence as the norm for assessing and dealing with risks across corporate groups and global value chains. This has since also been integrated in the OECD Guidelines.<sup>30</sup> The OECD Guidelines are characterised by the extra-judicial system of National Contact Points, which in the OECD countries where these function well, provide not only a possibility for mediation between complainant and corporation but also authoritative statements on what is regarded as acceptable business behaviour.<sup>31</sup> This provides a tentative correction to the free flow of sustainability claims that corporations have been able to make, but its impacts are limited through the non-judicial nature of the system, the low number of complaints and even lower number of cases in which remedy actually has been granted.<sup>32</sup>

While attempting to mitigate the short-termism that it seen as contributory to the global financial crisis, the EU Commission has largely concentrated on encouraging shareholders to be more active and in a long-term and sustainable manner. This shareholder-focused approach does not serve to mitigate the perceived pressure of shareholder interests on boards and by extension management, as it is far too reticent in merely asking institutional investors to make public their policies (or state publicly that they have no investment policy). This does not resolve the mixed signals of short-term returns and longer-term sustainability.<sup>33</sup>

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<sup>28</sup> E. Escrig-Olmedo, M. Á. Fernández-Izquierdo, I. Ferrero-Ferrero, J. M. Rivera-Lirio and M. J. Muñoz-Torres, 'Rating the Raters: Evaluating how ESG Rating Agencies Integrate Sustainability Principles' (2019) 11 *Sustainability* 915. It remains to be seen whether the taxonomy proposed as a part of the EU's Sustainable Finance Initiative will contribute to mitigating this, European Commission, Proposal for a Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment, Brussels 24.5.2018 COM(2018) 353 final.

<sup>29</sup> United Nations, 'Guiding Principles on Business and Human rights – Implementing the United Nations 'Protect, Respect and Remedy' Framework' (Office of the High Commissioner for Human Rights, 2011), see [www.unglobalcompact.org/library/2](http://www.unglobalcompact.org/library/2), OECD, 'Guidelines for multinational enterprises', see [www.oecd.org/corporate/mne/](http://www.oecd.org/corporate/mne/) and the UN Global Compact, see [www.unglobalcompact.org/](http://www.unglobalcompact.org/).

<sup>30</sup> See e.g. M.B. Taylor, 'Due Diligence: A Compliance Standard for Responsible European Companies' (2014) Volume 11 (2) *European Company Law*.

<sup>31</sup> See, however, the criticism in C. Villiers, 'Global supply chains and sustainability: the role of disclosure and due diligence regulation', Ch. 39 in this volume.

<sup>32</sup> See 'OECD watchdog calls for reform of failing complaint system', 15 June 2015, regarding the report C. Daniel, J. Wilde Ramsing, K.M.G Genovese, V. Sandjojo, *Remedy Remains Rare* (OECD Watch 2015), at [www.oecdwatch.org/news-en/oecd-watchdog-calls-for-reform-of-failing-complaint-system](http://www.oecdwatch.org/news-en/oecd-watchdog-calls-for-reform-of-failing-complaint-system).

<sup>33</sup> Indeed, one might say that it is outright contradictory to empower risk-preferring equity holders in response to crises fueled by too much risk, Bruner, 'Corporate Governance Reform in a Time of Crisis'. For a somewhat more positive analysis of the stewardship trend, D. Katelouzou, 'Shareholder stewardship: a case of (re)embedding institutional investors and the corporation?', Ch. 41 in this volume.

The EU Commission's Sustainable Finance Initiative may signal a willingness to ensure a deeper integration of sustainability into the regulation of business and finance.<sup>34</sup> Although concentrating on the financial sector, there is also a call for an integration of sustainability into the duties of the board and management, combined with clear and comprehensive reporting, in a way that resonates with the findings of our research.<sup>35</sup> This is currently being followed up by the EU Commission Directorate General Justice, responsible for corporate law. Whether it will be possible, for the first time after over 50 years of fragmented work of harmonising EU corporate law, to successfully introduce rules to that go to the core of corporate law, remains to be seen.

National legislators are starting to realise the necessity of legislative reform beyond that of reporting requirements, as for example the UK Anti-Slavery Act and the more recent French Duty of Care, indicate.<sup>36</sup> These are, however, still only limited examples of reform in the broader regulatory framework of transnational business.

