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SUSTAINABILITY ORIENTED TRANSFORMATION OF CORPORATE GOVERNANCE

Master thesis

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TABLE OF CONTENTS

LIST OF ABBREVIATIONS

BRT - Business Roundtable

CSDDD - Corporate Sustainability Due Diligence Directive

ESG – environmental, social, and governance

EU - European Union

MEP - Member of the European Parliament

OECD – Organization for Economic Cooperation and Development

SEC – US Securities and Exchange Commission

SMEs - small and medium-sized enterprises

SVM - shareholder value maximization

SWM - shareholder welfare maximization

WCED - World Commission on Environment and Development

INTRODUCTION

Relevance of the research. Regarding the world's orientation on all-around human rights protection and environmental conscious behaviour, there is a necessity to implement sustainability policy throughout all spheres of activities to achieve the real effect of glorifying human rights and preserving the environment. Free market economy with profit maximization driven businesses is a sphere which mostly affects the level of protection of human rights especially consumers, employees, suppliers, and environmental issues, but at the same time mostly hard to regulate according to private relationship priority. Corporate structures of the companies are oriented towards profit maximization in the shortest period of time regardless of the long-term perspective of business and interests of the affected stakeholders[1]. The global environmental problems are proved to be mostly the consequences of the large companies' operations in spheres of production such as agriculture, oil industry, textile, single-use plastic production, etc. According to scholars, only 100 worldwide private and state-owned companies are responsible for emission of 70% of annual global industrial greenhouse gas emissions during 1988-2015[2], top 100 polymer producers account for 90% of global single-use plastic waste in 2019[3]. The urgent need to mitigate the adverse impact on the environment and maintenance of sustainability leads to proposals on incorporating sustainability requirements in corporate governance through provisions on corporate purpose, directors' duties, liability, etc.

The discussion on the possible ways of implementing the principle of sustainability in the companies' operation was mostly formed in the end of 90s, with the notion that all businesses must satisfy the principle of "triple bottom line" - balance profitability, environmental quality, and social justice[4]. Later it was implemented in soft law with the introduction of environmental, social and governance factors (ESG) of the companies which started to be taken into consideration by investors during evaluation of the company's future perspective of investment[5].

National governments throughout the world with developed corporate and business policies (the USA, UK, some member states of the EU) are quite reluctant to implement comprehensive requirements of sustainable operation of the company. Some related to due diligence conditions are enshrined in the provisions of director's duty to promote the success of

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[1] Jamie Dimon & Warren E. Buffett, "Short-Termism Is Harming the Economy", *Wall St. J.*, June 6,2018. https://www.wsj.com/articles/short-termism-is-harming-the-economy-1528336801

[2] Paul Griffin, '"Carbon Majors Database", *CDP Carbon Majors Report 2017*, July 2017, 16. https://cdn.cdp.net/cdp-production/cms/reports/documents/000/002/327/original/Carbon-Majors-Report-2017.pdf?1501833772

[3] Charles D, Kimman L, & Saran, "The plastic Waste Markers Index", *Minderoo Foundation N 2021*, 86.

[4] John Elkingto, *Cannibals with Forks: The Triple Bottom Line of 21st Century Business*, (Capstone, 1999), 424.

[5] OECD (2021), "ESG Investing and Climate Transition: Market Practices, Issues and Policy Considerations", OECD Paris, accessed April 15, 2023, 36, https://www.oecd.org/finance/ESG-investing-and-climatetransition-Market-practices-issues-and-policy-considerations.pdf.

the company while taking into account the impact of the company's operations on the community and the environment[6]. The lack of effective enforcement mechanism, monitoring policy and blurred implementation of due diligence requirements and sustainable corporate purpose in corporate governance makes the present structure of companies not corresponding to the principle of sustainability. Nowadays sustainable operation of the company lays down mostly by the desire of some investors or major shareholders to operate business in balance with profitability, environmental quality, and social justice, but such voluntary and rare approach among businesses is not leading to full scale results of environmental preservation and protection of human rights. Moreover, numerous examples demonstrate how businesses use sustainability logos without truly following sustainable practices. Brands often exaggerate their environmental credentials, even when they do not actually possess them, in order to give the impression of environmental benefits and attract consumers and investors[7]. This misleading practice, known as greenwashing, undermines genuine sustainable development. The top-down harmonization and implementation of effective requirements of due diligence, expanding the scope of directors' duties, introduction of the adequate enforcement and liability measures, and establishment of the new corporate purpose which would address the environmental and societal issues in corporate governance should be presented to achieve the goal of sustainable and responsible behaviour in business activities. With understanding of the importance of imposing mandatory requirements of sustainability in corporate governance which can be achieved by due diligence, several initiatives were presented to the European Commission. On the 23 of February 2022 Commission adopted a proposal for a Directive on Corporate Sustainability Due Diligence which establishes new rules for companies by providing obligations to take into account actual and potential human rights adverse impact and environmental adverse impact with respect to the business operation and the value chain operation[8]. The proposal is served to correspond to the problem of corporate sustainability due diligence.

During the research the following jurisdictions will be carefully analysed through the lens of addressing matters related to corporate purpose, director's duties, due diligence obligations, and enforcement mechanism within corporate governance reorientation towards sustainability: the USA, the UK, Germany, France, Netherlands, Norway. These jurisdictions are of particular

[6] See Article 172, "Companies Act 2006", Legislation.gov.uk, accessed April 15, https://www.legislation.gov.uk/ukpga/2006/46/contents.

[7] "5 food and drink brands called out for greenwashing and the lessons we can learn", Provenance, accessed 28 April 2023, https://www.provenance.org/news-insights/5-food-and-drink-brands-called-out-for-greenwashing-and-the-lessons-we-can-learn.

[8] "Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937", General Approach. Interinstitutional File: 2022/0051(COD), Brussels, 30 November 2022, accessed 10 January 2023, https://data.consilium.europa.eu/doc/document/ST-15024-2022-REV-1/en/pdf

interest due to their well-established regulations in corporate governance, significant investment activities, strong consumer influence, and their export and import potential creates substantial market opportunities for other economies, making their practices and developments influential on a global scale.

Scientific research problem. Regarding a company's profit orientation and short-term maximization of it, sustainability which presumes to work in long-term run and perspective does not fit in the modern understanding of business. According to held studies and surveys directors are pressured by investors and shareholders to focus on short-term profitability, shareholders and investors mostly interested in quick return by means of dividends/investments[9]. Contrary to short-termism, environmental and socially conscious behaviour of the company requires long-term planning of business operation with environmentally healthy technology, a value chain which does not involve forced or unprotected labour relationships. The scientific research problem explored in this thesis revolves around understanding the obstacles in transforming corporate governance to prioritize sustainability and identifying effective regulatory mechanisms to ensure responsible and sustainable business practices. The research aims to fill the gaps in the current understanding of corporate governance and provide insights into the necessary changes and improvements needed to foster a culture of sustainability within the corporate sector.

In the light of recently proposed initiatives on adopting Directive on Corporate Sustainability Due Diligence the important questions arise: *are the proposed legislative tools offered by the Directive sufficiently enough to effectively correspond to the question raised above? And if not, what steps should be taken within corporate governance regulation in order to achieve sustainable businesses' operations?* The current research is aimed at answering those questions.

The level of the analysis of the research problem. The frames of this research includes analysis of the existing legislative provisions and requirements connected to sustainable corporate purpose, directors' duties in regard of sustainable business operations, due diligence in corporate governance in different states, disclosure of non-financial information, investor's obligation to disclose information, business impact human rights, etc.; evaluation of the proposed Directive on the matter of sufficiency to mitigate adverse environmental and social effects of business activities and the analysis of the core issue – the necessary requirements of due diligence in corporate governance and their implementation and enforcement mechanism. The existing literature in the sphere of impact of due diligence, corporate purpose restatement in corporate governance includes the research papers of the following scholars: John F. Sherman III who made research on the topic

[9] Dominic Barton, Jonathan Bailey, and Joshua Zoffer, "Rising to the challenge of short-termism", *FCLT Global*, 2016, 16, https://www.fcltglobal.org/wp-content/uploads/fclt-global-rising-to-the-challenge.pdf

"Human Rights Due Diligence and Corporate Governance"[10], Ruth V. Aguilera, J. Alberto Aragón-Correa, Valentina Marano, Pete Tashman who dedicated valuable work to environmental impact of corporate governance[11], etc. In addition to that, the question of the concept of sustainability within corporate due diligence and the flaws of such policy has been widely analysed by scholars and practitioners such as Mark, Roe, Holger Spamann, John G. Ruggie, Guido Ferrarini, Steen Thomsen, Jesse M. Fried[12], etc.

Scientific novelty of the master thesis. The scientific novelty of this paper lies in its comprehensive analysis of the root cause of environmental degradation, which can be attributed to the pervasive pursuit of profit at any cost within the economic and business paradigm that emerged after the Industrial Revolution. While previous studies have acknowledged the detrimental consequences of this profit-driven model, this research goes beyond by highlighting the need for a sustainability-oriented transformation of corporate governance to address these issues. The paper also proposes a new formulation of corporate purpose, emphasizing the importance of societal welfare and ethical conduct, and explores the potential of corporate law to establish duties that prioritize sustainability. Furthermore, the study critically evaluates the limitations of existing regulations and suggests the implementation of stringent legal measures, including criminal responsibility, to hold companies accountable for their actions. By addressing these research gaps and providing practical recommendations, this paper contributes to the understanding of corporate governance and offers insights into fostering a culture of sustainability within the corporate sector.

The aim of the master thesis – to analyse the detrimental consequences of the profit-driven business model and its impact on environmental degradation, highlighting the need for a transformation of the prevailing business paradigm towards sustainability. By proposing the establishment of binding regulations, a new formulation of corporate purpose, and stringent legal measures emphasizing criminal liability for company's directors, this research aims to foster a culture of responsibility and integrate sustainability considerations into all aspects of business decision-making and operations.

[10] John F. Sherman III, "Human Rights Due Diligence and Corporate Governance", *Corporate Responsibility Initiative*, Harvard Kennedy School, Working Paper No. 79, June 2021, 26. https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/CRI_WP_79_Final.pdf

[11] Aguilera, Ruth V. and Aragón-Correa, J. Alberto and Marano, Valentina and Tashman, Peter, "The Corporate Governance of Environmental Sustainability: A Review and Proposal for More Integrated Research", *Forthcoming at Journal of Management*, Northeastern U. D'Amore-McKim School of Business Research Paper No. 3760077, 2021, 81, https://ssrn.com/abstract=3760077

[12] Roe, Mark, Holger Spamann, Jesse M. Fried, and Charles C.Y. Wang. "The Sustainable Corporate Governance Initiative in Europe." Yale Journal on Regulation Bulletin 38 (2021): 133–153.

The objectives of the master thesis. To achieve the established aim of the master thesis the following tasks have to be carried out: 1) to analyse the scope of present soft law measures and alternative approaches in driving substantial change towards sustainability, while identifying the limitations in enforcement and scope that hinder their effectiveness; 2) to explore the need for governments and international institutions to implement binding regulations that ensure the incorporation of sustainable practices within business operations, recognizing that the efforts of conscientious business leaders alone are insufficient to guarantee sustainable development without adverse environmental and societal effects; 3) to examine the role of corporate purpose in shaping the behaviour of businesses and corporate leaders, with a focus on the need to redefine corporate purpose by including a notion of responsibility to conduct business ethically, and prioritize sustainability in their operations, thus addressing the obstacles hindering the transition to a sustainable business model.

The practical significance of the master thesis. The current research will be useful for scholars and practitioners in the field of corporate governance who deal with the issue of aligning business practices with sustainability objectives, investment relationship with the companies by the means of accessing the company as a suitable candidate for possible investments according to the sustainable corporate purpose and due diligence requirements.

The master thesis can also be useful for students studying corporate law who want to deepen their knowledge in such comprehensive matters as sustainability, corporate purpose, and due diligence in corporate governance.

Regarding the European Union policymakers, this research proposes redefining corporate purpose, incorporating morality and ethics, and implementing stringent legal measures to foster responsible business practices and integrate sustainability considerations. It provides valuable insights for European Union policymakers when proposing and adopting legislation on corporate law at national and EU levels.

The defended statements:

1. The lack of comprehensive legal implementation and enforcement of appropriate sustainable corporate purpose and, as a result, directors' duties in corporate governance create problems of non-fulfilment of sustainability policy.

2. The existing solutions on national level and proposed solutions to such problems on EU level through the CSDDD are not efficient enough to address the issues in question and require further consideration on broadening the reach of the of the due diligence obligations by encompassing majority of SMEs, indirect downstream partners, all financial institutions within the regulatory framework, and establishing burdenless and effective enforcement and liability mechanism to ensure the success of the regulations' objectives.

Methods used in the master thesis. Several methods will be used during the current scientific research.

The method of *data collection* and *data analysis* will be used during searching for and analysing legal texts, case law, academic articles. To achieve the understanding of grounds for different approaches towards corporate purpose, directors' duties, liability, enforcement, and due diligence among different states worldwide the method of *comparative analysis* will be used. Considering the problematic of the master thesis, implementation of comparative method will present the common and various provisions of the above stated objectives in corporate governance.

This master's thesis will employ a *correlation analysis* and *comparative* method to explore the relationship between the implementation of corporate purpose, directors' duties, liability, enforcement, and due diligence in corporate governance and the extent to which sustainability policies are fulfilled under different regulations. By utilizing a correlation analysis, this study aims to identify more suitable requirements for the reorientation of corporate governance towards sustainability.

In this master thesis, a *historical analysis* method will be used to track the dynamic of changes in the concept of sustainability and its legal implementation in corporate governance through different requirements while analysing legal acts on national and EU level. Another method used is a *content analysis* which will be applied to determine the concepts of corporate purpose, directors' duties, liability, enforcement, due diligence, and sustainability that are used by the legislative authorities in different jurisdictions, judicial authorities and the EU bodies when regulating, proposing, or explaining issues related to current research.

The structure of the master thesis. The thesis consists of several parts.

In the first part of the thesis, the following will be provided: theoretical-philosophical-historical analysis of background information on the integration of sustainability into corporate governance, exploration of the evolution of environmental concerns leading to the need for sustainability and examination of the role of governments in promoting and implementing sustainable development policies.

The second part of the research focuses on the practical implementation of sustainability in corporate governance. It includes a comprehensive discussion on corporate purpose and director's duties within sustainability frameworks, the integration of sustainable corporate purpose through the "benefit corporation" model, and the evolving roles of directors in considering sustainability. It also addresses challenges and prospects related to soft and hard law measures, such as reporting duties and due diligence obligations, and evaluates the effectiveness of the Corporate Sustainability Due Diligence Directive. The structure concludes with an examination of the enforcement model for sustainability requirements in corporate governance.

1. SUSTAINABILITY INTEGRATION INTO CORPORATE GOVERNANCE

1.1. From resource shortage to sustainability

The term "sustainability" has a relatively short history period, officially the term was firstly presented in 1987 by the WCED. The report "Our Common Future" conceptually established the principle of sustainable development as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs"[13]. Sustainable development is considered to be composed of three interdependent elements: economic, social, and environmental sustainability[14]. With regards to those elements the current model of sustainable development became a priority in the modern world's agenda, including business and corporate governance.

Despite its various expressions throughout history, the concept of sustainable development has always revolved around the fundamental need for humanity to survive with limited resources, ensuring the well-being of both current and future generations.

Tracing back to ancient times there were examples of different communities implementing the idea of continued usage of resources for sustainability. Indigenous communities of the Mongolian Plateau for centuries used a rotational grazing system to regenerate and to prevent overgrazing. By applying this technique sustainability of the grassland ecosystems was ensured. In the other part of the world the Amazon indigenous communities used selective logging with the purpose to protect important trees for ecosystem health and biodiversity. Ancient communities in the Pacific Northwest of North America practiced seasonal fishing restrictions to allow fish populations to reproduce and refill[15]. Above mentioned practices demonstrate the understanding of indigenous communities the importance of sustaining different types of resources, maintaining ecological resilience, and commitment to use fishing or forestry resources in a way that ensures their long-term viability. Centuries later, the methods used by indigenous communities would become a part of sustainability development policies throughout the world. For example, in Canada the "precautionary approach" to fisheries management is adopted which stands for proper exploitation of the fish to promote the sustainability of the stock[16] meaning: leaving enough fish in the water to allow populations to replenish.

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[13] World Commission on Environment and Development, *Our Common Future*, Oxford University Press, 1987, 400.
[14] *Ibid.*
[15] Berkes Fikret. "Importance of Continued Use for Sustainability", in *Sacred Ecology*. New York: Routledge, 2012.
[16] See Section 6 (R.S.C., 1985, c. F-14), "Fisheries Act of Canada", justice.gc.ca, accessed 3 April 2023, https://laws-lois.justice.gc.ca/eng/acts/f-14/.

Thus, the same techniques which were used thousands of years ago and now, address the same problem of how to guarantee prosperity for humanity with the resource-based economy civilizations within the constraints of resource shortages and depletion. The problem of resource shortage arose with the new power due to the Industrial revolution[17]. Even though non-renewable resources, e.g., coal, oil, natural gas, metals, were used before the Industrial Revolution, the extent and impact of their use was much smaller than it would become during and after the Industrial Revolution.

As industries continue to emerge and production levels increase, there has been a corresponding surge in demand for resources, leading to the overexploitation of non-renewable resources. Furthermore, the expansion of transport systems and the proliferation of power factories have further compounded the problem of resource depletion. This unbridled industrialization has had far-reaching impacts, resulting in widespread environmental degradation, including deforestation, water and air pollution, and loss of biodiversity[18]. As production and consumption levels continue to rise, waste generation has become a significant issue, leading to the overburdening of landfills and recycling facilities.

The Industrial Revolution brought new opportunities and means of production and at the same time it changed social values, it led to the development of new principles of economy and business. The Revolution gave rise to: capitalism with private ownership of the means of production and the pursuit of profit as the primary goal of business; free market which is determined by supply and demand rather than by government intervention[19]. During the Industrial Revolution the new main principle of economy and business emerged - pursuit of profit. The pursuit of profit is rooted in the idea that individuals and businesses should be free to pursue their own interests, without undue interference from the government or other external forces. This derives from the Protestant Reformation[20] and forms the philosophy of classical liberalism[21].