### 3.3 The role of financial technology

The impact of 'architecture' in the regulatory ecology analysis of corporate decision-making is substantial. Currently architecture is more a barrier to sustainability-oriented corporate decisions than a driver, through the way the financial technology exacerbates the drive towards short-term maximisation of returns. The regulatory framework of financial markets and of the role of shareholders is still informed by legal-economic theories of information-efficiency and of the market for corporate control, assuming a link between the share price and the performance of corporations in the real economy.<sup>37</sup> However, with much of trading done by algorithms and through robots aiming to exploit small changes in share prices in different markets to make returns, and also partly creating share price movements, there is little left of the connection between what the corporations actually do and the development of the share price.<sup>38</sup> Even from a traditional corporate governance perspective, focused on long-term steady returns based on the financial performance of the corporation, the legal-economic assumptions are highly questionable. Expecting financial markets to stimulate sustainability seems then to be an even further stretch.

Also, the disconnect facilitated by physical distance between environmental destruction and exploitation of people across global value chains, on the one hand, and the end-users of produced goods and the beneficiaries of financial returns, on the other hand, constitutes a barrier to political pressure for corporate accountability and reform. The extensive use of index funds, belying the active investment of allegedly sustainability oriented investors, is moreover a part of this picture.<sup>39</sup> Nevertheless, there is a possibility that improved financial technology may come to be employed for

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<sup>34</sup> European Commission, *Action Plan: Financing Sustainable Growth*, COM(2018) 97 final, 8.3.2018; see [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en); see also Ch. 8.

<sup>35</sup> Action 10 of the EU *Action Plan: Financing Sustainable Growth*; Sjøfjell et al., 'Obstacles to Sustainable Global Business'.

<sup>36</sup> K. Morrow and H. Cullen, 'De-fragmenting transnational business responsibility: principles and process' Ch. 4 in this volume; Ch. 15; V. Magnier, 'Old-fashioned yet innovative: corporate law, corporate governance and sustainability in France', Ch. 20 in this volume.

<sup>37</sup> Sjøfjell et al., 'Obstacles to Sustainable Global Business'.

<sup>38</sup> See also V. Galaz and J. Pierre, 'Superconnected, Complex and Ultrafast: Governance of Hyperfunctionality in Financial Markets' (2017) 3 *Complexity, Governance & Networks* 12–28.; H.J Allen, 'Driverless Finance' (3 April 2019), forthcoming, *Harvard Business Law Review*, at <https://ssrn.com/abstract=3366016>.

<sup>39</sup> J. Fichtner and E. M. Heemskerck, 'The New Permanent Universal Owners: Index Funds, (Im)patient Capital, and the Claim of Long-termism' (2017) 19 *Business and Politics* 298–326.

better, more accurate and more reliable information about the sustainability performance of businesses, and facilitate improved information and transparency.<sup>40</sup>

### 3.4 Financial risk as a driver

A new understanding of financial risk may turn out to be one of the most important emerging drivers for the integration of sustainability issues in the core duty of the board, also amongst those who have a very narrow view of the duty of the board. As Sarah Barker argues: members of corporate boards cannot fulfil their role if they reject or ignore the science of climate change.<sup>41</sup> I have elsewhere discussed how this is equally relevant to other aspects of unsustainability, of continued transgression of the other core planetary boundary, biodiversity, and of exploitation of workers including violation of human rights amongst threats to the aim of securing the social foundation for humanity.<sup>42</sup> The physical impacts of continued environmental degradation may have direct financial consequences for corporations in various sectors, and a corporate board lacking in awareness or knowledge about these issues, may increase the financial risk for the corporation through the decisions they make or fail to make. Anticipating, adapting and where possible mitigating environmental change is therefore an intrinsic part of the corporate board's risk management in the core financial sense, as is anticipating and adapting to changes to the regulatory environment through policy-making.