The absence of any constraints or regulations in conjunction with the early free market created an optimal atmosphere for businesses to exploit various resources relentlessly and without

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[17] Robert B. Marks, *The Origins of the Modern World: A Global and Environmental Narrative from the Fifteenth to the Twenty-First Century*. (2nd ed. Rowman & Littlefield Publishers, 2007), 221.
[18] "The Rise of the Machines: Pros and Cons of the Industrial Revolution", Britannica, accessed 1 May 2023, https://www.britannica.com/story/the-rise-of-the-machines-pros-and-cons-of-the-industrial-revolution.
[19] See Smith, Adam, *An Inquiry into the Nature and Causes of the Wealth of Nations*, New York :Modern Library,1994, 537, https://www.google.fr/books/edition/An_Inquiry_Into_the_Nature_and_Causes_of/C5dNAAAAcAAJ?hl=ru&gbpv=1, and Friedman, "The Social Responsibility of Business Is to Increase Its Profits". *New York Times Magazine*, 13 September 1970, 122-126.
[20] Max Weber, *The Protestant Ethic and the Spirit of Capitalism*, (Routledge Taylor & Francis group 2001), 314, https://gpde.direito.ufmg.br/wp-content/uploads/2019/03/MAX-WEBER.pdf
[21] John Stuart Mill, *On liberty*. (J. W. Parker and Son, 1859), 207, https://books.google.fr/books?id=3xARAAAAYAAJ&pg=PA134&source=gbs_toc_r&cad=3#v=onepage&q&f=false

any hindrance or limitations. Furthermore, the proliferation of free markets and competition at that time placed pressure on companies to maximize profits to entice investors and maintain their competitiveness[22]. The combination of the Industrial Revolution and the profit-oriented mindset, ensured by the free market, provided the foundation for economic growth that relied on unregulated and unethical resource exploitation. Consequently, this approach gave rise to significant environmental and ecosystem issues.

The first scholars to observe these changes during the 18th century raised concerns about the future of humanity if it would continue the trend set by the Industrial Revolution. Thomas Malthus was the first one to argue the problem that population growth would eventually outrun the capacity of resources to support it, leading to collapse in living standards, human welfare, environmental, and social disasters[23]. His ideas were influenced by the works of David Hume and Adam Smith who did not directly address the modern concept of sustainability, but their ideas regarding human nature, social organization, and economic behaviour made an important contribution to understanding sustainability and its challenges. Smith believed that individuals acting in their own self-interest could lead to a more efficient allocation of resources and greater overall prosperity, but he also recognized the potential for market failures and the need for government intervention to address externalities and public goods[24]. The issue raised by Smith regarding externalities and how to cope with them transformed into the question of how to internalize externalities which is currently a number one priority in reorienting business towards sustainable operation. Hume argued that social norms and values are not fixed but are shaped by the social and cultural context in which we live[25]. Also, he believed that justice requires us to consider the interests of all members of society, including future generations[26]. Those perspectives are reflected in the modern concept of sustainable development where it is emphasized the importance of creating social and institutional frameworks that support environmentally sustainable practices and values and providing intergenerational justice.

Malthus' ideas break out a long-standing debate about the relationship between population growth, resource consumption, and sustainability. Nevertheless, it was not until the middle of the 20th century that these issues became the cornerstone of modern policy making, business management, and scholarly research activities. After World War II the problem of resource scarcity

[22] William J. Bernstein, *The Birth of Plenty: How the Prosperity of the Modern World was Created* (New York: McGraw-Hill, 2004), 400.
[23] T. R. Malthus, *An Essay on the Principle of Population* (DigiCat, 2022).
[24] Adam Smith, *The Wealth of Nations*, (1962).
[25] David Hume, *Enquiries Concerning Human Understanding and Concerning the Principles of Morals: Reprinted from the Posthumous Ed. of 1777 and Ed. with Introduction, Comparative Table of Contents, and Analytical Index by (*L.A. Selby-Bigge, 1975).
[26] David Hume,"Of Justice." *In A Treatise of Human Nature*, Book III, edited by David Fate Norton and Mary J. Norton, 428-451. Oxford: Oxford University Press, 2000.

became a global issue which was impossible to ignore. The global population increased rapidly, demand for natural resources grew, and the rise of industrialization with increasing use of fossil fuels posed additional strain on the planet's resources. Following the growing level of production and resource extraction, the visible harm to the environment was noticeable. The high-profile oil spills of the 1960s and 1970s drew attention to the environmental risks with the Torrey Canyon disaster[27], the Santa Barbara and the Amoco Cadiz oil spills[28]. Due to the media availability and influence of mass media in the 1960s and 1970s, the immediate reporting of environmental disasters spread worldwide and brought the impacts of these spills to public attention in a way that had not been possible before. Public environmental concern started to gain momentum, researchers proved the growing adverse effect on the environment and human health[29]. Demand for government action to protect the environment and public health started to gain its power. Water and air pollution were the first to be seen and felt and as a result addressed on the national levels e.g., the Clean Air Act of 1963[30] and the Clean Water Act of 1972[31] in the United States.

Nevertheless, there was a clear call for the actions on the international level as the consequences affected not a single nation, but the planet. In early 1960s was proposed the idea for the first global environmental conference, which took place in 1972 in Stockholm and is known as the United Nations Conference on the Human Environment. The agenda for the conference included a range of topics, such as air and water pollution, land use, resource conservation, and the protection of endangered species[32]. Also, it addressed the discussions on the economic and social dimensions of environmental protection and the role of international cooperation in addressing these issues. Prior to the conference the Rome Club published the book "The Limits to Growth"[33] which is considered to be a seminal work in the history of sustainability. It was one of the first studies to use computer modelling to explore the long-term consequences of economic and population growth on the global environment and economy. The book was published just a few months before the conference, and it influenced the debates about the long-term outcome of global economic growth and resource consumption. Book demonstrated that continued economic and population growth within the limited Earth's resources would eventually lead to ecological and

[27] "Torrey Canyon oil spill", Britannica, accessed 2 May 2023, https://www.britannica.com/event/Torrey-Canyon-oil-spill.
[28] "Amoco Cadiz oil spill: The largest loss of marine life ever", Safety4see, accessed 3 May 2023, https://safety4sea.com/cm-amoco-cadiz-oil-spill-the-largest-loss-of-marine-life-ever/.
[29] Rachel Carson, *Silent Spring* (Houghton Mifflin Harcourt, 2002).
[30] "Clean Air Act of 1963", Pub. L. No. 88-206, 77 Stat. 392 (1963), codified as amended at 42 U.S.C. §§ 7401-7671q.
[31] "Clean Water Act of 1972", Pub. L. No. 92-500, 86 Stat. 816 (1972), codified as amended at 33 U.S.C. §§ 1251-1388.
[32] United Nations General Assembly, "Resolution 1346(XLV) - Measures to Safeguard the Future of Humanity Against the Catastrophic Effects of Nuclear War," accessed 3 May 2023, https://undocs.org/en/E/RES/1346(XLV).
[33] Meadows, D. H., Meadows, D. L., Randers, J., & Behrens III, W. W. *The Limits to Growth: A Report for the Club of Rome's Project on the Predicament of Mankind,* (1975).

economic collapse. Furthermore, the publication popularized the concept of "sustainability" and suggested it as a keystone for modern humanity.

As a result, the United Nations Conference on the Human Environment officially opened the era of sustainable development for the international community, but as it is seen from the above mentioned the idea behind sustainability rooted in the issues of resource scarcity and unlimited economic growth driven by pursuit of profit as the main goal of business.

The United Nations Conference on the Human Environment in Stockholm resulted in adoption of the Stockholm Declaration[34]. Which is constituted out of 26 principles to inspire and guide the peoples of the world in the preservation and enhancement of the human environment. Principles 1-4 acknowledged the need for humanity to safeguard natural resources for the benefit of present and future generations, this idea would be further developed into the concept of sustainable development. And the main force in ensuring sustainable development is attributed to states which should:

- "take all possible steps to prevent pollution" (principle 7),
- "should enhance and not adversely affect the present or future development potential of developing countries" (principle 11),
- "adopt an integrated and co-ordinated approach to their development planning so as to ensure that development is compatible with the need to protect and improve environment for the benefit of their population" (principle 13),
- "exploit their own resources pursuant to their own environmental policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction" (principle 21),
- "co-operate to develop further the international law regarding liability and compensation for the victims of pollution and other environmental damage" (principle 22).

It has been recognized that sustainable development requires the active involvement of national and international governments to implement and enforce policies. The Stockholm Declaration introduced a social element as an indispensable component for achieving sustainable development (principle 8).

Fifteen years after the Conference in Stockholm the term "sustainable development" was presented in the report "Our Common Future" 1987. The report confirmed the ideas which arose centuries prior that "environment and development are not separate challenges; they are inexorably

[34] "Stockholm Declaration", adopted at the United Nations Conference on the Human Environment, Stockholm, June 16, 1972, accessed 10 April 2023, https://documents-dds-ny.un.org/doc/UNDOC/GEN/NL7/300/05/IMG/NL730005.pdf?OpenElement.

linked. Development cannot subsist upon a deteriorating environmental resource base; the environment cannot be protected when growth leaves out of account the costs of environmental destruction"[35]. This statement enabled the belief of unlimited economic growth based on resource consumption and was a shift maker in rethinking of the future business models which before operated with the goal of profit maximization and growth based on the idea of unlimited resource consumption. Furthermore, the report confirmed that sustainable development can be only achieved through interaction between social, environmental, and economic spheres. The evolution of inclusion social criteria in sustainable development cannot be underestimated. Tracing back in the history of sustainability it can be noted that the prior concern for humanity was environmental destruction and resource scarcity, but it was a consequence behind which was an unsustainable pattern of business - pursuit of profit while disregarding negative externalities. And in order to combat and prevent adverse environmental effects there is a need to change the pattern of business, meaning values. Sustainable development is impossible to achieve without social changes because sustainable development requires a shift in the way societies think about and interact with the environment and natural resources. Social changes are necessary to promote the values, attitudes, and behaviors that are necessary for sustainable development.

"Our Common Future" report became a basis for the next major milestones in the evolution of sustainable development - Rio Declaration 1992[36]. The Rio Declaration builds on the concept of sustainable development and makes significant progress by establishing numerous relevant legal indicators related to the environment, both in terms of substance and procedure[37]. Social concern was addressed in principles 1 and 5. The accumulative role of the states' policies in promoting and establishing sustainable development has been confirmed in principles 8, 11, 12, 13, etc. And in the Rio Declaration it can be noted the inclusion of business and elimination of unsustainable patterns of production and consumption (principle 8). And a crucial provision was presented "national authorities should endeavour to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investment" (principle 16). This principle provides a foundation and

[35] World Commission on Environment and Development, *supra note*, 13.
[36] "Report of the United Nations Conference on Environment and Development" a/conf.151/26 (vol. i), (Rio de Janeiro, 3-14 June 1992), accessed 3 April 2023, https://www.un.org/en/development/desa/population/migration/generalassembly/docs/globalcompact/A_CONF.151_26_Vol.I_Declaration.pdf.
[37] Günther Handl, "Declaration of the United Nations Conference on the Human Environment (Stockholm declaration), 1972 and the Rio declaration on environment and development, 1992", *United Nations Audiovisual Library of International Law*, 2012, 11 p. https://legal.un.org/avl/pdf/ha/dunche/dunche_e.pdf

justification for internalization of externalities, later it will become a priority in shifting corporate governance and business operation towards sustainability.

The United Nations Conference on Sustainable Development, Rio+20 in 2012, marked a significant milestone in prioritizing sustainability in the global agenda. This was especially important for businesses as it reflected a growing demand from society, investors, and governments for a more sustainable approach to economic development. The launch of the Sustainable Development Goals (SDGs)[38] was a crucial step in this direction as they provide a framework for businesses to align their strategies and operations with sustainable development objectives. As the outcome of the conference the political declaration "Future We Want"[39] was adopted, which explicitly "acknowledged that the implementation of sustainable development will depend on the active engagement of both the public and the private sectors…We support national regulatory and policy frameworks that enable business and industry to advance sustainable development initiatives, taking into account the importance of corporate social responsibility. We call on the private sector to engage in responsible business practices, such as those promoted by the United Nations Global Compact[40]".

The issue of resource scarcity has been a long-standing problem for humanity. Looking back through history, it is evident that the pursuit of profit as the sole goal of business after the Industrial Revolution has led to the neglect of adverse environmental and societal impacts caused by business activities. This concept has resulted in the irresponsible and brutal exploitation of natural and human resources, which has had visible consequences on the environment and societal conditions. The sustainability movement emerged as a response to these disasters and eventually transformed into international policies. In recent times, it has become increasingly clear that business activities play a significant role in causing environmental and societal damage. Thus, it is necessary to address the issue of business transformation towards sustainable corporate governance as a top priority in contemporary society.

1.2 Governments' involvement in achieving sustainable development

To promote sustainability, it is crucial to recognize the key stakeholders who play a role in advancing or hindering its realization. Within the context of a democratic free-market economy, modern society involves three primary actors—business, civil society, and government—in the

[38] "The 17 goals", United Nations Department of Economic and Social Affairs Sustainable Development, accessed 12 April 2023, https://sustainabledevelopment.un.org/index.php?menu=1300.
[39] UN General Assembly, "The Future We Want", *Resolution adopted by the General Assembly on 27 July 2012.* A/RES/66/288. https://sustainabledevelopment.un.org/index.php?menu=1298.
[40] *Ibid.*

pursuit of sustainable development. While business operations can have detrimental effects on the environment and human rights due to factors such as supply chain practices and inadequate labour standards, civil society advocates for governmental intervention to safeguard human rights and establish conditions for a secure and environmentally sound society.

To address the societal call for sustainable development, governmental bodies play a crucial role in establishing a regulatory framework for business operations. Although businesses may demonstrate a willingness to embrace socially responsible practices, external pressures from society, customers, investors, and regulatory frameworks are often necessary to drive such adoption. Regulations assume a central role in reflecting societal and consumer demands, imposing disclosure requirements and other obligations on businesses to safeguard investor interests and ensure transparency in their operations[41]. Consequently, these regulations serve to direct investments towards enterprises that pose lower risks while promoting sustainability. Hence, the effective fulfilment of society's sustainability expectations relies on the implementation and enforcement of government regulations that establish an equitable environment for businesses.

It is necessary to clarify why for the governments it is appropriate to intrude into the private sphere of business operation circulated in a free-market economy and impose new sustainable but restrictive frameworks. The history provides plenty of examples when government interference into the free market was called upon to save banks and financial institutions during crises, protect consumers[42], guarantee workers' rights[43], prevent monopolies and promote competition, and protect the environment[44]. Government intervention into the free market is based on the need to protect the stability of the economy and prevent further damage of the negative externalities that can result from unregulated free market activity. Negative externalities can include pollution, risks to the public health, economic inequality, and market failures that can harm individuals and the broader economy. The Great Depression and the 2008 financial crisis are examples of unregulated free market failures. In response to the economic devastation governments introduced a range of regulations and interventions to stabilize the economies and financial systems and prevent further damage. As a result, in 1933 in the US were established the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission (SEC), and the National Recovery

[41] Kateryna Varava, "Corporate governance revising: within sustainability business reorientation", *Mykolo Romerio Universitetas Teisinės minties šventė 2023,* Studentų mokslinių straipsnių rinkinys, 2023.
[42] See "Consumer Protection Act of 1987", c. 43, U.K. , and "Consumer Product Safety Act of 1972", Pub. L. No. 92-573, 86 Stat. 1207 (1972), 15 U.S.C. §§ 2051-2089.
[43] See "Fair Labor Standards Act of 1938", Pub. L. No. 75-718, 52 Stat. 1060 (1938), 29 U.S.C. §§ 201-219.
[44] See "Clean Air Act of 1963", Pub. L. No. 88-206, 77 Stat. 392 (1963), codified as amended at 42 U.S.C. §§ 7401-7671q., and "Clean Water Act of 1972", Pub. L. No. 92-500, 86 Stat. 816 (1972), codified as amended at 33 U.S.C. §§ 1251-1388.

Administration (NRA)[45]. After the 2008 crisis new regulatory rules included bailouts of large banks and financial institutions, regulatory bodies were formed, stricter rules for financial institutions were implemented.

Thus, it is acknowledged practices of government interference into the free market due to protect stability and prevent damage of the negative externalities.

In adherence to the principles of proportionality and necessity, government intervention is permissible as long as it does not distort the inherent primacy of private enterprise in business. Presently, there exists a disconnection between cause, consequence, and accountability for detrimental environmental and social impacts, as those responsible for such damages evade true liability. Take, for instance, the Coca-Cola Company, which has consistently ranked as the leading global plastic polluter since 2018[46]. Plastic pollution inflicts harm upon marine life, diminishes ecosystems' capacity to adapt to climate change, degrades water quality, and impacts human well-being. However, the expenses incurred in combating and mitigating the negative consequences of plastic pollution are shouldered by the government, utilizing taxpayer funds to establish landfills, implement recycling programs, and so forth. Consequently, it is the citizens, rather than the profit-gaining company itself, who bear the ultimate burden of the adverse effects[47]. The primary objectives of governments in establishing a legal framework for sustainable corporate governance are to hold companies accountable and responsible for their unsustainable business practices, while safeguarding the well-being of both people and the planet.

There is an ongoing debate whether or not sustainability corporate governance can be achieved without binding regulatory policy but through investors' influence and shareholders activism. The history of the appearance of sustainability as a phenomenon provides a ground to believe that investors play a rather follow-up role in reacting to the environmental or social crisis, and the primary position in preventing adverse environmental and social effects belong to the governments. Tracing back to the roots of the environmental problems, which humanity is facing now, it leads to the Industrial Revolution which sparked the movement of pursuing profit as the main principle of business operation. Investors, company directors, and shareholders' business decision making policies were driven primarily by profit maximization while neglecting negative externalities caused by the business activities. As a result, business was the one who was responsible for financing and benefiting from environmental destruction. Taking into account this argument it is highly doubtful that investors, company directors, and shareholders voluntarily

[45] "Transcript of Speech by President Franklin D. Roosevelt Regarding the Banking Crisis", Federal Deposit Insurance Corporation, accessed 2 May 2023, https://www.fdic.gov/about/history/3-12-33transcript.html.
[46] "Break Free From Plastic",.*Brand Audit Report 2018-2022*, 2022, accessed 10 January 2023, https://brandaudit.breakfreefromplastic.org/wp-content/uploads/2022/11/BRANDED-brand-audit-report-2022.pdf.
[47] Varava, *supra note, 41.*

would shift their harmful environmental and social business activities without governmental regulatory interventions. Posing self-restriction by business in order to diminish adverse effects on the environment would require additional costs, which would lead to decrease in profit and as a result shrink market competitiveness. In reality of the profit maximization principle of business this voluntary approach would fail.

While some scholars believe that ESG investing driven by activism of responsible investors who are willing to channel their investments into sustainable businesses may move companies in the desired direction of sustainable business operation[48], others[49] argue and provide evidence that company directors, shareholders, and investors are reluctant to serve for the benefit of stakeholders and address environmental and social issues beyond what would fulfil shareholder interests.

The empirical data collected regarding corporate acquisitions with aggregate value of more than $800 billion during the COVID pandemic in the US proved that deal terms provided large gains for shareholders of target companies and substantial private benefits for corporate leaders, but employee protections were largely not obtained, and corporate leaders failed to negotiate for protections for customers, suppliers, communities, the environment, and other stakeholders[50]. In 2020 it was already highly recognized the crucial importance of sustainable development. By the time of the pandemic corporate leaders expressed maximum support and commitment to follow stakeholderism and serve interests of employees, customers, suppliers, local communities, and the environment[51]. Nevertheless, corporate leaders ignored environmental and stakeholders concerns while conducting sales negotiations for their companies in favour of shareholder value maximization. The authors of the research "Stakeholder Capitalism in the Time of COVID" claimed that "if corporate leaders chose not to protect the environment, employees, or other stakeholders in a time when stakeholders needed extraordinary protection and shareholders enjoyed a booming market, it is not reasonable to expect them to protect stakeholders in normal times"[52]. Furthermore, when negotiating the acquisition of Twitter by Elon Musk, Twitter's leaders prioritized the interests of shareholders and themselves, disregarding the interests of stakeholders, including employees and the company's mission and values, which challenges the notion that

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[48] Paul L. Davies, "Shareholder Voice and Corporate Purpose: The Purposeless of Mandatory Corporate Purpose Statements", *European Corporate Governance Institute - Law Working Paper No. 666/2022,* (November 1, 2022), https://ssrn.com/abstract=4285770.

[49] Lucian A. Bebchuk, Kobi Kastiel, and Roberto Tallarita, "Stakeholder Capitalism in the Time of COVID" *Yale Journal of Regulation, Volume 40, 2023, pp. 60-126*
Harvard Law School John M. Olin Center Discussion Paper No. 1088
Harvard Law School Program on Corporate Governance Working Paper, European Corporate Governance Institute - Law Working Paper No. 670/202 2022-22, (August 1, 2022), http://dx.doi.org/10.2139/ssrn.4026803.

[50] *Ibid.*

[51] "Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy that Serves All Americans"", perma.cc, 2019, accessed 23 April 2023, https://perma.cc/AGQ9- 9PHV.

[52] Bebchuk L., Kastiel K., Tallarita R, op. cit., 72.

corporate leaders are expected to consider stakeholder interests and suggests that corporate mission statements may be superficial[53]. Another example is the endorsement of the Business Roundtable (BRT) Statement[54] by corporate executives, affirming their dedication to stakeholders, did not result in substantial enhancements in the treatment of stakeholders. This suggests that relying solely on the discretionary actions of corporate leaders to prioritize stakeholder interests proves to be an ineffectual and counterproductive strategy[55]. Thus, it can be seen that investors' and corporate leaders' desire for profit maximization overrun voluntary commitment to sustainable development. That provides a ground to argue that in order to achieve sustainability, there is a need to establish regulations which would bind companies with environmental and social responsibilities in their business operations.

The question arises regarding the feasibility of holding businesses accountable for their actions without enacting legal changes to corporate governance principles, but instead imposing restrictions solely through environmental regulations. The argument put forth is that achieving comprehensive corporate environmental protection is contingent upon successfully internalizing it within the corporate governance framework, rather than treating it as an external regulation that is merely met at a minimal level of compliance[56]. However, incorporating environmental concerns into business policymaking necessitates changes to corporate purpose, entailing the adoption of sustainable ethical behaviour, expanding the scope of directors' duties and including binding environmental and societal criteria in the decision-making process. Furthermore, the globalization of production and supply chains across countries with varying levels of national environmental protection can result in a lack of accountability for businesses responsible for environmentally harmful effects. Implementing due diligence policies within the supply chain encompasses all potential direct and indirect connections contributing to environmental damage, holding responsible businesses liable. Hence, there is a growing demand and necessity for the implementation of stringent legal regulations to redirect businesses toward a socially responsible model by transforming corporate governance practices.

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[53] Lucian A. Bebchuk, Kobi Kastiel, and Anna Toniolo, "How Twitter Pushed Stakeholders Under The Bus", *Forthcoming, Stanford Journal of Law, Business, and Finance, Volume 28, 2023, Harvard Law School John M. Olin Center Discussion Paper No. 1102, Harvard Law School Program on Corporate Governance Working Paper 2023-1, European Corporate Governance Institute - Law Working Paper No. 704/2023*, https://ssrn.com/abstract=4330393.

[54] "Statement on the Purpose of a Corporation", Business Roundtable, accessed 28 April 2023, https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporationJuly2021.pdf.

[55] Lucian A. Bebchuk, and Roberto Tallarita, "Will Corporations Deliver Value to All Stakeholders?", *Vanderbilt Law Review, Volume 75, 2022, pp. 1031-1091, Harvard Law School John M. Olin Center Discussion Paper No. 1078, Harvard Law School Program on Corporate Governance Working Paper 2021-11, European Corporate Governance Institute - Law Working Paper No. 645/2022*, (August 4, 2021), 62, https://ssrn.com/abstract=3899421.

[56] David M. Ong, "The Impact of Environmental Law on Corporate Governance: International and Comparative Perspectives", *European Journal of International Law*, Volume 12, Issue 4, 1 September 2001, Pages 685–726, https://doi.org/10.1093/ejil/12.4.685.

2. CORPORATE PURPOSE AND DIRECTOR'S DUTIES WITHIN SUSTAINABILITY FRAMEWORKS

2.1. Revising of corporate purpose

To accomplish a successful transition towards socially responsible corporate governance, it is crucial to establish decision-making processes guided by socially responsible principles. Within the corporate structure, the board of directors or a single director typically hold the responsibility for overseeing and managing daily business operations. These individuals exercise their authority by making operational and strategic decisions in accordance with their fiduciary duty, which obliges them to act in the best interests of the company. Current debates revolve around identifying who truly represents the best interests of the company, be it the shareholders, the company itself, or the stakeholders[57]. This determination ultimately shapes the formulation of the corporate purpose. As such, it is imperative to prioritize socially responsible decision-making to achieve a reorientation towards socially responsible corporate governance. Performance of the company is evaluated in relation to how the company delivers according to the established purpose, thus the values which are enshrined in the corporate purpose are decisive for the company's outcomes. The current model of corporate purpose which is now in place puts the profit maximization as the main purpose of the company's existence, crucial concern of shareholders and investors, and the highest responsibility of the directors. A topic of debate centres around how to hold directors accountable for both promoting the social and environmental interests of stakeholders while simultaneously generating profits for the company.

It is commonly believed that the most applicable corporate purpose of *shareholder value maximization* established by Friedman is harmful, and not addressing modern demands of the business and society[58].

Different approaches are coming to replace the shareholders' primacy.

2.1.1. Shareholder welfare maximization

Oliver Hart and Luigi Zingales propose to replace the current shareholder value maximization (SVM) approach with *shareholder welfare maximization (SWM)* where investors agree to have a lower dividend in return for the company they own to behave in a socially

[57] Varava, *supra note, 41*

[58] Oliver Hart, Luigi Zingales, "Companies Should Maximize Shareholder Welfare Not Market Value", *ECGI - Finance Working Paper No. 521/2017.* 2017. 39 p.

responsible manner taking into account effect of externalities and prosocial views[59]. This new idea for the corporate purpose is based on the trend of shareholders engagement regarding environmental and social issues. The data demonstrate that shareholders are willing to improve the environmental and social effect of the business performance even if such a business decision is decreasing the profit. The research provides examples the shareholders support in introducing and adopting different sustainable policies, e.g., DuPont's pollution policies[60], ExxonMobil's lobbying activities[61], Wendy's human rights disclosure policy[62], etc. This shareholders' behaviour contradicts the current concept of SVM and argues that there more than just shareholder value affects the decision-making policy of the company.

Several reasons are causing that shift in the companies' policies. Beginning with the increasing role of institutional investors with diversified portfolios. Institutional investors as shareholders who have multiple investments will likely prioritize optimizing the overall value of their portfolio as opposed to focusing solely on the value of an individual company. This reasoning has been recently presented in the class action filed in the Delaware Court of Chancery against the directors of Meta Platforms, Inc[63]. The lawsuit argues the directors failed in their fiduciary duties by neglecting to consider how the company's operations would affect the diverse investment portfolios of its shareholders. The top five institutional holders of the Meta's stock were the well-known asset managers BlackRock, Vanguard, Fidelity, State Street and T Rowe Price, collectively owning 27.84% of the Company's outstanding stock[64]. The plaintiff states that Meta is "the largest social media network company in the world, with 3.5 billion users—43% of humanity. Its business decisions inevitably create financial impact well beyond its own cash flows and enterprise value and have significant impacts on the global economy. While defendants have a duty to operate the Company as a business for the financial benefit of its stockholders, those stockholders are often diversified investors with portfolio interests beyond Meta's own financial success. If the decisions that maximize the Company's long-term cash flows also imperil the rule of law or public health, the portfolios of its diversified stockholders are likely to be financially harmed by those

[59] Oliver Hart, Luigi Zingales, "The New Corporate Governance", *University of Chicago Business Law Review 1 (1).* 2022.195-216.
[60] "DuPont Loses Plastic Pollution Vote With Record 81% Rebellion", by Kevin Crowley, BLOOMBERG (May 3, 2021), accessed 23 April 2023, https://perma.cc/4HCR-2M5N.
[61] "ExxonMobil Co., Amended Current Report "(Form 8-K/A), accessed 23 April 2023, https://ir.exxonmobil.com/sec-filings/sec-filing/8-ka/0000034088-21-000037.
[62] "The Wendy's Co., Current Report" (Form 8-K), accessed 18 April 2023, http://pdf.secdatabase.com/2786/0001193125-22-158700.pdf.
[63] "James Mcritchie v. Mark Zuckerberg, Sheryl K. Sandberg, Robert M. Kimmitt, Peggy Alford, Marc L. Andreessen, Andrew W. Houston, Nancy Killefer, Tracy T. Travis, Tony xu, and Meta platforms, INC.", October 3, 2022, accessed 15 April 2023, https://theshareholdercommons.com/wp-content/uploads/2022/10/Stamped-Complaint-FINAL-10.3.22.pdf.
[64] See "Top Institutional Holders" in Meta platforms, accessed 15 April 2023, https://finance.yahoo.com/quote/META/holders?p=META.

decisions"[65]. "In recent years investors have increasingly focused on what must be done to protect the value of their portfolios from system-wide risks created by the declining sustainability of various aspects of the natural or social environment. If risks of this sort materialised, they would therefore damage the performance of a portfolio as a whole and all portfolios exposed to those systems"[66]. The lawsuit is grounded in the conventional concept of shareholder primacy, where the board of directors is responsible for upholding the financial interests of the company's residual equity, typically the common stockholders, and not obliged to extend those responsibilities to other stakeholders[67]. The lawsuit seems to deter from the shareholder value maximization concept for the sake of social issues, but the real reason standing behind is still shareholder value maximization, just not from the investments in Meta company, but maximization of profitability of their other investments. The plaintiffs are willing to sacrifice the profit maximization in one company for the profit maximization in others, but the main concept is still profit maximization, which does not address the concerns of sustainability development. Furthermore, institutional investors are reluctant to include in their portfolios the economies of the developing or low-income countries, which limit the access of those countries to global financial markets and as a result constrains the sustainable development in these regions[68].

Following up on the increasing role of the institutional investors as a financial intermediary, Oliver Hart and Luigi Zingales analyse the voting process held by the mutual funds on behalf of their investors. The scholars argue that institutional investors generally hold the view that they are obliged to vote for the outcome that maximizes the value, based on their fiduciary duty, but in reality, that value maximization approach does not reflect the initial preferences of individual investors which can prioritize environmental and social criteria over profit. Mutual fund votes do not correlate with the votes of their individual investors, except for ESG funds[69]. To combat that false representation of individual investors' interests, more and more institutional investors introduce proxy advising services customized to specific needs. To increase shareholder activism in addressing the needs and interest of the latest different voting methods are introduced which

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[65] "James Mcritchie v. Mark Zuckerberg, Sheryl K. Sandberg, Robert M. Kimmitt, Peggy Alford, Marc L. Andreessen, Andrew W. Houston, Nancy Killefer, Tracy T. Travis, Tony xu, and Meta platforms, INC.", op. cit., p.2.

[66] *Ibid.* and "A Legal Framework for Impact: Sustainability Impact in Investor Decision Making", *PRI, UNEP FI and The Generation Foundation*, 2021, p.558, https://www.unepfi.org/wordpress/wp-content/uploads/2021/07/A-Legal-Framework-for-Impact_Report.pdf.

[67] Frederick Alexander, "Lawsuit Against Meta Invokes Modern Portfolio Theory To Protect Diversified Shareholders", *Harvard Law School Forum on Corporate Governance*, November 4, 2022, https://corpgov.law.harvard.edu/2022/11/04/lawsuit-against-meta-invokes-modern-portfolio-theory-to-protect-diversified-shareholders/#more-151109.

[68] "Financing for Sustainable Development Report 2021", United Nations, 2021, 209, https://developmentfinance.un.org/sites/developmentfinance.un.org/files/FSDR_2021.pdf.

[69] Jonathon Zytnick, "Do Mutual Funds Represent Individual Investors?", *NYU Law and Economics Research Paper No. 21-04*, (October 16, 2022), 78, https://ssrn.com/abstract=3803690.

should increase the voting turnouts, e.g., so-called "Big Three"– BlackRock, Vanguard and State Street – introduced different guidelines on proxy voting[70]. Among other proposed strategies is presenting investors' funds with a very clear and predetermined voting strategy, this would provide the choice for the individual investors to select the most appropriate investment funds according to the preferences of the initial investors.

Thus, the concept to replace shareholder value maximization with shareholder welfare maximization proposed by Oliver Hart and Luigi Zingales is trying to address the issue of shift in the investors' preferences with diversified portfolios and those especially young investors who are concerned about social and environmental externalities. Scholars "suppose that each individual puts some weight on doing the right or socially efficient thing, but only if he feels responsible for the action in question" and the way of making individual investors closer to the business actions they propose that company and asset managers should pursue policies consistent with the preferences of their investors[71]. The idea of bringing business decision making process to the hands of individual investors hoping for their sustainability consciousness is a one way of solving the problem of reorienting business towards sustainability, but the reality provides as positive[72] experiences of implementing this strategy as the negative[73] ones. And in order to not depend on a sustainable oriented attitude of some investors and suffer for the unsustainable approach of others, the implicate full-scale sustainability-oriented business requires more regulatory actions which would set the new sustainable rules for the business operation.

2.1.2. Purpose primacy

Colin Mayer advocates for establishing the *purpose primacy* where the company is committed to pursue a communal or a social purpose, with prohibition of depleting natural or social capital in favour of financial capital[74]. The scholar explores the idea that business should have a greater purpose beyond just making profits for shareholders. He argues that businesses should be responsible for creating value for all stakeholders, including employees, customers, suppliers, and the community. The current law of corporate purpose has overlooked the potential of purpose in mitigating the primary flaw of the current system, which is the disjunction between the private

[70] "BlackRock Investment Stewardship Proxy voting guidelines for U.S. securities", BlackRock, January 2023, accessed 16 April 2023, https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf.
[71] Oliver Hart and Luigi Zingales, "Companies Should Maximize Shareholder Welfare Not Market Value", *Journal of Law, Finance, and Accounting*, 2017, 2: 247–274, https://scholar.harvard.edu/files/hart/files/108.00000022-hart-vol2no2-jlfa-0022_002.pdf.
[72] See DuPont's pollution policies, ExxonMobil, Duke Energy.
[73] Bebchuk, Kastiel, and Tallarita, *supra note*, 49.
[74] Colin Mayer. *Prosperity: Better Business Makes the Greater Good.* Oxford: Oxford University Press, 2018. 288 pp.

interests of corporations and the public interests of society and the environment. This disconnect stems from the misalignment between the private motivation of profit-seeking and the public aim of promoting human and environmental flourishing and prosperity[75]. The cornerstone of introducing a new corporate purpose concept derived from the failure of Friedman's shareholder value maximization based on profit maximization to address to cope with sustainable development. The current corporate framework fails to acknowledge whether a company's profitability is achieved at the detriment of other parties, such as when it results in employee or supplier layoffs, or when it imposes negative externalities on third parties like local communities and the environment. The British Academy proposes to acknowledge that modern companies should "create profitable solutions for the problems of people and planet, while not profiting from creating problems for either"[76]. While it is recognized that solving problems is the primary purpose of business, considering the pursuit of sustainable development those problems' solutions should take into account interests of customers and communities, employees and the environment, societies and suppliers in ways that are commercially viable, financially sustainable and profitable[77]. By instituting these frameworks, the British Academy grants credibility to the boundaries within which companies are permitted to pursue profit maximization. It recognizes that profit generation should not arise from the exploitation of human welfare and the environment. As we approach the thresholds of ecological and social limits, the magnitude of such exploitation becomes increasingly pronounced.

The new corporate purpose based on the "purpose primacy" concept advocates for establishing the process where the benefits of shareholders would be a result of addressing the problems of external parties, rather than the other way around. Additionally, this approach is crucial in determining how trustworthy the company is perceived to be in protecting the interests of these external parties[78].

Additionally, the "purpose primacy" model revises the meaning of the company's success. Success of the company is evaluated accordingly to the effective delivering of the company's purpose[79]. While the maximization pursuit being the purpose of the company, the success is determined by the profit account. The "purpose primacy" suggestion of aligning personal

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[75] Colin Mayer, "What is Wrong with Corporate Law? The Purpose of Law and the Law of Purpose", *European Corporate Governance Institute* - Law Working Paper No. 649/2022, (May 2, 2022), https://ssrn.com/abstract=4136836.

[76] "Policy & Practice for Purposeful Business The final report of the Future of the Corporation programme", The British Academy, 2021, accessed 17 April 2023, https://www.thebritishacademy.ac.uk/publications/policy-and-practice-for-purposeful-business/.

[77] *Ibid.*

[78] Mayer, *supra note,* 74.

[79] Colin Mayer, "The Role of Corporate Law Reconsidered: A Brief Response to Paul Davies' Blog", *the ECGI blog*, 19 July 2022, https://www.ecgi.global/blog/role-corporate-law-reconsidered-brief-response-paul-davies%E2%80%99-blog.

incentives of generating financial profit with the environmental and social advantages of addressing problems without creating new ones[80], shifts the concept of companies' success which would rather be determined by the level of welfare creation for individuals, communities, and the natural world, rather than shareholders' and investors' wealth being.

2.2. Implication of sustainable corporate purpose in the "benefit corporation"

To address the issue of implementing a sustainable corporate purpose, a number of jurisdictions introduced regulations that provide companies with the opportunity to opt for a corporate purpose that allows boards to focus on conducting sustainable business. The type of companies with such a corporate purpose are called by the general term of a *benefit corporation*.