Corporate boards taking the more cynical approach of betting against significant sustainability policy changes, may find that the financial risks of further environmental degradation and of social unrest are exacerbated, if policy-makers do not regulate to mitigate.<sup>43</sup> On the aggregate level of business lobbying, a more active approach to policy risk by promoting sustainability-enhancing policies may accordingly be the best financial risk management, also in the sense that this may give a higher degree of certainty in terms of policy developments. Conversely, corporations involved in working against necessary policies, may face financial risks in the form of liability risks.<sup>44</sup>

The international trend of lawsuits against corporations shows that the liability risk of unsustainability is tentatively materialising. These include cases against parent corporations for environmental or social harm allegedly caused by their subsidiaries and against lead corporations for negative environmental or social impacts in their global value chains, which illustrates the potential

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<sup>40</sup> See e.g. T. Verhagen and A. Voysey, *Catalysing Fintech for Sustainability: Lessons from multi-sector innovation* (Cambridge: Cambridge Institute for Sustainability Leadership, 2017), [www.cisl.cam.ac.uk/resources/publication-pdfs/catalysing-fintech-for-sustainability.pdf](http://www.cisl.cam.ac.uk/resources/publication-pdfs/catalysing-fintech-for-sustainability.pdf).

<sup>41</sup> See e.g. S Barker, 'Directors' personal liability for corporate inaction on climate change' (2015) 67 (1) *Governance Directions*, 21.

<sup>42</sup> B. Sjøfjell, 'Beyond Climate Risk: Integrating Sustainability into the Duties of the Corporate Board' (2018) 23 *Deakin Law Review* 41–62, inspired by C. Clapp et al, *Shades of Climate Risk. Categorizing Climate Risk for Investors* (Oslo: Cicero, 2017) <http://hdl.handle.net/11250/2430660>, which complements the Task Force on Climate-Related Financial Disclosures, *Final Report: Recommendations of the Task Force on Climate-Related Financial Disclosures* (2017) [www.fsb-tcfd.org/publications/final-recommendations-report/](http://www.fsb-tcfd.org/publications/final-recommendations-report/).

<sup>43</sup> In the 2019 Global Risks Report, extreme weather and climate-change policy failures are seen as the gravest threats, World Economic Forum, *Global Risks Report 2019* (14<sup>th</sup> ed.), [www.weforum.org/reports/the-global-risks-report-2019](http://www.weforum.org/reports/the-global-risks-report-2019).

<sup>44</sup> Exxon, one of the petroleum companies accused of actively working to prevent climate policies, has been sued by its investors for misleading information, S. Laville, 'Top oil firms spending millions lobbying to block climate change policies, says report', *Guardian*, 21 March 2019, [www.theguardian.com/business/2019/mar/22/top-oil-firms-spending-millions-lobbying-to-block-climate-change-policies-says-report](http://www.theguardian.com/business/2019/mar/22/top-oil-firms-spending-millions-lobbying-to-block-climate-change-policies-says-report); S. Mufson, 'New York sues ExxonMobil, saying it 'misled' investors about climate change risks', *The Washington Post*, 24 Oct. 2018, [www.washingtonpost.com/energy-environment/2018/10/24/new-york-sues-exxonmobil-accusing-it-deceiving-investors-about-climate-change-risks/](http://www.washingtonpost.com/energy-environment/2018/10/24/new-york-sues-exxonmobil-accusing-it-deceiving-investors-about-climate-change-risks/).

financial risk of carrying on with mainstream governance models in corporate groups or of global value chains.<sup>45</sup> While corporate law may have the starting point that a parent corporation is not responsible for its subsidiaries' actions, and even less so a lead corporation for that of its global value chains, modern financial risk management will increasingly need to take a broader – arguably a life-cycle-based – approach.

Corporate boards that do not reconsider the business model of the corporation from time to time, face the financial risks of technology changes and even systems change, illustrated by the 'stranded assets'<sup>46</sup> discussion and more broadly, the tentative shift from unsustainable linear business models to the sustainable circular model.

Ultimately, the financial risk is existential; if we do not manage to find out how to reposition our economies and societies within planetary boundaries and in a way that secures a safe and just operating space for humanity now and in the future, we risk societal collapse. There are a number of scenarios that can lead to such collapse, including climate change and other environmental degradation, and social unrest caused by inequality and the corporate undermining of the economic basis of our welfare systems.<sup>47</sup> There are no such scenarios with societal collapse where stable and good long-term level of returns for investors are likely.