Different jurisdictions provide various definitions for the benefit corporations, but all of them include the idea of sustainable business operation with promoting public benefits. Italian Law no. 208 of 28 December 2015 establishes the "Società Benefit" - "the benefit corporations - which, in carrying out their economic activities shall pursue, in addition to the aim of distributing profits, one or more aims of common benefit, and operate in a responsible, sustainable and transparent manner vis-à-vis individuals, communities, territories and the environment, cultural and social heritage, entities and associations as well as other stakeholders"[81]. The law provides with definitions what is considered "common benefit" and "other stakeholder" and establishes the requirement to appoint responsible individuals to perform tasks for pursuing the common benefit. The additional duty of the *Società Benefit* prescribed by law is the obligation to produce an annual report concerning the pursuing of common benefit which includes the description of the specific objectives, modalities and actions implemented by the directors in order to pursue the aims of common benefit and the possible mitigating circumstances which have prevented, or slowed up, the achievement of the above aims; the evaluation of the generated impact, etc. (article 5). Article 4 states that administration of the benefit corporation should be carried out in a manner that considers the interest of the shareholders, the pursuit of the common benefit objectives, and the interests of identified stakeholders.

In case the administration of the benefit corporation failed to comply with obligations to operate in a responsible and sustainable manner, such behaviour may be deemed as a breach of the duties imposed by the applicable laws and the by-laws upon the directors of the company[82]. Nevertheless, the applicable Italian law limit the scope of claimants who can bring the lawsuit

[80] *Ibid.*
[81] "Società Benefit" LEGGE 28 dicembre 2015, n. 208, accessed 18 April 2023, https://www.societabenefit.net/wp-content/uploads/2017/03/Italian-benefit-corporation-legislation-courtesy-translation-final.pdf.
[82] *Ibid.*

against director for breaching duties imposed in relation to the benefit corporation. According to the Italian Civil Code article 2393, the action against directors can be brought by the company itself, the liquidator, or the board of supervisor (*collegio sindacale*) with the approval of at least two-thirds of its members[83]. Third parties generally cannot bring a direct action against a director for breaching their duties to the company, even if one of the directors' duties to the benefit company affects a third party, meaning conducting business in a responsible, sustainable and transparent manner while pursuing common benefit. Only general principle of tort liability provided by the Italian Civil Code in the article 2043 "any intentional or negligent act that causes unjust damage to others obliges the person who committed the act to compensate for the damage", can be a base for the third party to bring an action for damages against the director, provided they can establish a causal link between the breach of duty and the harm suffered. This principle is applicable to the directors of benefit corporations, as they have a duty to act in a responsible and sustainable manner, and if they breach that duty and cause harm to third parties, they may be held liable under Article 2043. But, in the case of breaching director's duties in benefit corporations in pursuing common benefit and operating business in a sustainable and responsible manner it is extremely hard to prove the direct causal link between director's breach of duty and causing harm to specific persons. The lack of effective mechanism to hold directors of benefit corporations liable for operating in an unsustainable manner is obvious, and that makes the whole mechanism of benefit corporation operation questionable if that model is enabled to achieve the goal of effective companies' reorientation towards sustainability.

The concept of benefit corporation is slightly different implemented in one province of Canada - British Columbia, with the enactment of the British Columbia Benefit Companies Act in 2019[84]. Article 51.992 (1) of the Act establishes a definition of the benefit company, which states the following: the company is considered to be a benefit company if it is committed to conducting its business in a responsible and sustainable manner and promoting one or more public benefits. The legislator provides the meaning of responsible and sustainable business operation which includes taking into account the well-being of persons affected by the operations of the benefit company and using a fair and proportionate share of available environmental, social and economic resources and capacities. Public benefit is defined as a positive effect for the benefit of a class of persons, other than shareholders of the company in their capacity as shareholders, or a class of communities or organizations, or the environment.

[83] "Codice Civile 2023" Testo del Regio Decreto 16 marzo 1942, n. 262 aggiornato con le modifiche apportate, da ultimo, dalla Legge n. 41/2023, accessed 19 April 2023, https://www.altalex.com/documents/codici-altalex/2015/01/02/codice-civile.

[84] "Business corporations amendment act (NO. 2), 2019", accessed 18 April 2023, https://www.bclaws.gov.bc.ca/civix/document/id/bills/billsprevious/4th41st:m209-3.

While there are many similarities that can be noticed between definitions of benefit corporation in Italian Law and British Columbia Act, the latest Act establishes clearer rules on addressing directors' duties in relation to the benefit company. Article 51.993 of British Columbia Benefit Companies Act states that a director or officer of a benefit company, when exercising the powers and performing the functions of a director or officer of the company, must act honestly and in good faith with a view to (i) conducting the business in a responsible and sustainable manner, and (ii) promoting the public benefits specified in the company's articles, and balance the duty with a view to the best interests of the company[85]. The formulation of the directors' duty to pursue a public benefit in addition to company's financial objectives expand the scope of directors' obligations, but when it comes to the possible enforcement, the law excludes directors' duty to a person whose well-being may be affected by the benefit company's conduct, or a person who has an interest in a public benefit specified in the company's articles. No legal proceeding may be brought by an affected third person against the directors of a benefit company in relation to the duties (article 51.993 (2) of Columbia Benefit Companies Act). The law specifically limits to shareholders of the benefit company the ability to bring legal proceedings against directors in case of breach of duties related to the sustainable and responsible business operation. The constraints to commence the proceedings by third parties in relation to the directors' duties in the benefit companies raise the same issues of the effective enforcement as in Italy with "Società Benefit".

Another statutory alternative to enable and encourage social enterprises is provided in the USA, where different states introduced legislation empowered formation of the benefit corporations. Delaware, by far the most important and influential state for corporate law, in the Delaware General Corporation Law in article 362, defines the benefit corporation as a for-profit corporation organized under and subject to the requirements of the relevant chapter that is intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner. To that end, a public benefit corporation shall be managed in a manner that balances the stockholders' pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit or public benefits identified in its certificate of incorporation[86]. Directors' duties in the benefit corporations should be exercised by balancing the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation (article 365 of the Delaware General Corporation Law). Nonetheless, Delaware

[85] "Business corporations Act [SBC 2002] Chapter 57", British Columbia, Canada, accessed 20 April 2023, https://www.bclaws.gov.bc.ca/civix/document/id/complete/statreg/02057_06#section142.
[86] "The Delaware code, TITLE 8 Corporations CHAPTER 1. General Corporation Law. Subchapter XV. Public Benefit Corporations", accessed 20 April 2023, https://delcode.delaware.gov/title8/c001/sc15/.

corporate practice is one of the examples of inconsistency of directors' duties imposed by the law on benefit corporations with the case law which constitutes that ordinary Delaware corporations are legally obliged to ultimately serve the financial interests of shareholders alone[87], without prioritizing or balancing public benefit generation.

The law of Delaware in the same way as mentioned in the above examples limits the power to enforce the balancing obligations of directors established in article 365 to shareholders (article 367 Delaware General Corporation Law). The California Corporations Code introduced a benefit enforcement proceeding as the only possibility to bring action or assert a claim against a benefit corporation or its directors for breaching the duties of generating general or specific public benefit (article 14623 of the California Corporations Code)[88]. Nevertheless, only directors, shareholders, and benefit corporations can commence the benefit enforcement proceeding. The law excludes directors' liability for monetary damages for any failure of the benefit corporation to create a general or specific public benefit (article 14620 (f)). The benefit enforcement proceeding does not result in any monetary compensation, the sole available solution is the issuance of an injunctive relief.

Thus, the analysis of the above-described laws on the benefit corporations proved several points. First, the limits imposed by law on the ability of third affected parties to commence benefit enforcement proceedings constitutes the failure of the whole enforcement mechanism. Only directors, shareholders, and benefit corporations themselves are guaranteed with the power to bring action against corporation's or directors' failure to operate a company in a sustainable and responsible manner. And those corporate actors demonstrate reluctance in commencing enforcement proceedings as they are the ones who will be financially affected in case of company's non-compliance with stated public benefit purpose. As the benefit corporations are for-profit, the risk of financial losses does not encourage shareholders and directors to bring actions against the company. And the profit orientation of the benefit companies is not debatable, as in the definition itself the generation of a general public benefit is an addition to financial returns. As a result, there is no effective mechanism to make companies and directors accountable for breaching duties of generating public benefits. Moreover, the exclusion of the companies' and directors' monetary liability for not operating business in a sustainable and responsible manner facilitates companies' opportunistic behaviour in conducting business under the title of benefit corporation without actual compliance with sustainable corporate purpose. This opportunistic behaviour with the label of

[87] Brett H. McDonnell, "The Corrosion Critique of Benefit Corporations" (September 9, 2019), https://ssrn.com/abstract=3450747.

[88] "California corporations code" §14620-14623, accessed 21 April 2023, https://casetext.com/statute/california-codes/corporations-code-corp/title-1-corporations-100-14631/division-3-corporations-for-specific-purposes-12000-14631/part-13-benefit-corporations-14600-14631/chapter-3-accountability-14620-14623.

benefit corporation widespreads greenwashing practices among companies and undermines the real purpose of the benefit corporations. Simply stating a purpose does not ensure that a corporation will align its decision-making and actions with that purpose. To enable effectiveness of the benefit corporation, the accountability of the directors and corporations should be real, by means of empowering affected third parties (individuals, communities) with legal ability to bring actions against directors for breaching their duty of sustainable business operation and lift the limits of monetary liability of the company and its directors. Those actions will truly lead benefit companies to pursue public benefits and the needs of persons other than shareholders.

2.3. Directors' duties in the era of sustainability

The act of formulating a sustainable purpose statement alone does not provide a fool proof guarantee that the corporation will effectively direct its decision-making processes and behaviours in accordance with the defined purpose. The examples of the implication of benefit corporations in different jurisdictions demonstrated the ineffectiveness of delivering public benefits due to the lack of accountability policy of corporations and mainly its directors. Legislation establishes the directors' duty to ensure business operation in a sustainable and responsible manner by balancing the interests of the stockholders, materially affected by the corporation's conduct, and the public benefits. However, the law clearly specifies that "a director shall not have a fiduciary duty to a person that is a beneficiary of the general or specific public benefit purposes"[89]. The present regulations governing benefit corporations, which are the most notable instances of corporate purpose being aligned with sustainability objectives, exclude the fiduciary duties of directors in relation to the beneficiaries of public benefits, namely communities, individuals, and the environment. In order to effectively enforce sustainable corporate purpose, there is a necessity to expand the scope of directors' duties which would lead to directors' accountability.

The consideration of diverse stakeholders' interests and environmental impact in the decision-making process of directors is implemented in various ways. The UK Company Act 2006 mandates that one of the director's duties is to promote the success of the company, with a focus on benefiting its shareholders, while also taking into account the interests of employees, suppliers, customers, the community, and the environment, among other factors that are important in maintaining a positive reputation[90]. However, the text suggests that the primary criterion for company success is shareholder benefits, and the phrase "have due regard" implies that stakeholder interests are of secondary importance and may not prevail in the event of a conflict between

[89] *Ibid.*
[90] See UK Companies Act 2006, *supra note, 6.*

shareholders and stakeholders. The adopted formulation of the directors' duties in the Company Act 2006 was a result of a compromise between the shareholder value maximization business model and the stakeholderism movement. During the mid-nineteenth century, the UK legislature expressed concerns regarding the potential consequences of the introduction of limited liability in the context of new business organizations, especially in relation to the directors' power in managing companies' affairs. As a result, companies were mandated to specify their intended areas of business operation and the corresponding powers they were authorized to wield. Subsequently, courts in the UK, as well as in other common law jurisdictions, applied the "ultra vires" doctrine to such statements, whereby any transactions conducted beyond the scope of the stated purposes were deemed legally invalid. Furthermore, directors were potentially held personally accountable to the company for failing to uphold the requirements of its constitution[91]. The rationale behind this approach was to create strict boundaries for the directors' duties and impose liability for unauthorized actions outside the satiated scope of the company's purpose. The imposition of personal liability on directors was not favoured by them, shareholders, or third parties engaging with the company, given the potential implications of the "ultra vires" doctrine[92]. As a result, the company risked missing out on significant business opportunities that emerged in related areas of operation[93]. Consequently, the "ultra vires" doctrine was eventually abandoned, and instead, the presentation of directors' duties and liabilities aligned with the idea of maximizing shareholder value[94]. Nonetheless, this historical illustration highlights the importance of protecting the company by holding directors responsible for any failures to adhere to the corporate purpose, which was previously accomplished through the application of the "ultra vires" doctrine.

Accountability of the directors is directly linked to the issues of directors' duties and to whom they are owned. Different jurisdictions address this issue differently, but the main common similarity is the formulation of directors' duties as to act in good faith in the interests of the company, to promote the success of the company for the benefit of its members as a whole, where members are limited to shareholders[95]. This current formulation of directors' duties facilitates in delivering shareholder value maximization purpose of the company and does not involve responsibilities of the directors of pursuing sustainable business operation. Nevertheless, the common law system is trying to expand directors' duties regarding different stakeholders.

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[91] Mackie, C, "A tale of unintended consequence: corporate membership in early UK company law", *Journal of Corporate Law Studies*, 17 (1), (2017), 37, https://doi.org/10.1080/14735970.2016.1209803.
[92] *Ibid.*
[93] Paul Davies, "The role of corporate law in corporate purpose: the British Academy Report", the ECGI blog, 5 July 2022, https://www.ecgi.global/blog/role-corporate-law-corporate-purpose-british-academy-report.
[94] *Ibid.*
[95] See UK Companies Act 2006.

The judgment of the UK Supreme Court in relation to the case of *BTI 2014 LLC v. Sequana SA and others*[96] has addressed the issue that directors' duties are owed to the company itself, rather than directly to its shareholders. The proceeding commenced regarding the question of directors' duties in the moment of the company's insolvency. While in the normal course of business operation it is considered that directors owe fiduciary duties solely to shareholders, in the course of company's insolvency proceedings interests of creditors should become the priority for directors rather than shareholders' needs. The debates are generated around the purposes of the director's fiduciary duty to act in good faith in the interests of the company, and whether or not the best interests of the company are taken to be equivalent to the interests of its shareholder, or other stakeholders[97]. The judgment confirms that at a certain point in time the interests of creditors will have to have priority for the directors over any other interest, and if a company becomes irreversibly insolvent, directors must disregard the interests of shareholders if they conflict with those of creditors[98]. This statement has engendered a paradigm shift in the conception of directors' duty to promote the success of the company for the benefit of members, where members at normal course of business are considered to be shareholders, but during insolvency proceedings - creditors. I do believe that taking into account the need of corporate governance reorientation towards sustainability the directors' duties should be to promote the success of the company itself, without solely attachment to shareholders. In some jurisdictions like the USA and the UK the dispersed ownership prevails, which dominated by short-term shareholders rather than long-term shareowners, and is therefore a low commitment economy[99]. At the same time if the directors would pursue the success of the company, where the success of the company is defined by delivering value to society in a sustainable and responsible manner, then directors' duties would correspond to the corporate governance reorientation towards sustainability.

The role of the directors cannot be underestimated in delivering corporate purpose, taking into account the consideration of sustainability as a part of business strategy. Scholars propose to expand the list of directors' duties and introduce the duty of social responsibility, a duty to ensure that the corporation acts as a responsible corporate citizen in society[100]. The establishment of such a duty within corporate law would create an obligation for corporations to prioritize the fulfilment of societal needs, thereby fostering a culture of commitment within the organization. This

[96] See The Supreme Court's Decision in *BTI 2014 LLC (Appellant) v Sequana SA and others (Respondents)* [2022] UKSC 25.
[97] "Directors' and Officers' Duties Evaluation of the 'best interests' duty", Allens & Linklaters LLP, accessed 29 May 2023, https://www.aicd.com.au/content/dam/aicd/pdf/news-media/research/2022/Allens-research-the-best-interests-duty-26-05-2022.pdf.
[98] *Ibid*, par. 250.
[99] Mayer, *supra note, 74*, 164-165.
[100] Jaap W. Winter, "Addressing the Crisis of the Modern Corporation: The Duty of Societal Responsibility of the Board" (April 13, 2020), https://ssrn.com/abstract=3574681.

commitment would encourage the corporation to align its objectives with broader societal interests and take proactive measures towards fulfilling these interests. It is suggested that when fulfilling their duty of societal responsibility, directors should act in a manner that is reasonable and appropriate given the circumstances[101]. This standard of behaviour is commonly utilized by courts when evaluating the actions of directors and enables a review of decision-making and conduct in light of what is considered reasonable under the circumstances. This standard assumes that directors exercise sound judgment and reason when balancing the interests and concerns for which they are responsible. By applying this standard, directors can be held accountable for their actions and decisions and can be expected to prioritize the fulfilment of societal needs alongside the interests of shareholders[102].

Corporate law has the potential to establish a duty for boards and directors to ensure that corporations act in a responsible manner, considering the interests of society and the utilization of various forms of capital, including investor, human, social, and natural capital. This would require boards and directors to consider the broader implications of their actions on stakeholders beyond just shareholders, including the environment, employees, customers, and the wider community. By embedding such a duty within corporate law, organizations can be held accountable for their impact on society and the environment and be incentivized to adopt sustainable and socially responsible practices. In various jurisdictions, the recognition of a duty of societal responsibility for boards of directors would complement the core duties of loyalty and care that are typically acknowledged.

2.4. New moral and ethical corporate purpose

The above explored judgment *BTI 2014 LLC v. Sequana SA and others* interpreted the text of section 172(1) of the 2006 Company Act regarding directors' duties in the following manner: "This provision [art. 172(1)] recognizes that, as a separate entity from its shareholders, a company has responsibilities of legal, societal, environmental and, in a loose sense, moral or ethical nature, compliance with which is likely to secure rather than undermine its success. These responsibilities are not those of its shareholders, even viewed as a whole. But compliance with them is a matter for the directors, as custodians of what Lord Templeman memorably called the "conscience of the company" in the Winkworth case [1986] 1 WLR 1512, 1516"[103]. This statement supports the idea of the leading role of directors in delivering a company's success according to the corporate purpose, it also emphasizes the responsibilities of the company with respect to societal and

[101] *Ibid.*
[102] Peter Van Schilfgaarde, *Law and Life, why Law?* Springer 2019, 180.
[103] See The Supreme Court's Decision in *BTI 2014 LLC (Appellant) v Sequana SA and others (Respondents)* [2022] UKSC 25, par. 140.

environmental issues. The statement claims that the company has responsibilities "of legal, societal, environmental, and in a loose sense, moral or ethical nature". While the argument addresses the moral and ethical responsibilities of the company in a loose sense, I believe that exactly the moral and ethical responsibilities of the company should play a crucial role in establishing modern corporate purpose.

The desire to include sustainability into the corporate governance is impossible without transforming corporate purpose as the base of the decision-making policy and directors' duties. Sustainability as the idea focuses on addressing the needs of the present generation without incurring debt to future generations, in different forms of sources, e.g., social and environmental capitals. However, while the needs of the current generation are visible in the protection of human rights, ensuring equality, combating natural disasters, and creating a healthy environment, the needs of the future generations are not foreseeable and modern society can only try to predict what will be a concern for the future generations. Will it be preserving humanity or protecting individuals in the AI era, nowadays society cannot surely claim what will be the needs of future generations, just try to guess. Meaning that in order to effectively reflect and address the changing needs of society in corporate purpose formulation, this formulation should include the dynamic category which would correspond to social transformations. I believe that this category is morality and ethics which should be considered during corporate decision making not in a loose sense but as a keystone of corporate operation.