This underlines that we cannot settle for a mainstream 'business case' approach. The argument made here about financial risks as a driver for the integration of sustainability is not intended as a boundary of what issues are relevant to corporate sustainability. The point is to challenge the dichotomy of profits versus sustainability and show that however little a corporate board may care about 'ethics' and 'corporate social responsibility', (un)sustainability will sooner or later, in one way or other, affect most corporations.

### 3.5 Change is coming, but not fast enough

Changes in legislative norms, as well as the evolving norms (including UNGPs and OECD guidelines) while initially weak, may be seen as a part of a broader change in societal norms.

There is encouraging indication of the beginning of a gradual shift in the attitude to the relationship between business and society, where the youngest generation appears more willing to emphasise sustainability issues.<sup>48</sup> Civil society is becoming wiser to the ways of business, and together with journalists, exposing wrong-doings by business in our increasingly globalised society serves to further enhance this trend. It does not, however, seem to be enough by itself to instigate the fundamental transition that is required for decision-making in business, also because there is a lack of relevant, reliable and comparable information for consumers and civil society. Fundamentally, at the heart of the problem are business models based on overconsumption. Nevertheless, increased emphasis in civil society on the sustainability performance of corporations, are indicators that have some, albeit still limited, influence on corporate decision-making.

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<sup>45</sup> E.g. *Vedanta Resources PLC and another v Lungowe and others* (2019) UK Supreme Court 20; M.B. Taylor, 'Litigating corporate sustainability - towards a taxonomy of transnational liability risk', working paper 2019 on file with author.

<sup>46</sup> This is directly relevant to the petroleum industry but also impacts corporations indirectly relying on these resources, such as manufacturers of fossil-fuelled cars or of plastic products.

<sup>47</sup> *Global Risks Report 2019*.

<sup>48</sup> The school strikes for climate are a notable example, T. Stuart 'A New Generation of Activists Is Taking the Lead on Climate Change', *Rolling Stone*, 26 Apr. 2019, [www.rollingstone.com/politics/politics-features/climate-change-school-strike-825719/](http://www.rollingstone.com/politics/politics-features/climate-change-school-strike-825719/).



It is gradually becoming clear that the duty of business goes beyond merely making profit. Corporations cannot today expect that unsustainability within the scope of their business – be that tax evasion, human rights abuse or environmental harm – remains hidden from the public eye. Yet, the incremental improvements that we may expect through this very tentative internalisation of externalities and the slow pace of these changes indicate that the emerging drivers are currently insufficient to mitigate the barriers to corporate sustainability in our global economic system.

#### 4 Redefining the role of the board

##### 4.1 Corporate law reform is necessary

The dynamic picture of evolving and competing norms indicates a changing regulatory ecology that may shift towards corporate sustainability. However, the competing norms to the shareholder primacy drive are for various reasons still not strong enough. I turn in this Section therefore to discussing what needs to be changed in the regulatory ecology of corporate decision-making, so that it shifts towards one that more clearly facilitates and actively promotes corporate sustainability.

The social norm of shareholder primacy is so strongly entrenched that it has taken on the life of a legal myth, undermining corporate law. This calls for a reform of corporate law, to take back the power of defining what the purpose of corporations is and what the role and duties of the board are. A stronger and clearer integration of sustainability into the corporate board should take place through legislative reform.<sup>49</sup> This is not an argument for corporate law taking over the role of for example environmental law or human rights law; rather it is based on a recognition of the limitations of environmental law and human rights law, and the intrinsic problem with silo-thinking.

Realising the potential of the corporate board, and by extension management, to play a key role in facilitating corporate sustainability, should be supported by a reform of corporate governance codes, as the recent and generally rather superficial attempt at including sustainability-related issues in these codes is insufficient.<sup>50</sup>

Such a reform, designed thoughtfully, could involve a standardization of a process that corporations wishing to achieve long-term sustainable value would need to do anyway. Standardization would contribute to lowering costs and establishing a level playing field. Within this framework, such a reform could also promote each company's individual, innovative approach to contributing to corporate sustainability. Revising corporate law and corporate governance could also give a basis for meaningful reporting and thereby give content to reporting rules such as the EU's 'non-financial' reporting directive.<sup>51</sup> This in turn would provide an improved informational basis for the apparently growing number of investors that wish to invest sustainably, and should be an integrated part of any 'sustainable finance' initiative.<sup>52</sup>

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<sup>49</sup> There is in the same vein a call for clarification of the fiduciary duty of fund managers, Sullivan et al, 'Fiduciary Duty in the 21<sup>st</sup> Century' at 21; and in the EU's Sustainable Finance Initiative, see text accompanying n. 34 and 35 above.

<sup>50</sup> Sjøfjell, 'When the Solution Becomes the Problem'. There may be a small opening to push back against the shareholder primacy drive in the way corporate sustainability language, albeit very tentatively, is making its way into some of the codes, n. 56 below.

<sup>51</sup> As elaborated on in B Sjøfjell, 'Bridge over troubled water: corporate law reform for life-cycle based governance and reporting', *University of Oslo Faculty of Law Research Paper* No. 2016-23, available at <https://ssrn.com/abstract=2874270>.

<sup>52</sup> Tentatively acknowledged in Action 10 of the EU's *Action Plan: Financing Sustainable Growth*; text accompanying n. 34 and 35 above.

#### 4.2 Moving beyond permissive regulation

Such a reform would need to move beyond just clarifying the scope that corporate law, with variations across jurisdictions, permits the corporation to shape its own purpose and direction. As a number of the chapters in Part III of this volume show, more or less expressly formulated permissive regulation – typically allowing the corporate decision-makers to take other interests than those of the shareholders ‘into account’<sup>53</sup> – are insufficient in the face of the shareholder primacy drive. More innovative reforms such as the South African Social and Ethics Committee arguably illustrate, through the struggle of recognition of this as a committee on board level,<sup>54</sup> that instead of add-ons it is time to reform the very core of the corporate law, which shapes corporate governance: the purpose of the corporation and the role and duties of the corporate board.

Such a reform should engage with a research-based understanding of what corporate sustainability entails and an evidence-based recognition of the significance of corporations for achieving sustainability.<sup>55</sup> It should be principle-based and flexible enough to encompass on the one hand, the range of business ventures and the innovativeness of the individual firm in various markets and under changing circumstances, and on the other hand, the continuous work-in-progress development of knowledge as regards the different aspects of sustainability. At the same time, it would need to provide a firm framework within which corporate sustainability is to be facilitated, in terms both of providing a hard line (‘a floor’) beneath which business cannot go, and setting out the sustainability goals towards which corporations must strive in business.

#### 4.3 ‘Sustainable value’ within ‘planetary boundaries’

In the redefinition of the corporate purpose and the role and duties of the board, the two key concepts should be ‘sustainable value’ and ‘planetary boundaries’. Accordingly, corporate purpose as a legal concept could be formulated as creating ‘sustainable value within planetary boundaries’. To operationalize this redefined purpose it would need to be integrated into the duties of the board, which should clarify the board’s duty to adopt and implement a system for this purpose that encompasses all of the company’s areas of business and the full life impacts of its products, services and processes.

Sustainable value creation is an emerging concept in corporate law and corporate governance,<sup>56</sup> which in the context of a corporate law reform needs to engage with a research-based concept of sustainability. As we discuss in the introduction to this volume, true sustainability is an integrated,

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<sup>53</sup> Or ‘have regard to’ them, as is mandated in the UK Companies Act s. 172, which simultaneously subordinates these other interests to shareholder interests; see Ch. 15.

<sup>54</sup> T.H. Mongalo, ‘The Social and Ethics Committee: Innovating corporate governance in South Africa’, Ch. 26 in this volume.

<sup>55</sup> Ch. 1.

<sup>56</sup> Examples include: the 2017 revision of the Australian Council of Superannuation Investors (ACSI) Governance Guidelines, emphasising board oversight of ‘sustainable, long-term value creation’; V. Schnure Baumfield, ‘The Australian paradox: conservative corporate law in a progressive culture’, Ch. 12 in this volume, at xx; the German Corporate Governance Code on the duty of the Management Board to manage the company ‘in the best interests of the company ... with the objective of sustainable value creation’; A. Rühmkorf, ‘Stakeholder value versus corporate sustainability: company law and corporate governance in Germany’, Ch. 17 in this volume, at xx; the increased emphasis in the 2016 revision of the Dutch Corporate Governance Code on acting ‘in a sustainable manner by focusing on long-term value creation’; A. Lafarre and C. Van der Elst, ‘Corporate sustainability and shareholder activism in the Netherlands’, Ch. 19 in this volume, at xx. A majority of stewardship codes also describe stewardship as connected to ‘the creation of long-term sustainable value’, D. Katelouzou, ‘Shareholder stewardship: a case of (re)embedding institutional investors and the corporation?’, Ch. 41 in this volume, p. xx.