Morality and ethics play an important role in shaping societal norms and behaviours by providing guidelines and standards that promote social cohesion and functioning. In this sense, the development and evolution of moral and ethical systems are closely tied to the needs and goals of society, as they facilitate the establishment of shared values and beliefs that guide individual conduct and promote collective well-being. While today it is considered unethical for the business operation to cause adverse environmental and social effects, as societal responsibilities to protect and flourish human rights and environmental responsibilities to not cause harm to nature became part of today's morality and ethics. Previous business and as a result corporate governance model based on pursuing profit is now considered to not fit in the morality of sustainable development, but after the Industrial Revolution profit maximization business orientation was moral and ethical for that time society. According to the prominent ideas of Max Weber[104] who explores the relationship between religious beliefs and economic behaviour in Western societies, the Protestantism, particularly the Calvinist branch, played a significant role in the development of capitalism in the West. Weber suggests that the pursuit of profit was seen as a moral and ethical

[104] Weber, *supra note, 20.*

duty in Protestantism, rather than a sinful or selfish endeavour. This mindset encouraged individuals to work hard, save money, and invest in business ventures, which helped to fuel the growth of capitalism in the West. It was believed that success in the material world could be seen as a sign of God's favour, which led to the development of what Weber called the "worldly asceticism" of Protestantism. In this way, the pursuit of profit was seen as a moral and ethical duty for Calvinists, as it allowed them to demonstrate their commitment to God and to contribute to the growth and success of society.[105] This perspective on profit and economic activity differed significantly from the Catholic view, which tended to view wealth as a potential source of temptation and sin.

Thus, the pursuit of profit was considered to be moral and ethical at the beginning of capitalism development[106]. This morality was enshrined in the company governance structure through adopting corporate purpose based on delivering shareholder value maximization, and directors' duties which were determined by solely serving financial interests of shareholders. Nevertheless, morality and ethics have changed since Industrial revolution times with occurrence of new social and environmental challenges: protection of environment and human rights, sustainable development, but the new morality is not addressed in the corporate governance structure which is still serving pursuit of profit by any means as the main business purpose. The necessity to include the moral and ethical responsibilities of the company in the corporate purpose would adjust businesses operation, directors' duties, and corporate governance as a whole, to the needs of society in an intergenerational term. The formulation of corporate purpose as "the responsibility of the company to operate in moral and ethical manners", which includes a dynamic category of morality and ethics, has the potential to address current and future sustainability concerns of business activities. In this sense, sustainability can be considered a contemporary moral imperative of the late 20th to 21st centuries, and such a formulation of corporate purpose can address emerging ethical concerns that will shape the morality of future generations.

Furthermore, the expansion of corporate responsibility to encompass moral and ethical dimensions is crucial for holding companies accountable for unsustainable practices. Sustainability introduces the concept of intergenerational responsibilities, as defined by the principle of meeting the present needs without compromising the ability of future generations to meet their own needs[107]. This definition broadens the scope of responsibilities, requiring the current generation, including businesses, to ensure that their activities do not hinder the ability of future generations

[105] *Ibid.*
[106] *Ibid.*
[107] World Commission on Environment and Development, *supra note, 13.*

to pursue their needs. Thus, in order to fully achieve sustainable development, the responsibility to safeguard the interests of future generations must be explicitly articulated.

While there may be uncertainty regarding the specific needs of future generations, the current generation and corporate leaders are bound by the principle of not compromising the well-being of future generations. Therefore, current business practices must make a conscientious effort to assess whether their activities have the potential to harm future generations' abilities. This obligation is embedded in the realms of moral and ethical conduct within the firm. Individuals and civil societies should posses a mechanism to hold companies and their boards accountable for actions that not only fail to harm the current generation but also pose a threat to future generations, based on prevailing moral and ethical norms within society.

When companies' operations create an actual or potential deviation from moral and ethical norms, they may be perceived as breaching their duty to operate in a morally and ethically responsible manner. To fully implement this approach, it is necessary not only to establish norms of responsibility within the corporate purpose but also to empower the court system to evaluate and assess the arguments presented by claimants. This evaluation should extend beyond the assessment of the immediate harm caused, which is the current practice, to include an evaluation of the potential harm to future generations. Companies should be held liable for their failure to foresee potential threats to intergenerational human and environmental well-being.

On the support of the above stated approach, The Hague District Court in 2021 ruled the decision by which ordered Royal Dutch Shell (RDS) to reduce the CO2 emissions of the Shell group[108]. The group of associations and foundations, responsible for initiating the class action against RDS and the Shell group, presented the claimants who alleged non-compliance with the Paris Agreement and international standards regarding the reduction of carbon dioxide emissions. The claimants' argument rests on the notion that RDS bears a responsibility, in accordance with the unwritten standard of care established in Book 6 Section 162 of the Dutch Civil Code, to actively contribute to the mitigation of hazardous climate change through the implementation of appropriate corporate policies. Section 162 of the Dutch Civil Code reads as follows: “A person who commits a tort towards another, which is imputable to him, is obliged to compensate the other for the damage that has arisen as a result thereof. An unlawful act is regarded as an infringement of a right and an act or omission that is contrary to a legal duty or to what is considered socially acceptable according to unwritten standards, all this subject to the presence of a justification. An unlawful act can be attributed to the perpetrator if it is due to his fault or to a cause for which he is

[108] “Claimants versus ROYAL DUTCH SHELL PLC in The Hague” case number / cause list number: C/09/571932 / HA ZA 19-379, the Hague district court, 26 May 2021, https://en.milieudefensie.nl/news/verdict-climate-case-milieudefensie-shell-26-may-2021-1.pdf.

responsible under the law or generally accepted beliefs"[109]. Incorporating the concepts of "unwritten standards" and "generally accepted beliefs" provides the court with the ability to approach violations of rights in a dynamic manner, given that the prevailing moral and ethical standards of society shape these unwritten standards and beliefs over time. The Hague district court's interpretation of the unwritten standard of care is informed by a variety of factors, including pertinent facts and circumstances, the most up-to-date scientific knowledge on the hazards of climate change and strategies to mitigate them, and the widely held international agreement that human rights provide a safeguard against the consequences of hazardous climate change, with corporations bearing the responsibility of respecting human rights. The court's interpretation of the unwritten standard of care has incorporated the globally advocated and approved principle that corporations must truly assume accountability for their emissions[110]. It was admitted that RDS must observe the due care exercised in society. The unwritten standard of care mandates RDS to uphold the human rights of Dutch residents and the inhabitants of the Wadden region, as stipulated in its reduction obligation.

In regard to the damage of the greenhouse gas emission the court stated that the Shell group represents an autonomous source of harm that has the potential to contribute to environmental damage, including the imminent risk of such damage to both Dutch residents and the inhabitants of the Wadden region. This argument was used to confirm the applicability of the Dutch law to the case and simultaneously set a precedent for further litigations against international companies which constrain sustainable development on the global level. The Shell group, being a significant participant in the fossil fuel market, bears responsibility for substantial CO2 emissions that surpass those of numerous countries. This contributes to global warming and climate change in the Netherlands and the Wadden region, leading to severe and irreversible consequences and risks to the human rights of both Dutch residents and inhabitants of the Wadden region. The court recognizes that the issue of dangerous climate change is a global problem that RDS cannot single-handedly resolve. Nonetheless, this fact does not release RDS from its individual and partial responsibility to take action regarding the emissions of the Shell group, which it has the power to regulate and affect[111]. In its ruling, the court finds that RDS is obligated to ensure a net reduction of 45% in the CO2 emissions resulting from the activities of the Shell group by the end of 2030,

[109] See "Dutch Civil Code Book 6", Article 162, https://wetten.overheid.nl/BWBR0005289/2017-09-01/0/Boek6/Titeldeel3/Afdeling1/Artikel162/afdrukken.
[110] See paragraphs 4.1.3., 4.4.1. and 4.4.2. of "Claimants versus ROYAL DUTCH SHELL PLC in The Hague" case number / cause list number: C/09/571932 / HA ZA 19-379, the Hague district court, 26 May 2021, https://en.milieudefensie.nl/news/verdict-climate-case-milieudefensie-shell-26-may-2021-1.pdf.
[111] "Supreme Court 23 September 1988, ECLI:NL:HR:1988:AD5713 (Kalimijnen)", legal ground 3.5.1, third paragraph.

relative to the 2019 level. This obligation is to be met through the implementation of the Shell group's corporate policy.

RDS asserted in its defence that it is the duty of states to establish the framework and regulations for private parties, and that private parties cannot act until the states establish the rules of the game. However, the court refuted this argument by stating that the responsibility of companies exists regardless of the states' capacity and/or willingness to fulfil their human rights obligations, and it does not reduce these obligations.

The recent high-profile court decision regarding Royal Dutch Shell (RDS) has significant implications and raises several important questions. One of the key aspects of the ruling is the inclusion of the duty of care according to the “unwritten standards" in a company's responsibility, which mandates that companies must adhere to unwritten standards and policies that address emerging global challenges and externalities. This decision allows the court to interpret these unwritten standards by analysing current scientific evidence and holding companies accountable for their actions in relation to these emerging challenges.

Secondly, the defendant in the case argued that it is the responsibility of the state to address these issues and that private parties will follow their lead. However, the court established that companies cannot shirk their responsibilities solely because the state has not taken action, and that their obligations exist independently of the state's willingness or ability to fulfil its own human rights obligations. It is not uncommon for businesses to hold the opinion that they are allowed to do anything that is not explicitly forbidden within their business operations. To address this issue, regulatory power should establish a legal framework that states that companies have a responsibility to operate in a moral and ethical manner. By using such formulations, courts would be able to evaluate companies' breaches of the law from the perspective of morals, ethos, or "generally acceptable beliefs," as stated in the Dutch Civil Code. This approach includes dynamic formulations that allow the consideration of present ethical concerns of society, e.g., sustainable development and future emerging global concerns that may shape society's morality.

3. SUSTAINABILITY STRATEGY IMPLEMENTATION IN CORPORATE GOVERNANCE

The theoretical analysis presented above has demonstrated that government intervention, through the imposition of regulations within corporate law, is a necessary prerequisite for achieving the objective of sustainable development. Subsequently, the forthcoming section shall provide an examination of current instances of hard and soft law, outlining examples of the incorporation of sustainability concepts into corporate governance.

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3.1. Soft law implementation of sustainability in the corporate governance: challenges and perspectives

Soft law instruments have become an important means of addressing corporate governance issues, with corporate governance codes and stewardship codes being ones of the key instruments. Corporate codes serve as a primary mechanism for encouraging companies to voluntarily adopt responsible business practices. These codes are non-binding, voluntary sets of principles, guidelines, or standards that companies may adopt to demonstrate their commitment to responsible business conduct. The main objective of corporate governance codes and stewardship codes is to set forth aspirational standards for corporate behaviour, with the aim of establishing transparency, accountability, ethical conduct, and best practices for an effective corporate governance model that is intended to promote long-term value creation[112]. Although not legally binding, corporate codes can play a significant role in shaping corporate behaviour and improving corporate governance practices.

Many European corporate governance codes enshrined the concept of sustainable business practices. In 2023, the Corporate Governance Code of Portugal was revised to the necessity of addressing sustainability matters. The new chapters were included which are solely dedicated to the sustainability-oriented business operation and environmental and social risk management. The code introduced the obligation of the company to contribute to the pursuit of the Sustainable Development Goals defined within the framework of the United Nations Organisation and identify, measure and seek to prevent negative effects related to the environmental and social impact of the operation of its activity, in terms that are appropriate to the nature and size of the company"

[112] "Dutch stewardship code", adopted on 20 june 2018, accessed 3 May 2023, https://www.eumedion.nl/en/public/knowledgenetwork/best-practices/2018-07-dutch-stewardship-code-final-version.pdf.

(principles I.A. and I.B.)[113]. Furthermore, the code emphasizes the duty of the management body to consider the interests of shareholders and other investors, employees, suppliers, and other stakeholders in the activity of the company (principle I.C.)[114].

In the Dutch Corporate Governance Code, the principle of "sustainable long-term value creation" was introduced as the first principle[115]. This principle places responsibility on the management board for ensuring the continuity of the company and its affiliated enterprises, as well as creating sustainable long-term value. In fulfilling this responsibility, the management board is expected to consider the impact that the actions of the company and its affiliated enterprises have on people and the environment, and to weigh the relevant stakeholder interests. The supervisory board is tasked with monitoring the management board in fulfilling this responsibility. Austrian corporate governance code suggests that "the management board shall endeavour to take into account the interests of the shareholders, of the employees and the public good"[116]. German code says "the Management Board is responsible for managing the enterprise in its own best interests, meaning that the Management Board shall systematically identify and assess the risks and opportunities associated with social and environmental factors, as well as the ecological and social impacts of the enterprise's activities"[117]. The Norwegian code of practice for corporate governance establishes that "the board of directors should define clear objectives, strategies and risk profiles for the company's business activities such that the company creates value for shareholders in a sustainable manner"[118].

Thus, it can be seen that the incorporation of sustainability into corporate governance has gained significant recognition as a critical policy in shaping a company's purpose, strategy, and the scope of directors' duties. It underscores the responsibility of the directors to anticipate and mitigate the risks arising from the company's business activities, which in turn, contributes to long-term value creation and enhances the company's reputation. By embracing sustainability principles, companies can achieve a balance between their economic goals and their social and environmental impact, promoting greater transparency and accountability. Nevertheless, as the corporate codes

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[113] "Corporate governance code 2018" of Portugal Revised in 2023, Portuguese Institute of Corporate Governance, https://www.ecgi.global/sites/default/files/codes/documents/corporate_governance_code_2018_revised_in_2023.pdf .

[114] *Ibid.*

[115] "The Dutch Corporate Governance Code 2022", updated on 20 December 2022, https://www.ecgi.global/node/10194.

[116] "Austrian Code of Corporate Governance (2021)", Austrian Working Group for Corporate Governance , https://www.ecgi.global/node/9028.

[117] "German Corporate Governance Code 2022", https://www.dcgk.de//files/dcgk/usercontent/en/download/code/220627_German_Corporate_Governance_Code_2022.pdf.

[118] "The Norwegian Code of Practice for Corporate Governance (2021)", https://nues.no/eierstyring-og-selskapsledelse-engelsk/#:~:text=The%20Norwegian%20Code%20of%20Practice%20for%20Corporate%20Governance%20is%20based,areas%20not%20addressed%20by%20legislation.

have recommendatory nature and non-binding effect the effective adoption of the above analysed principles is extremely low. In the realm of corporate governance, it is generally observed that non-compliance with a voluntarily adopted corporate code may result in adverse reputational effects but not legal sanctions[119].

However, the importance of recognizing the need for sustainable business operations cannot be overstated, especially as it pertains to business strategy and the scope of directors' duties. While it may be argued that voluntary adoption of corporate codes carries only reputational consequences for non-compliance, it is crucial to acknowledge the significance of soft law in driving the development of sustainability policies in corporate governance. The concept of the "Overton window"[120] serves to illustrate the progression of public ideas from being considered "unthinkable" to forming a policy. In the case of sustainability, it began as an unthinkable idea when profit maximization was the sole focus, and businesses were not held accountable for the negative environmental and social impacts of their operations. As awareness grew, sustainability became a radical and then acceptable idea in the mid-20th century. Today, the adoption of sustainability goals and their incorporation into European corporate governance codes represent the "popular" stage, marking full recognition of sustainability as a fundamental element of business strategy and corporate governance.

It is the next and final stage where the integration of sustainability into corporate governance becomes a binding rule introduced through regulation. The emphasis on sustainable business practices has been steadily increasing over the years, and it is now widely recognized that a company's social and environmental responsibilities should be an integral part of its operations[121]. Therefore, the recognition of sustainability in corporate governance codes represents a significant shift in the way businesses operate, and it is imperative that this recognition is translated into binding rules to ensure that sustainability remains a priority in corporate decision-making.

3.2. Hard law implementation of sustainability in the corporate governance

3.2.1. Companies' reporting duties

[119] Guido Ferrarini, and Michele Siri, and Shanshan Zhu, "The EU Sustainable Governance Consultation and the Missing Link to Soft Law", *European Corporate Governance Institute* - Law Working Paper No. 576/2021, (April 9, 2021), https://ssrn.com/abstract=3823186.
[120] "The Overton window", Conceptually, accessed 3 May 2023, https://conceptually.org/concepts/overton-window.
[121] "Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee - Implementing the partnership for growth and jobs : making Europe a pole of excellence on corporate social responsibility /* COM/2006/0136 final */", EUR-Lex, accessed 3 May 2023, https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2006:0136:FIN:EN:HTML.

In recent years, sustainability and corporate responsibility have gained increasing recognition, prompting both international and national governance bodies to address the growing concerns through regulatory means. To introduce regulatory measures in the private business sector, governments have started by introducing both mandatory and voluntary reporting frameworks. As such, reporting has emerged as a crucial mechanism for ensuring accountability and transparency in corporate sustainability practices[122]. Nowadays, companies are increasingly required to disclose information regarding their environmental, social, and governance (ESG) performance, along with their impact on stakeholders and society at large.

The significance of monitoring and reporting obligations in the context of establishing socially responsible corporate governance is crucial. These obligations provide a means for companies to communicate their efforts towards sustainable and responsible business practices to their stakeholders, including investors, customers, and the wider community. At an international level, there already exist obligations for companies to disclose non-financial information, such as their environmental impact, human rights policies, and social responsibility initiatives.

The introduction of non-financial reporting regulations regarding environmental and social impact of activities takes different approaches in various regions. In the European Union and member states, the main objective is to promote society's interests by enhancing transparency of undertakings and providing information to meet the needs of investors, stakeholders, and consumers[123]. On the other hand, the United States focuses primarily on the interests and needs of investors. According to Gary Gensler, the SEC Chair, the proposed by the SEC climate disclosure rules "would provide investors with consistent, comparable, and decision-useful information for making their investment decisions, and it would provide consistent and clear reporting obligations for issuers"[124]. The rules would also require the disclosure of a registrant's greenhouse gas emissions, which is a commonly used metric to assess a registrant's exposure to climate-related risks[125]. To ensure that the information provided is accurate and can be relied upon by investors. As part of the proposed modifications, registrants would be required to incorporate an attestation report from an independent attestation service provider to enhance the dependability of greenhouse gas (GHG) emissions disclosures for investors. The inclusion of an independent third party, in the

[122] "Big shifts, small steps Survey of Sustainability Reporting 2022", KPMG, accessed 3 May 2023, https://assets.kpmg.com/content/dam/kpmg/se/pdf/komm/2022/Global-Survey-of-Sustainability-Reporting-2022.pd.
[123] See par.3 of the Preamble to 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 Text with EEA relevance. OJ L 330, 15.11.2014, p. 1–9, accessed 23 April 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095.
[124] "SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors" sec.gov, March 21, 2022, accessed 23 April 2023, https://www.sec.gov/news/press-release/2022-46.
[125] "The Enhancement and Standardization of Climate-Related Disclosures for Investors", Securities and Exchange Commission, [Release Nos. 33-11042; 34-94478; File No. S7-10-22], accessed 2 April 2023, https://www.sec.gov/rules/proposed/2022/33-11042.pdf.

form of an attestation service, within non-financial reporting regulations in the US, offers a viable solution for ensuring the credibility of reported information and subsequently increasing corporate accountability. This, in turn, reinforces the obligation of companies to report on environmental concerns, elevating it to a matter of significant importance that must be considered when drafting policies and strategies related to both environmental and societal issues. The repercussions of violating The US Securities and Exchange Commission (SEC)'s proposed climate disclosure rules are not explicitly mentioned, given that the regulations are still pending complete implementation. However, the SEC retains the power to enforce penalties for non-adherence to its regulations. The penalties may vary from monetary fines to the suspension or cancellation of a company's registration statement, potentially resulting in its delisting from stock exchanges. Furthermore, non-compliance could impugn a company's reputation and adversely affect its capability to entice investments.