dynamic, interconnected and complex aim.<sup>57</sup> The goal of creating ‘sustainable value’, as a redefinition of corporate purpose, must reflect the multifaceted and interconnected environmental, social, cultural, economic and governance aspects of securing the social foundation for humanity. Translated into the governance of business, this encompasses issues such as fair treatment of employees as well as of workers and local communities across global value chains, with respect for international human rights and core ILO conventions as a minimum, ensuring a ‘living wage’ and safe working conditions. This further entails supporting democratic political processes and as a minimum not undermining these through engaging in corporate capture of regulatory processes. It also entails contributing to the economic basis of the societies in which the business interacts by not engaging in so-called aggressive tax planning and outright evasion.

The concept of planetary boundaries,<sup>58</sup> embodying the fundamental recognition of non-negotiable ecological limits for all economic activity and social development, signals that these are non-negotiable boundaries where the room for trade-offs is limited. For corporate decision-makers it should stress the unacceptability of ignorance in the face of these severe environmental risks and the necessity of a knowledge-based precautionary approach. The concept of planetary boundaries sets out the biosphere framework within which the aim of securing the social foundation for humanity now and in the future must be realised, and in the context of redefining corporate purpose: the framework within which corporations must seek to (re)position their business models.

Done properly, integrating ‘sustainable value’ and ‘planetary boundaries’ into company law, in a principles-based manner, could support the enforcement of any jurisdiction’s environmental and labour laws, the compliance with which would be a minimum, and also form a basis for pushing business in a direction towards true corporate sustainability. As with general clauses typical in civil law systems, these concepts could be filled with more content as society evolves and scientific knowledge increases, for example concerning the sustainable level of a specific substance.

#### 4.4 Scope, implementation and enforcement

A meaningful reform should encompass the responsibility of the parent corporation for a transnational corporate group, and that of a lead corporation for its global value chain. This would contribute to mitigating the problem of legislation normally being national while business is transnational.<sup>59</sup> Although it presumably will always be a struggle to regulate corporate actors’ creativity in evading regulation and creating new veils of opacity,<sup>60</sup> a reform could go some way towards achieving this by including the full life of the products and processes encompassed in a business within a regulatory domain, transcending national boundaries and those between legal entities and across global value chains.

The details of the reform, of how this should be implemented in business and how implementation should be verified and enforced would need to be carefully considered, to mitigate the danger of

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<sup>57</sup> Ch. 1.

<sup>58</sup> J. Rockström, W. Steffen, K. Noone, Å. Persson, F. S. I. Chapin, E. Lambin, T. Lenton, M. Scheffer, C. Folke, H. J. Schellnhuber, B. Nykvist, C. de Wit, T. Hughes, S. van der Leeuw, H. Rodhe, S. Sörlin, P. Snyder, R. Costanza, U. Svedin, M. Falkenmark, L. Karlberg, R. Corell, V. Fabry, J. Hansen, B. Walker, D. Liverman, K. Richardson, P. Crutzen and J. Foley, ‘Planetary Boundaries: Exploring the Safe Operating Space for Humanity’ (2009) 14 (2) *Ecology and Society*; W. Steffen, K. Richardson, J. Rockström, S. E. Cornell, I. Fetzer, E. M. Bennett, R. Biggs, S. R. Carpenter, W. de Vries, C. A. de Wit, C. Folke, D. Gerten, J. Heinke, G. M. Mace, L. M. Persson, V. Ramanathan, B. Reyers and S. Sörlin, ‘Planetary boundaries: Guiding human development on a changing planet’ (2015) 347 *Science* 1259855.

<sup>59</sup> E.g. Ch. 5.

<sup>60</sup> L. Anker-Sørensen, ‘Financial Engineering as an Alternative Veil for the Corporate Group’ (2016) 13 *European Company Law* 155-66.

boilerplate compliance and avoid contributing to regulatory fatigue. The enforcement of a duty to create sustainable value within planetary boundaries, and remedies for parties and interests affected by non-compliance, would need to be carefully considered. A starting point concerning enforcement could be to align such a duty with traditional core duties of the corporate board, notably those concerning corporate finances, and integrate a redefined duty to create sustainable value within the same system, with the same sanctions.<sup>61</sup> As opposed to current sustainability reporting regimes, which is aimed at investors and expecting them to follow up, a corporate law reform should accordingly include public enforcement in the same way as we do in most jurisdictions concerning other core corporate governance aspects of company law.<sup>62</sup> To ensure that such a rule is not ignored in practice, as various forms of sustainability reporting regimes have tended to be (also where they are included in accounting acts),<sup>63</sup> a corporate law reform should include some details on implementation with corresponding sanctions.

To this end, a reform should specify and ensure that the tone is set clearly from the top of the organisation, and that the redefined purpose is integrated throughout the business under the auspices of the corporate board, based on its redefined duty.<sup>64</sup> This should be based on a stringent, research-based sustainability assessment of the business of the corporation,<sup>65</sup> with sustainability due diligence as an important tool.<sup>66</sup> An important part of this would be to ensure that all sustainability impacts relevant to all aspects of the business were included, irrelevant of whether these were conducted in-house or somewhere down a value chain. The corporate law reform should contain language that would require such an integrated assessment and provide guidance as to how this would be done. The selection of the aspects to be included in the sustainability assessment should be verified by external experts, and proof of such verification obligatory to submit to the company register along with other core company documents. The reporting based on this should also be verified but the corporate law reform should not be one focused on reporting as an end goal. Rather, a successful reform would bridge the gap between corporate purpose and duties of the board, on the one hand, and reporting, on the other, providing a basis for more meaningful communication about the sustainability impacts of the business both internally and externally.

Although public enforcement is arguably necessary, ensuring that affected parties or those representing interests to which the company has caused harm also can bring a case against the

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<sup>61</sup> When Norway introduced a duty for all public companies to have a minimum of 40 per cent of each gender on their boards, the sanction for non-compliance was the same as for other comparable rules concerning the board. If, for example, the general meeting of a public company decided that a single-member board is sufficient when the Companies Act mandates a minimum of three members – or failed to appoint an auditor, or to send in annual accounts, the company would, after warnings, be subject to compulsory liquidation. The gender diversity requirement is treated as a core corporate governance rule in company law, instead of as a ‘CSR’ rule, which we otherwise often see in practice in initiatives concerning gender diversity; B. Sjøfjell, ‘Gender Diversity in the Board Room & Its Impacts: Is the Example of Norway a Way Forward?’ (2015) 20 *Deakin Law Review* 25–52.

<sup>62</sup> And as opposed to the way is done in the B Corp regime; leaving enforcement to shareholders, Liao, ‘B.C. MLAs should recognize “benefit corporation” is an American branding exercise’.

<sup>63</sup> As has been the case in Norway, B. Sjøfjell, ‘Sustainable Companies: Possibilities and Barriers in Norwegian Company Law’ (2013) 11 *International and Comparative Corporate Law Journal* 1–58.

<sup>64</sup> B. Sjøfjell and M.J. Muñoz-Torres, ‘The Horse before the Cart: A Sustainable Governance Model for Meaningful Sustainability Reporting’, *University of Oslo Faculty of Law Research Paper* No. 2019-04, available at <https://ssrn.com/abstract=3378473>.

<sup>65</sup> M.J. Muñoz-Torres, M.A. Fernández-Izquierdo, J.M. Rivera-Lirio, I. Ferrero-Ferrero, E. Escrig-Olmedo, J.V. Gisbert-Navarro and M.C. Marullo, ‘An Assessment Tool to Integrate Sustainability Principles into the Global Supply Chain’ 10 (2) *Sustainability* 535; doi:10.3390/su10020535.

<sup>66</sup> On due diligence, see Ch. 39.

company or directly against its shareholders or board members, can be a supplement. This is to varying degrees already possible around the world, as we see illustrated through the foreign direct liability cases, in themselves a driver for change. It might be considered, to allow for a faster and less expensive remedy, to set up a mediation system along the lines of the National Contact Points for the OECD Guidelines, as an optional first step for those wishing to bring a complaint against a company.