However, there have been challenges in addressing these issues. Some scholars argue that the SEC's climate disclosure rules should be more flexible and allow companies to opt out of all or part of the requirements if investors vote to do so[126]. However, this could impede standardization and make it difficult for investors to compare information across sectors and over time. Impeding mandatory climate disclosure by either blocking it or allowing opt-outs may negatively impact the reputation, competitiveness, and stability of the US capital markets. This could result in the US being the sole major market where investors are unable to access reliable and comparable climate risk information as a standard practice[127]. Thus, in the US, lawmakers are in the process of imposing binding requirements for businesses to produce climate-related disclosures of their activities in the market.

In accordance with the EU Directive on the disclosure of non-financial information[128], companies are required to provide information on their due diligence processes in the non-financial statement. This information of the non-financial statement according to the article 19a of the Directive must cover to the extent necessary for an understanding of the undertaking's development, performance, position, and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption, and bribery

[126] Scott Hirst, "Saving Climate Disclosure", *Boston Univ. School of Law Research Paper No. 4134822, 28 Stanford Journal of Law, Business, and Finance 91 (2023), European Corporate Governance Institute* - Law Working Paper No. 675/2023, (November 1, 2022), 88, https://ssrn.com/abstract=4134822.

[127] Virginia Harper Ho, "Why climate disclosure is the SEC's job – Not investors'", *the ECGI blog*, 17 April 2023, https://www.ecgi.global/blog/why-climate-disclosure-sec%E2%80%99s-job-%E2%80%93-not-investors%E2%80%99?mc_cid=b3820964c1&mc_eid=fa7b3967c9.

[128] 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 Text with EEA relevance. OJ L 330, 15.11.2014, p. 1–9, accessed 23 April 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095.

matters. Following the adoption of the EU Directive on disclosure of non-financial information national legislators included the provisions on the non-financial statements into the national legislations: the German government transposed the Directive into the German Commercial Code (HGB)[129] in sections 315b and 315c in conjunction with 289b to 289e, the French government transposed the Directive into the Article 225 of the country's Commercial Code[130], etc.

Merely imposing non-financial reporting obligations on companies through legislation is not enough to ensure their transition into sustainable operation. Effective enforcement and accountability mechanisms are necessary to give those reporting provisions real impact. The consequences for non-compliance with non-financial statement reporting requirements differ by member state, ranging from fines in some jurisdictions, such as Italy, to imprisonment in Germany[131]. While France has implemented sufficient and coherent non-financial reporting requirements for companies, it fails to address cases of non-compliance. The only consequence of non-compliance in France is that any interested party or individual may request that the information be provided to the presiding judge of summary proceedings[132]. The non-financial reporting legislation in France is incorporated in Ordinance No. 2017-1180 of July 19, 2017 [133], which was further supplemented by Decree No. 2017-1265 of August 9, 2017. The legislation distinguishes between the factors that listed and unlisted companies should report on, such as the consequences of their activities on the environment, the impact of their activities and products on climate change, and measures taken to promote diversity. Listed companies are also required to disclose information on the effects of their activities on human rights and corruption. Nonetheless, under Article L. 225-102-4 of the French Commercial Code, does not provide sufficient non-compliance liability for the companies, which leads to the diminished inclusion of environmental and social concerns in companies' strategies since there is no accountability for breaching those requirements.

3.2.2. Due diligence obligations in supply chains

[129] "Commercial Code (*Handelsgesetzbuch* – HGB)", Commercial Code in the revised version published in the *Bundesgesetzblatt*, accessed 23 April 2023, https://www.gesetze-im-internet.de/englisch_hgb/englisch_hgb.html.
[130] "French COMMERCIAL CODE", BOOK I
Commerce in general, accessed 23 April 2023, https://wipolex-res.wipo.int/edocs/lexdocs/laws/en/fr/fr199en.pdf.
[131]Claire Jeffery, "Comparing the implementation of the EU Non-Financial Reporting Directive in the UK, Germany, France and Italy", *Frank Bold,* November 2017, https://deliverypdf.ssrn.com/delivery.php?ID=400020126087064103123094087071114010096068026065069063076087022102112029127118101127028021100056061044043005099115106112095103049022017012058022014070126077125065030073087060027099078117127026030003119082068078121112024105027103120094092022067084017123&EXT=pdf&INDEX=TRUE.
[132] *Ibid.*
[133] "Ordonnance n° 2017-1180 du 19 juillet 2017", accessed 24 April 2023, https://www.legifrance.gouv.fr/loda/id/JORFTEXT000035250851.

Apart from non-financial reporting duties different jurisdictions introduced regulations on due diligence in supply chains. The underlying principle behind new adopted regulation is that corporations should be held responsible for any detrimental social or environmental effects that may arise from their supply chain activities. To fulfil this responsibility, companies are required to establish and implement a comprehensive supply chain policy and tracking mechanism to identify and assess potential risks.

In Germany, on 1 January 2023, the Act on corporate due diligence obligations in supply chains came into force[134]. The legislation mandates that companies exercise due diligence in their supply chains to prevent or mitigate any risks associated with human rights or environmental violations. These risks are identified based on a list of prohibited societal and environmental behaviours. Human rights risks include prohibition of (section 2 (2)): child labour, all forms of slavery, forced labour, disregarding the occupational safety and health obligations, disregarding freedom of association, unequal treatment in employment, withholding an adequate living wage, etc. Environmental risks include the prohibition of (section 2 (3)): manufacture and use of mercury-added products, other chemicals, exports of the hazardous waste, the collection, storage, and disposal of waste in non-environmental manner, etc. The legislator has set up an extensive list of activities that would be deemed as a breach in the supply chain, thereby establishing the principle that anything not prohibited is allowed. While this approach can be seen as a step forward in identifying and addressing environmental and societal risks in the supply chain, it can also be viewed as short-sighted. As new challenges in environmental and human rights protection arise, the current list of prohibited activities may not be comprehensive enough to address these emerging risks. This means that companies may not be held accountable for new and evolving environmental and social risks that are not explicitly mentioned in the legislation. As a result, it is essential for policymakers and stakeholders to continuously review and update supply chain regulations to ensure that they remain relevant and effective in addressing current and future sustainability challenges.

Supply chain as the main objective of regulation is defined as all steps in Germany and abroad that are necessary to produce the products and provides the services, starting from the extraction of the raw materials to the delivery to the end customer (section 2 (5)). In the context of supply chain management, due diligence pertains to a set of responsibilities that companies are obligated to fulfil. These include the establishment of a risk management system and complaints procedure, conducting periodic risk assessments, issuing policy statements, and documenting and

[134] "German Act on Corporate Due Diligence Obligations in Supply Chains" *Gesetz über die unternehmerischen Sorgfaltspflichten in Lieferketten*. Vom 16. Juli 2021, accessed 10 January 2023, https://www.csr-in-deutschland.de/SharedDocs/Downloads/EN/act-corporate-due-diligence-obligations-supply-chains.pdf;jsessionid=2D9D1A275B4294A2F6A0204214CBACC1.delivery1-master?__blob=publicationFile.

reporting findings, among others (section 3 (1)). Establishing and managing a risk management system is a critical aspect of due diligence, as the negative impact of business activities on the environment and society can create risks that affect the company's performance. Adopting a risk-based approach is increasingly being demanded by investors and financial institutions. They require companies to assess and manage the potential liability for their actions and those of their subsidiaries to avoid investing in companies where the risk is difficult to evaluate[135].

The Act also necessitates the performance of due diligence with regards to foreign suppliers that are part of the supply chain. To ensure sustainable business practices and protect national markets, regulation mandates that companies perform due diligence with foreign suppliers involved in their supply chains. This legal obligation requires companies to engage in risk assessment management throughout their supply chain operations. The German Act has global reach, impacting suppliers across the world who participate in supply chains involving goods supplied to Germany. For instance, this regulation will have an impact on Polish suppliers and sub-suppliers who are part of the supply chain for goods supplied to Germany. As a result, certain obligations may need to be extended and/or transferred to these (sub)suppliers. Consequently, Polish companies may be required to implement appropriate internal policies to maintain cooperation with German companies. To fulfil these requirements, Polish suppliers must conduct regular risk assessments for their deliveries and implement appropriate preventive and remedial measures[136]. Therefore, companies operating in the German market need to introduce a compliance procedure to ensure compliance with the regulations. By enforcing due diligence requirements in the supply chain which includes the assessment of the abroad company-suppliers environmental and societal risks will allow the market to be rid of unsustainable businesses and encourage outside companies to adopt more appropriate internal policies to maintain market cooperation.

The German Act on corporate due diligence obligations in supply chains has been established with a view to improving environmental and societal risk management and thereby promoting sustainability-oriented business operations. However, the Act's reliance on an exhaustive list of activities[137] that would be considered as a breach in the supply chain means that new emerging risks in human rights and environmental protection may not be addressed. Despite this flaw, the Act represents an important step forward because the establishment of binding

[135] "Corporate Sustainability Due Diligence An effective approach for financial institutions 23 January 2023", AFME, ISDA, FIA and EPIF, accessed 24 April 2024, https://www.isda.org/a/yzxgE/CS3D-An-effective-approach-for-financial-institutions.pdf.

[136] "The legal status of due diligence regulations in supply chains in Poland", Rödl &Partner, 15 September 2022, accessed 24 April 2023, https://www.roedl.com/insights/international-supply-chain-law/poland-harmonised-control-mechanism-risk-analysi.

[137] See section 2 (2) and section 2 (3) of "Corporate Sustainability Due Diligence An effective approach for financial institutions 23 January 2023", AFME, ISDA, FIA and EPIF, accessed 24 April 2024, https://www.isda.org/a/yzxgE/CS3D-An-effective-approach-for-financial-institutions.pdf.

environmental and societal risk assessments within supply chain operations, which goes beyond domestic corporate regulations, is spreading the idea of sustainability-oriented business operations far beyond national borders. This approach sets a precedent for other highly democratic and developed countries, such as EU member states, the US, the UK, and Australia, to adopt similar top-down regulations on due diligence within supply chains. As a result, businesses in other countries that are not willing to address concerns about human rights and environmental protection on a regulatory level may still be forced to adopt due diligence policies to gain access to these countries that have established binding regulations. For example, companies in China. While representatives of the People's Republic of China claim that there is "no one-size-fits-all model for the protection of human"[138], meaning that they may not be willing to adopt corporate due diligence regulations that address societal and environmental issues in a way that aligns with the Western approach. Nevertheless, Chinese companies may still be compelled to adopt such policies as part of their internal corporate regulations if they wish to maintain their export capabilities to countries with binding regulations on due diligence within supply chains. The result is a global shift towards greater corporate responsibility and a more sustainable business model.

France has established one of the most advanced mechanisms to promote corporate accountability and assess the societal and environmental impacts of a company's operations. This approach is enshrined in French law, which requires companies to develop and implement a "vigilance plan." "The plan shall include the reasonable vigilance measures to allow for risk identification and for the prevention of severe violations of human rights and fundamental freedoms, serious bodily injury or environmental damage or health risks resulting directly or indirectly from the operations of the company and of the companies it controls, as well as from the operations of the subcontractors or suppliers with whom it maintains an established commercial relationship, when such operations derive from this relationship"[139]. The plan must contain various components, including a risk assessment mapping, regular assessment procedures, an alert mechanism, an action plan to prevent and mitigate risks, and a monitoring scheme (article L. 225-102-4. – I.). However, the "vigilance plan" in France also has its drawbacks, including an unclear interpretation of the duty of vigilance, inadequate clarity and visibility within the management report, and a need for improved dialogue with trade unions and NGOs[140].

[138] "Following a Chinese Path of Human Rights Development and Contributing China's Strength to Global Human Rights Governance 2023/02/27", embassy.gov.cn, accessed 24 April 2023, http://se.china-embassy.gov.cn/eng/zgxw_0/202302/t20230228_11032426.htm.
[139] "French Law no. 2017-399 of 27 March. 2017", accessed 10 January 2023, https://respect.international/wp-content/uploads/2017/10/ngo-translation-french-corporate-duty-of-vigilance-law.pd.
[140] "Assessment of Duty of Vigilance Law". French High Council for the Economy. 2020, accessed 10 January 2023, https://www.economie.gouv.fr/files/files/directions_services/cge/Duty-of-Vigilance.pdf.

Merely having a good law in place may not necessarily lead to the intended benefits for the people it is designed to assist. Enforcement and remedies mechanisms play a vital role in this regard. The German Act on corporate due diligence obligations in supply chains establishes the special capacity to sue according to which any person claiming to have been violated in regard of human rights protection addressed by the Act may authorise a domestic trade-union or non-governmental organisation to bring proceeding to enforce rights (section 11(1)). Furthermore, the competent authority is empowered to take necessary and appropriate measures to detect, end, and prevent violations of the obligations imposed by the act, which may include summon people, order enterprise to submit reports in a certain timeframe, and require enterprise to take specific action to fulfil its obligations (section 15). In case of breaching due diligence requirements financial penalty up to 50.000 euros (section 23), and administrative fines (section 24) are possible to be enforced.

According to the French duty of vigilance law, if a parent company fails to comply, interested parties have the right to issue formal notice to demand that the company establish, publish, and implement a vigilance plan. If the formal notice remains unanswered for 3 months, stakeholders may seek injunctive relief in summary proceedings, with the possibility of imposing a recurring financial penalty to ensure the enforcement of the court order[141]. In addition, parent companies may face tort actions in civil proceedings, where their civil liability could be sought for failure to prevent human rights violations through the effective implementation of a reasonable and suitable vigilance plan.

While the German Act has recently come into force and no law proceedings are caused, the French law on vigilance plan was introduced in 2017 and the first lawsuit under the French supply chain law has failed. In 2019, a legal action was filed by four Ugandan NGOs and two French NGOs against TotalEnergies alleging that the company had unlawfully taken land from over 100,000 individuals without providing them with appropriate compensation, by doing this failed to adhere to a “duty of vigilance”[142]. On 28 February 2023, the court ruled the case was "inadmissible", saying the plaintiffs did not correctly follow court procedures against the French energy giant. Even though that the judgment did not rule on the matters of the case but on the procedural issues, it sheds light on the nature of the obligation of vigilance duties. It is noted that the measures related to due diligence imposed by the law are general and lack detail, as the decree envisioned by the law to provide further information has not yet been published. Additionally, the law does not specify any text to guide the judge in assessing the conformity of the due diligence

[141] “France's Duty of Vigilance Law”, Business & Human Rights Resource Centre, accessed 30 April 2023, https://www.business-humanrights.org/en/big-issues/corporate-legal-accountability/frances-duty-of-vigilance-law/.
[142] “NGOs file lawsuit against Total in France over Uganda oil project, includes company comments”, Business and Human Rights Resource center, Oct 25, 2019, accessed 24 April 2023, https://www.business-humanrights.org/fr/derni%C3%A8res-actualit%C3%A9s/ngos-file-lawsuit-against-total-in-france-over-uganda-oil-project-includes-company-comments/.

plan with "guiding principles, international standards, nomenclatures, classifications of due diligence." The positive law also lacks a "reference framework, typology of the measures concerned, modus operandi, master plan, monitoring indicators, measuring instruments," making it more challenging to apply. The judgment further highlights the absence of an oversight body, with the judge having the sole responsibility to carry out control based on the concept of the "reasonableness of the vigilance measures contained in the vigilance plan," which is a vague and flexible notion[143]. Therefore, the effectiveness of a law depends heavily on how it is interpreted and applied.

With understanding of the necessity to introduce and implement the concept of corporate due diligence on the regional level and cover common EU market by the requirement of due diligence in supply chains, the EU is in the process of adopting Directive on corporate sustainability due diligence (henceforth CSDDD). CSDDD aimed to adopt Union legislation on substantive corporate duty to perform due diligence - identify, prevent, mitigate and account for external harm resulting from adverse human rights and environmental impacts in the company's own operations, its subsidiaries, and in companies' chains of activities[144]. The adoption process began in February 2022 with European Commission proposal for a Directive (in the text - first Draft CSDDD[145]). In November 2022, the Council of the European Union submitted the amended proposal (in the text - second Draft CSDDD[146]).

The proposal for the CSDDD was based on the inadequacy of existing voluntary measures to induce businesses to manage their social, environmental, and governance impacts, and provide redress to those adversely affected. The civil society has demanded the implementation of EU-wide mandatory and enforceable due diligence regulations to establish legal consistency, ensure equal treatment, and set a non-negotiable standard for business relationships across the entire supply chain. The goal of the CSDDD is to encourage effective harmonization and foster a system that guarantees redress for those impacted by corporate activities, regardless of where they occur in the supply chain[147]. In accordance with Article 1, the primary aim of the CSDDD is to establish a set of regulations consisting of three distinct rules. Firstly, companies are obligated to take

[143] "Lessons learned from the 28 February Paris Court ruling in the "TotalEnergies" case", Rödl &Partner, 15 March 2023, accessed 24 April 2023, https://www.roedl.com/insights/france-paris-court-ruling-totalenergies-case-lessons-learned.
[144] Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937
COM/2022/71 final, accessed 23 April 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022PC0071.
[145] *Ibid.*
[146] See *supra note, 7.*
[147] "EU Commission releases study on options for regulating due diligence", Business and Human Rights Resource center, 24 Feb 2020, accessed 25 April 2023, https://www.business-humanrights.org/en/latest-news/eu-commission-releases-study-on-options-for-regulating-due-diligence/.

responsibility for any actual or potential adverse impacts on human rights and the environment arising from their own operations, those of their subsidiaries, and the operations of their business partners within their activities' chains. Secondly, companies will be held liable for any breaches of the aforementioned obligations. Lastly, companies must develop a plan to ensure that their business models and strategies are aligned with the transition to a sustainable economy and the goal of limiting global warming to 1.5 °C.