#### 4.5 Facilitating sustainable finance

Mandating sustainability-oriented governance in corporations changes the regulatory ecology of corporate decision-making in the direction of the transition to sustainable business. To reinforce this, other important drivers should be strengthened and barriers dismantled. To mitigate one of the strongest barriers to corporate sustainability, namely the shareholder primacy drive for maximisation of returns for investors through the investment chains of the capital markets, sustainable finance must be facilitated, not because it is sufficient in itself but because it can provide an important support. Conversely, leaving the capital markets as they are, risks undermining whatever could be achieved through a company law reform. Further, the shifting of investments from fossil-fuelled and unsustainable projects to those that are within planetary boundaries and contribute to securing the social foundation, are essential to financing the achievement of sustainability goals.<sup>67</sup>

Excluding unsustainable business projects and positively selecting more sustainable ones, is crucial. To achieve this, the full range of influential intermediaries need to be considered, including asset managers, fund managers, index fund providers, rating agencies, and proxy advisors. The question could be raised whether index funds can continue to exist. Certainly they cannot function as the mainstream funds do now – a total overhaul of how they are created would be necessary.

There is an emerging recognition of the extent to which these intermediaries control and influence investment decisions and the corporations themselves.<sup>68</sup> There is also a growing body of research showing the lack of integration of a research-based concept of sustainability underpinning the decisions that are made by these intermediaries.<sup>69</sup> Their potential as a driver for corporate sustainability is thereby curtailed. The proposals as a follow-up of the EU's Sustainable Finance Initiative mitigate this only to a limited extent,<sup>70</sup> and should be developed further within the framework of a research-based concept of sustainability. Legal requirements and economic incentives encouraging asset and fund managers' short-term fixation on returns are among the barriers for sustainable finance that would need to be reversed.

### 5. Reflections

This chapter argues that corporate law reform is key to integrating sustainability into mainstream corporate governance, into the core duties of the corporate board, to changing corporations from within. This should be the core of a comprehensive reform of law and governance. Path-dependency and the difficulty of securing a political consensus on fundamental change is a barrier.

Yet, now may be the right time for such a proposal. While previous attempts have failed, there are currently three drivers for reform in Europe that may lead to change: the above-mentioned Sustainable Finance Initiative, which concentrates mainly on the environmental aspects of

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<sup>67</sup> Notably, there is an enormous infrastructure funding gap for renewable infrastructure, especially in light of the UN Sustainable Development Goals, McKinsey Global Institute, *Bridging Global Infrastructure Gaps* (McKinsey & Company, 2016), <https://www.un.org/pga/71/wp-content/uploads/sites/40/2017/06/Bridging-Global-Infrastructure-Gaps-Full-report-June-2016.pdf>.

<sup>68</sup> Fichtner and Heemskerk, 'The New Permanent Universal Owners'.

<sup>69</sup> Escrig-Olmedo, 'Rating the Raters'.

<sup>70</sup> Ch. 8.

sustainability;<sup>71</sup> the push for law reform to introduce legal requirements for due diligence on human rights;<sup>72</sup> and that some national legislators within the EU have begun to experiment with reforms of their own.<sup>73</sup>

However, the risk of corporate capture of any proposals that challenge ‘business as usual’ is pervasive. Collaboration between business and academia, to identify how the corporate board and management could implement sustainability-oriented governance, is arguably necessary. Academic-business collaboration may identify new avenues for reform and help transcend the stalemate between policymakers who appear unwilling to affect reform before business supports it, and business being wary of supporting reform initiatives the effects of which are uncertain. In this picture, the financial risk of unsustainability may turn out to be the most effective driver, and the EU’s Sustainable Finance Initiative the best door-opener, for change that realises the potential of the corporate board as key in the shift towards corporate sustainability.

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<sup>71</sup> And in parts even more narrowly on climate change.

<sup>72</sup> B. Fox, ‘Upping the ante on human rights due diligence’, *EurActiv*, 25 March 2019, [www.euractiv.com/section/economy-jobs/special-report/upping-the-ante-on-human-rights-due-diligence/](http://www.euractiv.com/section/economy-jobs/special-report/upping-the-ante-on-human-rights-due-diligence/).

<sup>73</sup> E.g. France, Ch. 20.