The primary issue with the CSDDD is its effectiveness in addressing the challenges of shifting businesses, by means of due diligence requirements, towards sustainability in response to societal and environmental concerns. To begin with, the scope of the CSDDD is primarily targeted towards large companies (article 2 of the CSDDD), while small and medium-sized enterprises (SMEs) are generally not directly covered by these initiatives. It is anticipated that merely about 13,000 companies within the EU and 4,000 companies outside of the EU will be obligated to conform, which amounts to approximately 1% of all EU companies[148]. This is particularly notable given that SMEs make up a substantial portion of all companies in the European Union, accounting for around 99% of the total. As a result, the exclusion of SMEs from the direct scope of the CSDDD represents a notable limitation in its effectiveness and potential impact on the overall sustainability of the business sector in the EU[149]. In an effort to broaden the reach of the CSDDD, the MEPs on the Legal Affairs Committee have put forward their own proposal, which expands the requirements for conducting due diligence to include EU-based companies with more than 250 employees (previously 500 employees) and a global turnover exceeding 40 million euros (previously 150 million euros), as well as parent companies with over 500 employees and a worldwide turnover exceeding 150 million euros. Furthermore, the proposed rules would apply to non-EU companies with a turnover exceeding 150 million euros if at least 40 million euros was generated in the EU[150]. This marks a significant change in the scope capacity of the CSDDD from the Commission proposal.

Furthermore, considering the debate regarding the inclusion of the financial sector in the scope of the CSDDD the Legal Affairs Committee affirmed that financial institutions will be subject to the scope of the CSDDD directive. The directive's eligible scope is cantered on activities

[148] "Legislating for impact analysis of the proposed EU Corporate sustainability due diligence directive", The Danish Institute for Human Rights, March 2022, accessed 24 April 2023, https://www.humanrights.dk/files/media/document/Legislating%20for%20impact%20-%20analysis%20of%20the%20proposed%20EU%20corporate%20sustainability%20due%20diligence%20directive.pdf.

[149] "Analysis of the draft Directive on Corporate Sustainability Due Diligence", Business and Human Rights Resource center, 15 Mar 2022, accessed 24 April 2023, https://www.business-humanrights.org/en/latest-news/analysis-of-the-draft-directive-on-corporate-sustainability-due-diligence/.

[150] "Corporate sustainability: firms to tackle impact on human rights and environment", News European Parliament, April 25 2023, accessed 26 April 2023, https://www.europarl.europa.eu/news/en/press-room/20230424IPR82008/corporate-sustainability-firms-to-tackle-impact-on-human-rights-and-environment.

that financial institutions can effectively control, especially in terms of extending financing to clients and their subsidiaries. Asset managers and institutional investors are among the financial institutions included in the directive's coverage, while pension funds, alternative investment funds, market operators, and credit rating agencies remain outside its purview[151]. The inclusion of financial institutions into the scope of the directive was highly anticipated by the investors and civil society, who recognized the importance of the due diligence carried out by the financial institutions. Even though financial institutions usually do not commit environmental or human rights violations themselves, they facilitate business activities, by providing financial services, that might cause human rights or environmental violations. The first draft of the CSDDD did not impose the due diligence requirements on the financial undertakings The second draft introduced the limited due diligence obligations for certain regulated financial undertakings but left for the consideration of member states where to impose those obligations while transposing directive into national regulation (article 2 (8)).

The Legal Affairs Committee voted that financial institutions fall within the scope of the CSDDD directive, it is a positive development in the harmonization and expansion of due diligence requirements. However, it must be noted that there remain significant shortcomings. One such limitation is the exclusion of pension funds, alternative investment funds, market operators, and credit rating agencies from the obligation to carry out due diligence requirements. It is crucial that all financial institutions are held to the same ongoing due diligence obligations as other companies, given the long-term nature of investment, crediting, and other financial sector activities. Furthermore, the CSDDD has established a limited scope of the due diligence requirement assigned to the specificity of financial institutions[152]. While other companies are required to identify actual and potential adverse impacts on an ongoing basis, regulated financial undertakings providing their service within the 'chain of activities' need only carry out identification before providing that service. This pre-contractual due diligence obligation falls short of the ongoing risk-based due diligence obligations that are necessary for assessing and monitoring potential or actual adverse human rights impacts in long-term investment relationships[153]. To effectively achieve the objectives of the Directive, which are the protection of human rights and the environment within

[151] "Corporate Sustainability Due Diligence Directive (CSDDD): Parliament is willing to adopt a more ambitious text than the Council", Ksapa website, April 26, 2023 by François Thiombiano, accessed 29 April 2023, https://ksapa.org/corporate-sustainaibility-due-diligence-directive-csddd-parliament-is-willing-to-adopt-a-more-ambitious-text-than-the-council/.

[152] "ECCJ Analysis of CSDDD Proposal 2022",Corporate Justice, accessed 29 april 2023, https://corporatejustice.org/wp-content/uploads/2022/04/ECCJ-analysis-CSDDD-proposal-2022.pdf.

[153] "Strengthening due diligence requirements for financial institutions in the Corporate Sustainability Due Diligence Directive (CSDDD)", Fair Finance International, accessed 29 April 2023, https://fairfinanceguide.org/media/498005/ffi-position-paper-csdd.pdf.

supply chains, the scope of the due diligence obligation of financial institutions should be expanded to align with the ongoing risk-based due diligence obligations. This proposed enlargement would enhance the capacity of financial institutions to effectively identify and mitigate negative effects arising from their operational activities and investment portfolios.

In addition, the MEPs on the Legal Affairs Committee are advocating for more severe penalties than those proposed by the Commission. While the Commission's proposal links the monetary penalties imposed to the company's worldwide net turnover, the MEPs propose to establish a clear penalty threshold, with fines set at a minimum of 5% of the company's net worldwide turnover. The MEPs also propose to ban non-compliant third-country companies from public procurement[154]. The adopted proposal thus aims to broaden the scope of the CSDDD's applicability and increase the accountability of companies, which should improve the effectiveness of due diligence compliance.

The CSDDD's material scope has received significant criticism for not including the binding consideration of climate impacts as a part of due diligence[155]. The applicability of the requirement for the companies to conduct human rights and environmental due diligence within assessing adverse climate impacts is explicitly left out for further revision (article 29d). Meaning CSDDD reluctance to impose binding obligations for the companies to conduct due diligence in regard to the climate impacts by integrating due diligence into their policies and risk management systems, identifying actual or potential adverse impacts, preventing and mitigating potential adverse impacts, establishing and maintaining a complaints procedure, monitoring the effectiveness of their due diligence policy and measures (article 4 (1)).

The issue of directors' duties concerning new due diligence obligations of companies was a subject of debate. The initial version of the first Draft CSDDD proposed that company directors should bear the responsibility for due diligence, considering input from stakeholders and civil society organizations and integrating due diligence into corporate management systems. This was reflected in the preamble of the first Draft CSDDD, as well as articles 5, 25, and 26, which assigned due diligence responsibilities to the directors. Article 5 stipulated that "companies conduct human rights and environmental due diligence," while articles 25 and 26 established that directors should fulfil their "duty of care" and be responsible for "putting in place and overseeing the due diligence." However, due to concerns raised by Member States and debates surrounding articles 25 and 26 of first Draft CSDDD[156], these articles were ultimately removed because of lack of clarification.

[154] "Corporate sustainability: firms to tackle impact on human rights and environment", News European Parliament, April 25 2023, accessed 26 April 2023, https://www.europarl.europa.eu/news/en/press-room/20230424IPR82008/corporate-sustainability-firms-to-tackle-impact-on-human-rights-and-environment.
[155] "EU must make business legally accountable for the climate crisis", Justice is everybody's business, accessed 29 April 2023, https://justice-business.org/civil-society-supporters/.
[156] See par. 31 of the second Draft CSDDD.

Consequently, the European Council adopted its negotiating position on the proposed CSDDD without provisions assigning direct due diligence obligations to the scope of directors' duties.

Criticism of articles 25 and 26 of the first Draft CSDDD centred on the concept of "company interest," which is not universally recognized, and the "duty of care" of directors, which is derived from the Anglo-Saxon legal tradition and interpreted differently among Member States[157]. Furthermore, Article 25 of the first Draft CSDDD resembles Section 172 of the UK Company Law 2006, but with an open-ended list of additional factors directors must consider and a reference to the more general "best interests of the company" without prioritization of shareholder interests[158]. While the proposal aimed to present a more general corporate purpose with the primacy of the best company interests, it could be interpreted differently by Member States according to their national legislation. As a result, the wording in Article 25 created more uncertainty than it facilitated harmonization in the EU.

However, by removing Articles 25 and 26 from the first Draft CSDDD, policymakers have provided too much leeway for Member States to interpret and add their own rules during the implementation of the CSDDD into national legislation. While civil society demanded clear board obligations to integrate sustainability risks and impacts into the company's strategy[159], policymakers simply removed the article which assigned a new duty to the directions' scope of duties. This lack of systematic regulation of directors' duties regarding due diligence requirements undermines the primary objective of sustainability business initiatives, which is to prevent the fragmentation of rules within the single market.

The previous language of Articles 25 and 26 was ambiguous and lacked clarity, although it aimed to allocate due diligence responsibilities to the directors. The preamble of the first Draft CSDDD contained paragraph 63, which was also removed, and it stated that: *"in all Member States' national laws, directors owe a duty of care to the company. In order to ensure that this general duty is understood and applied … in a harmonised manner, the general duty of care of directors to act in the best interest of the company, by laying down that directors take into account the sustainability matters, ... Such clarification does not require changing existing national corporate structures"*. The original purpose of the first Draft CSDDD was to establish that the best interests of the company, in relation to which directors exercise their duties, should encompass

[157] European Company Law Experts Group (ECLE), "The proposed Due Diligence Directive should not cover the general duty of care of directors", *the ECGI blog*, August 2022, https://ecgi.global/blog/proposed-due-diligence-directive-should-not-cover-general-duty-care-directors.
[158] Federica Agostini, Michele Corgatelli, "Art. 25 of the proposed Due Diligence Directive: Quo Vadis*?", Faculty of law blogs / University of Oxford*, September 2022, https://blogs.law.ox.ac.uk/blog-post/2022/09/art-25-proposed-due-diligence-directive-quo-vadis.
[159] "The case to save Article 25: Directors' Duty of Care", B Lab Europe, accessed 29 April 2023, https://bcorporation.eu/blog_post/the-case-to-save-article-25-directors-duty-of-care/.

human rights, climate change, and environmental concerns. This approach aimed to establish a new corporate purpose for sustainable business models, without which a full and consistent transition to sustainability and the enforcement of due diligence requirements would be challenging to achieve[160].

Further developments were related to the question whether or not the CSDDD should establish the link between variable remuneration of directors to their contribution to the company's business strategy and long-term interest and sustainability. The first draft of Article 15(3) of the CSDDD supported the approach of ensuring that companies take into account the fulfilment of their obligations to combat climate change when setting variable remuneration. However, the second draft of the CSDDD excluded this provision explicitly, stating that the form and structure of directors' remuneration fall within the company's competence and that of its relevant bodies or shareholders. Research studies indicate that the emphasis on environmental, social, and governance (ESG) metrics exacerbates the agency problem of executive pay, making it difficult to determine whether these metrics provide valuable incentives or simply result in performance-insensitive pay for CEOs[161].

Therefore, it can be argued that leaving the remuneration policy outside the scope of the directive is a positive compromise. The directive recognizes the competence of companies and their relevant bodies or shareholders to determine the form and structure of directors' remuneration. By avoiding the prescription of specific ESG metrics for variable remuneration, the directive avoids exacerbating the agency problem of executive pay. This approach ensures that companies can tailor their remuneration policies to suit their individual needs and contexts, while also providing flexibility for adaptation to evolving standards in ESG performance.

Besides the exclusion of directors' duty of care from the CSDDD, the second major change adopted by the Council is the deviation from the due diligence requirements in the full "value chain" to the obligation to carry out due diligence within "chain of activities". This amendment has been highly criticized for the omission of the downstream phase, which involves the use of the company's products or services[162]. In the first Draft of CSDDD due diligence was ruled to be carried out with respect to the company's own operations, the operations of their subsidiaries, and

[160] Varava, *supra note, 41.*

[161] Lucian A. Bebchuk, and Roberto Tallarita, "The Perils and Questionable Promise of ESG-Based Compensation Journal of Corporation Law", Volume 48, 2022, pp. 37-75, Harvard Law School John M. Olin Center Discussion Paper No. 1090, Harvard Law School Program on Corporate Governance Working Paper 2022-10, European Corporate Governance Institute - Law Working Paper No. 671/2022, (March 1, 2022), https://ssrn.com/abstract=4048003.

[162] "EU: Civil society urge MEPs to include downstream & climate in due diligence law ahead of key vote; rapporteurs reach political agreement", Business & Human Rights Resource Centre, accessed 30 April 2023, https://www.business-humanrights.org/en/latest-news/eu-parliament-struggles-to-agree-on-due-diligence-rules-before-key-vote/.

the value chain operations (article 1 (1(a))). Where value chain means activities related to the production of goods or the provision of services by a company of upstream and downstream established business relationships of the company (article 3(g)). The second Draft of the CSDDD limited the scope of the business activities with binding due diligence performance to the "chain of activities" which covers activities of a company's upstream business partners related to the production of goods or the provision of services by the company, but limits downstream business partners only to those who are directly related to the distribution, transport, storage and disposal of the product, by leaving out the indirect downstream partners. In certain industries, the greatest risks may lie not in the upstream value chain, but rather in the downstream value chain. Examples of such risks may include the provision of surveillance technology that enables human rights abuses by state actors, the delivery of mining equipment for operations that cause significant environmental harm, the supply of pesticides that endanger the health of local populations, or the financing of plantations where individuals are forcibly evicted without appropriate compensation.[163]

Therefore, it is improbable that the current proposal would effectively tackle the harm that extends beyond the primary tier of the supply chain. Consequently, it is inadequate in preventing human rights violations that frequently occur at the beginning of supply chains, which can involve multiple stages and subcontractors outside the purview of European corporations[164]. It is imperative to adopt more comprehensive measures to address these issues and ensure that supply chains are free from adverse environmental effects and human rights abuses. The approach of importance to cover the whole value chain was supported by the recent case law which stated that "the responsibility to respect human rights encompasses the company's entire value chain"[165]. The compromise adopted by the Council with introduction of "chain of activities" due diligence established the shield for the companies from addressing due diligence within whole supply chains.

The effectiveness of the CSDDD depends on the liability of companies in case of non-compliance and the access to justice for those who suffer harm. The Council proposal amended the article 22 of the CSDDD which established the provision on civil liability. According to the article 22, companies will be held liable for the damage cause to legal or natural person caused by non-compliance with obligations to take appropriate measures to prevent, or where prevention is

[163] "EU: Downstream due diligence must be part of CSDDD for it to be effective & in line with international standards, says policy brief", Business & Human Rights Resource Centre, 13 Mar 2023, accessed 29 April 2023, https://www.business-humanrights.org/en/latest-news/eu-downstream-due-diligence-must-be-part-of-csddd-to-be-effective-in-line-with-international-standards-says-policy-brief/.
[164] "EU: Over 100 civil society & trade union organisations launch campaign calling on EU to issue a strong due diligence law", Business & Human Rights Resource Centre, 6 Sep 2022, accessed 29 April 2023, https://www.business-humanrights.org/en/latest-news/eu-over-100-civil-society-trade-union-organisations-launch-campaign-calling-on-eu-to-issue-a-strong-due-diligence-law/.
[165] "Claimants versus ROYAL DUTCH SHELL PLC in The Hague", *supra note, 107.*

not possible or not immediately possible, adequately mitigate potential adverse human rights impacts and adverse environmental impacts, and to bringing actual adverse impacts to an end. The company should be held liable for failure to comply with due diligence requirements within its own operations, subsidiaries operations, and operations of direct and indirect business partners. The second draft of the CSDDD significantly amended the initial provision on liability by establishing four conditions which must be met to hold the company accountable. Firstly, there must be a demonstrated harm inflicted on a natural or legal person. Secondly, there must be a breach of a duty owed to that person. Thirdly, a causal connection must be established between the breach of duty and the harm suffered. Finally, there must be a demonstration of fault, either intentional or resulting from negligence. In the second version of the CSDDD, there is a clear exclusion of a company's liability if the harm was solely inflicted by its business partners in the chain of activities (article 22 (1)). The installed conditions are criticized for several reasons. First, the burden of proof. The CSDDD does not explicitly state who should bear the burden of proof and leave this to the Members' states consideration, but the obligation to prove the line-up of four established conditions for the companies' liability - breach of duty, fault, damage, causality link - typically belong to the plaintiffs. In the regard where the burden of proof lies with the victim, the responsibility for the actions of upstream companies' indirect partners essentially diminished because the victim lacks the access to the evidence and knowledge of the companies' chain of activities, or unable to easily acquire information about the company's processes. The limited access to information on the value chain highlights the issue of transparency, which can be addressed by implementing a requirement for companies to map their value chain and business relationships, and subsequently disclose the pertinent information to the public. Civil society groups have urged for stronger civil liability provisions and facilitate the access to the justice by including a fair distribution of the burden of proof[166], or even placing the burden of proof on the company to demonstrate compliance with the law[167].

Furthermore, according to Article 22, a company is not accountable for damages caused exclusively by its business partners in the value chain of activities, which includes direct or indirect upstream partners, or direct downstream partners. This provision raises the issue of the break of causation chain (novus actus interveniens)[168], which is approached differently by various

[166] "European Commission's proposal for a directive on Corporate Sustainability Due Diligence A comprehensive analysis", *European coalition for corporate justice,* April 2022, 25, https://corporatejustice.org/wp-content/uploads/2022/04/ECCJ-analysis-CSDDD-proposal-2022.pdf.
[167] "Civil society statement on the proposed EU CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE", Civil society statement
May 2022, accessed 29 April 2023, https://corporatejustice.org/wp-content/uploads/2022/05/CSO_statement_CSDDD_EN.pdf.
[168] Penelope A. Bergkamp, "Models of Corporate Supply Chain Liability", *Jura Falconis,* 55(2), 2018, 185.

jurisdictions. The law and economics literature has often criticized the limitation of liability based on causation, as this undermines the incentive for tortfeasors to internalize negative externalities and consider the potential low-probability outcomes of their actions or inactions[169]. Consequently, it may lead to scenarios where companies choose to incorporate in a more favourable jurisdiction, which could potentially break the causation chain for their own benefit.

Additionally, the proposed strategy to enforce due diligence obligations on both EU and non-EU companies for regulating negative externalities on human rights and the environment can be impeded by various corporate structural changes. The Directive applies to non-EU companies that surpass a turnover threshold in the EU. However, this provision can be bypassed by operating through several small companies that are not consolidated. Additionally, third-country corporations can evade the CSDDD by conducting operations via subsidiaries incorporated in an EU Member State[170]. Although the subsidiaries would be subject to the CSDDD, the non-EU parent company, which is typically where the group's net worth is concentrated, would not be bound by it[171].

Thus, all the above-mentioned analysis of the CSDDD demonstrates that the main objectives of establishing mandatory and enforceable due diligence regulations are to manage social, environmental, and governance impacts, provide redress for those adversely affected, and encourage effective harmonization across the supply chain. Despite the current proposals aimed at introducing due diligence requirements, there exist significant shortcomings which hinder the achievement of the stated objectives and present notable loopholes. The effectiveness of the CSDDD in shifting businesses towards sustainability is limited firstly by the scope as it is primarily targeting large companies. Even with MEPs on the Legal Affairs Committee proposal on expanding the scope by decreasing thresholds, the CSDDD does not cover the majority of the SMEs. Furthermore, partial inclusion of the financial institutions with limited scope of imposed due diligence requirements remains a significant shortcoming. The ongoing risk-based due diligence obligations should be expanded to ensure that financial institutions are covered with obligations to address adverse impacts in their operations and investments.

The omission of Articles 25 and 26 from the initial Draft CSDDD, which pertained to directors' due diligence responsibilities, has resulted in a lack of systematic regulation and introduced ambiguity. This undermines the primary objective of sustainability business initiatives, which aim to prevent the fragmentation of rules within the single market. Criticism of the original

[169] Alessio Maria Pacces, "Civil Liability in the EU Corporate Sustainability Due Diligence Directive Proposal: A Law & Economics Analysis", *European Corporate Governance Institute* - Law Working Paper No. 691/2023, Amsterdam Law School Research Paper No. 2023-14, Amsterdam Center for Law & Economics Working Paper No. 2023-02, Forthcoming in Ondernemingsrecht (2023), (March 16, 2023), https://ssrn.com/abstract=4391121.
[170] *Ibid.*
[171] *Ibid.*

wording of Article 25 centred on its lack of clarity and precision, which created potential confusion and uncertainty when implementing and interpreting the impacts of corporate activities on third parties and the environment. The article failed to address the interrelationship between the duty of care and the business judgment rule systems present in specific Member States, as well as the procedural aspects related to the right to initiate legal action for breaches of this duty[172]. Despite scholarly criticism of the Commission's proposed wording[173], the second draft of the Directive simply removed the provision without suggesting alternative language that would offer greater clarity and precision. Nonetheless, there continues to be a pressing need and demand from civil society to achieve harmonization across different corporate law regimes, legally acknowledging and binding directors with responsibilities and duties to fully integrate the dynamic due diligence process into corporate strategy.

The Council's adoption of the "chain of activities" approach for due diligence in the second draft of the CSDDD is omitting indirect downstream partners and failing to effectively tackle risks that extend beyond the primary tier of the supply chain, making it inadequate in preventing human rights violations and environmental harm. It is imperative to adopt more comprehensive measures to address these issues and ensure that supply chains are free from adverse effects. In conclusion, the provision in Article 22 of the CSDDD stating that companies are not accountable for damages caused by their business partners raises concerns about causation and may lead to companies incorporating in more favourable jurisdictions, while the proposed strategy to enforce due diligence obligations on both EU and non-EU companies may be impeded by various corporate structural changes, and with the burden of proof placid on the plaintiffs the accountability of the companies for breaching their due diligence duties is highly doubtful.

3.3. Enforcement model of sustainability requirements in corporate governance

The previous examination highlighted the recognition of the need to redefine corporate objectives, broaden directors' responsibilities, and implement mandatory due diligence measures in supply chains. However, the successful implementation of these innovations depends heavily on effective enforcement mechanisms and mechanisms of accountability.

The regulatory framework established regarding vigilance duty, benefit corporations, reporting duties, and the CSDDD lack the effective provisions of liability for breaching

[172] Federica Agostini, Michele Corgatelli, "Art. 25 of the proposed Due Diligence Directive: Quo Vadis*?", Faculty of law blogs / University of Oxford*, September 2022, https://blogs.law.ox.ac.uk/blog-post/2022/09/art-25-proposed-due-diligence-directive-quo-vadis.

[173]Anne Lafarre, "Mandatory Corporate Sustainability Due Diligence in Europe: The Way Forward", *Faculty of law blogs / University of Oxford*, 21 April 2022, https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/mandatory-corporate-sustainability-due-diligence-europe-way-forward.

sustainability requirements in business operation. The analysis of mentioned cases demonstrates different ways of holding companies accountable. In the case against Royal Dutch Shell (RDS),[174] the court ruled that "RDS is obligated to ensure a net reduction of 45% in the CO2 emissions resulting from the activities of the Shell group by the end of 2030, relative to the 2019 level". However, the current framework lacks sufficient measures to impose substantial liability on directors and companies for their role in causing adverse environmental and social impacts. This reluctance to hold accountable those responsible for the negative effects undermines the motivation for directors and companies to adopt responsible and sustainable business practices. To effectively promote sustainable reorientation, the liability of companies and directors for non-compliance should accurately reflect the damages caused. Given the widespread recognition and urgency of sustainability concerns, there is a pressing need to establish a robust and stringent liability regime (including administrative, financial, and criminal consequences) for unsustainable business operations, which would effectively render such businesses insolvent or restrict their access to the market.

The principle of responsibility and accountability plays a crucial role in ensuring compliance with rules and regulations. It serves as a deterrent for unlawful behaviour and encourages adherence to established norms. However, without imposing significant liability on corporate actors for their detrimental environmental and social impacts, the mere adoption of sustainable conduct rules, due diligence requirements, and directors' duty of care for stakeholders may remain ineffective in achieving their intended goals. To effectively address the adverse effects caused by businesses, it is necessary to establish robust mechanisms that hold corporate actors accountable for their actions, ensuring that the consequences of non-compliance reflect the severity of the misconduct.

In the mentioned case involving Royal Dutch Shell, it was evident that the directors of the company possessed knowledge about the detrimental consequences of CO2 emissions and the associated risks of climate change to Dutch residents and the inhabitants of the Wadden region. The company had also maintained records of the volume of CO2 emissions within the Shell group through reporting. However, the court's focus primarily rested on the collective responsibility of the company rather than attributing personal liability to specific directors for their involvement in the company's actions. Consequently, this approach resulted in a lack of accountability for directors who were responsible for engaging in unsustainable business practices that led to adverse environmental effects. Moreover, Royal Dutch Shell's executive remuneration policy further hindered the transformation of business strategies towards responsible and sustainable practices,

[174] "Claimants versus ROYAL DUTCH SHELL PLC in The Hague", *supra note, 104.*

as it tied executive compensation predominantly to short-term targets and heavily weighted financial performance indicators, with the "energy transition" indicator comprising only 10% of the overall weighting[175]. Thus, with such established policies and the court's ruling, directors are not incentivized to redirect their business strategies towards responsible and sustainable practices.

In my view, bridging the accountability gap between directors' and companies' duties requires the establishment of criminal liability for directors who engage in unsustainable business practices. Numerous jurisdictions (the USA[176], the UK[177], Canada[178], etc.) have recognized the need to impose criminal liability on directors for offenses such as corporate fraud, wrongful trading, bribery, and corruption. The justification for holding directors criminally liable for these offenses lies in safeguarding the interests of well-functioning states and societies. Directors hold influential positions and play a pivotal role in shaping a company's policies, decision-making, and overall trajectory.

Imposing criminal liability ensures that directors are held accountable for their actions, especially when such actions result in harm to stakeholders, the public, or the environment. It promotes responsible decision-making and discourages reckless or negligent behaviour. Given the trust and influence vested in directors, criminal liability becomes essential when their actions endanger public safety, the environment, or public health. By doing so, it upholds the public interest and prevents directors from acting with impunity, particularly in cases involving serious offenses.

Therefore, in today's society, where sustainable development is a paramount goal, the adverse environmental and human rights effects resulting from unsustainable business operations should be deemed as a serious offense, warranting the establishment of criminal liability for directors. While the United States imposes criminal penalties on directors for corporate fraud, including false financial reporting[179], it falls short in imposing criminal liability for false non-financial reporting. This prioritization of financial reporting duties over non-financial reporting, which encompasses the assessment of environmental and societal impacts of business operations, reflects that directors' duties still prioritize profit maximization over sustainability considerations.

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[175] *Ibid*, p.2.5.2.
[176] "United States Code, 2006 Edition, Supplement 5, Title 18 - Crimes and criminal procedure", Part I – Crimes chapter 63 - Mail fraud and other fraud offenses Sec. 1350 - Failure of corporate officers to certify financial reports, accessed 27 April 2023, https://www.govinfo.gov/app/details/USCODE-2011-title18/USCODE-2011-title18-partI-chap63-sec1350.
[177] "The Bribery Act 2010 (c. 23)", Legislation.gov.uk, accessed 27 April 2023, https://www.legislation.gov.uk/ukpga/2010/23/pdfs/ukpga_20100023_en.pdf.
[178] "Competition Act (R.S.C., 1985, c. C-34)", Laws.justice.gc.ca, accessed 27 April 2023, https://laws-lois.justice.gc.ca/eng/acts/c-34/section-45.html, and "Criminal Code (R.S.C., 1985, c. C-46)", Laws.justice.gc.ca, accessed 27 April 2023, https://laws-lois.justice.gc.ca/eng/acts/C-46/section-123.html.
[179] *Ibid.*

However, it is precisely the relentless pursuit of profit maximization that has led society to the issues of environmental degradation and human rights violations. Thus, to genuinely achieve sustainability, which is now advocated by entire societies, it is imperative to recalibrate the priorities and establish criminal liability for directors who steer companies towards unsustainable practices. This would signify a crucial step in firmly establishing sustainability as the cornerstone of civilization's development.

In light of the aforementioned justifications for implementing criminal liability for directors engaged in unsustainable business practices there is a call for introduction of the provision addressing directors' criminal liability[180] which should be presented on the national levels of different jurisdictions. The provision should be based according to the rules and principle of criminal law by encompassing[181]:

- subject - director of the company regardless of company's size or sector;
- object - sustainable business practices, which focused on protection of the environment, and upholding international human rights standards;
- actus reus - director's engagement in company's business operations that cause significant and avoidable harm to the environment or violate internationally recognized human rights standards;
- mens rea - 1. intentional (director wilfully causes, contributes or is linked to the company's engagement in unsustainable business operations), 2. gross negligence (director without reasonable foresight, engages in, contributes to, or is associated with the company's involvement in unsustainable business operations, where a reasonable person in similar circumstances could have reasonably anticipated the potential consequences of their actions);
- causation - between director's engagement in company's unsustainable business operations and significant but avoidable harm to the environment or violate internationally recognized human rights standards.

The environment and internationally recognized human rights standards, should be defined according to the international conventions and treaties following the example of the CSDDD Annex[182]. Due to the specificity of the sustainability as legal category and inclusion

[180] See *"Recommendations"*.
[181] "Criminal law", Cornell Law School, accessed 4 May 2023, https://www.law.cornell.edu/wex/criminal_law#:~:text=In%20general%2C%20every%20crime%20involves,or%20but%2Dfor%20causation).
[182] European Commission, "Directive on Sustainable Corporate Governance - Annex to the Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Reporting and Corporate Social Responsibility" [PDF], (February 2022), accessed 3 May 2023, https://commission.europa.eu/system/files/2022-02/1_2_183888_annex_dir_susta_en.pdf.

intergenerational responsibility the definition of significant harm concerning environmental and human rights violations resulting from unsustainable business operations should be established through a court's assessment of substantial negative effects on the environment, which may include pollution, deforestation, and the depletion of natural resources. It should also encompass actions that contravene internationally recognized human rights, spanning civil, political, economic, social, and cultural rights. The determination of significant harm ought to rely on objective criteria, considering the magnitude, duration, and irreversibility of the inflicted damage, as well as the potential ramifications for affected individuals, communities, and future generations. This evaluation should be conducted with careful consideration of the factual circumstances and implications in each specific case, employing expertise in environmental and human rights assessments. In the context of criminal liability for unsustainable business practices, the mental element, or "mens rea," should encompass the director's knowledge, intention, or gross negligence and recklessness regarding their involvement in such practices. The inclusion of these mental states is essential due to the director's role as a position of trust and authority, responsible for setting and implementing corporate strategies. It is not sufficient to focus solely on intentional engagement in unsustainable practices; rather, the director's obligations extend to taking all necessary measures to gather relevant information, foresee potential risks, and prevent the company from engaging in unsustainable operations. The director's position of power and decision-making authority places them in a unique position to shape the direction and conduct of the company. As such, they bear a heightened responsibility to exercise due diligence and act in the best interests of the company within the sustainability framework. By requiring the director to assess the potential environmental and social impacts of the company's activities, the legal framework acknowledges their duty to be well-informed, exercise reasonable foresight, and actively prevent the engagement of the company in unsustainable practices[183]. This approach aligns with the principle of accountability and reinforces the notion that directors should be held responsible for their actions and omissions in relation to sustainability issues.

By implementing a provision on the criminal liability of directors, the legal framework would establish a powerful deterrent against unsustainable practices and prioritize the long-term well-being of society and the environment. This development would contribute to shaping a business landscape where sustainability considerations are deeply embedded in decision-making processes and operations, ultimately fostering the sustainable development of both businesses and societies.

[183] "Claimants versus ROYAL DUTCH SHELL PLC in The Hague", *supra note,* 107.

CONCLUSIONS

1. The root cause of the existing generation's problems related to environmental degradation can be attributed to the pervasive pursuit of profit at any cost within the economic and business paradigm that emerged and gained widespread adoption after the Industrial Revolution. It became apparent that transforming the prevailing business model, which prioritizes profit maximization while neglecting environmental and societal concerns, was necessary to achieve the goal of sustainable development.

2. While a minority of conscientious and responsible business leaders within the private sector have made efforts to address sustainability issues within their internal strategies, their actions alone are insufficient to guarantee sustainable development within reality of the continued profit maximization business paradigm. Thus, there is a need for governments and international institutions to implement binding regulations that ensure the incorporation of sustainable practices within business operations.

3. The current corporate purposes often lack a sense of responsibility, which provides constraints on companies' pursuit of profit over other values. The corporate purpose should embody both a desire for success, as defined by achieving sustainable development, and a responsibility to conduct business in an ethical and moral manner. The inclusion of these dynamic yet ambiguous terms compels companies to anticipate and prevent any harmful business activities, thereby shaping their ethical policies. Furthermore, incorporating morality and ethics into the corporate purpose enables companies to address not only currently established acceptable beliefs, such as sustainability, but also emerging challenges within an intergenerational lens.

4. Although the international community acknowledges the necessity of addressing corporate transformation through binding regulations, the effectiveness of soft law measures has been limited, mainly resulting in the popularization of guidance rather than substantial change. Governments have primarily focused on introducing alternatives to profit-maximizing companies through the establishment of benefit corporations and the implementation of non-financial reporting duties and due diligence requirements in supply chains. However, the effectiveness of national regulations is hindered by the lack of enforcement, rendering these regulations ineffective. The analysis of forthcoming Corporate Sustainability Due Diligence Directive (CSDDD) is constrained by its limited scope, targeting companies based on size, and its inadequate inclusion of financial institutions, which play a pivotal role in investment channels. The failure to address and clarify directors' duties in implementing and managing companies' due diligence, the omission of downstream partners, and the inadequate tackling of risks beyond the primary tier of the supply chain further undermine the effectiveness of the directive in preventing human rights violations

and environmental harm. Additionally, the liability provisions are formulated in a manner that makes it challenging to hold companies accountable.

5. The current legal landscape falls short in establishing the necessary mechanisms to hold companies accountable for their actions. Without the threat of serious legal consequences, businesses may continue to prioritize profit over sustainability concerns. It is imperative to introduce stringent legal measures that foster a culture of responsibility and deter irresponsible behaviour within the corporate sector. By implementing legal provisions that introduce criminal liability for directors who engage and lead companies in unsustainable business operations, companies and directors would be compelled to consider the long-term environmental and societal impacts of their actions. This would necessitate a fundamental shift in mindset and practices, ensuring that sustainability considerations are integrated into all aspects of business decision-making and operations.

RECOMMENDATIONS

Based on the conclusions drawn from the thesis, the following two recommendations can be made:

1. To promote responsible business conduct and address the adverse effects of corporate activities, it is recommended to reformulate the corporate purpose in a new way by incorporating the notion of responsibility. The proposed formulation states the following "the responsibility of the company to operate in moral and ethical manners." This addition aims to encourage companies and directors to proactively assess, anticipate, and mitigate potential adverse effects arising from their business activities, thereby prompting a shift in their course of action.

The determination of adverse effects would be based on the breach of moral and ethical norms that are shaped by societies and address the challenges faced by current generations. By integrating the responsibility to operate in moral and ethical manners, companies and directors would be compelled to align their practices with these norms, minimizing harm to society and the environment.

Moreover, this reformulated corporate purpose allows for flexibility in addressing emerging concerns and adapting business strategies accordingly. As the challenges and moral considerations of future generations are yet unknown, the proposed formulation enables companies to remain responsive to evolving societal expectations and values. By embracing the responsibility to act in moral and ethical ways, businesses can proactively address emerging concerns and align their strategies with the evolving needs and values of society.

Ultimately, the incorporation of the responsibility notion within the corporate purpose seeks to promote a culture of ethical business conduct, ensuring that companies and directors prioritize the well-being of society and the environment. This reformulation encourages businesses to take a proactive approach in preventing adverse effects, thereby fostering sustainable practices, and enhancing their contribution to the overall welfare of society.

2. To ensure compliance with established norms on due diligence in supply chains, non-financial reporting duties, etc. Given that directors play a central role in implementing and executing business strategies aligned with the corporate purpose, it is crucial to realign their priorities and introduce criminal liability for directors who steer companies towards unsustainable practices. This significant development would signify a crucial step in firmly establishing sustainability as a fundamental pillar of both business and societal progress. To illustrate the possible provision regarding the criminal liability of directors, the following text is suggested:

“Criminal Liability for Unsustainable Business Operations:

1. Director of the company regardless of company's size or sector engaged in business operations that cause significant and avoidable harm to the environment or violate internationally recognized human rights standards, as defined by the international conventions and treaties listed in Annex 1[184], shall be subject to criminal liability.
2. For the purposes of this provision, unsustainable business operations shall be defined as those actions or practices performed by the company that result in substantial negative impacts on the environment, including but not limited to pollution, deforestation, and depletion of natural resources, or that violate internationally recognized human rights, including civil, political, economic, social, and cultural rights.
3. Director of the company who:
   3.1. through gross negligence and without reasonable foresight, engages in, contributes to, or is associated with the company's involvement in unsustainable business operations, where a reasonable person in similar circumstances could have reasonably anticipated the potential consequences of their actions, shall be subject to a fine of no less than [...] or a minimum imprisonment term of [...] years, or both.
   3.2. wilfully causes, contributes or is linked to the company's engagement in unsustainable business operations shall be fined not less than […] or imprisoned not less than […] years, or both.
4. The burden of proof shall rest with the prosecution to establish beyond a reasonable doubt that the director knowingly engaged in unsustainable business practices resulting in significant harm.
5. Evidence may include internal company documents, expert testimony, witness statements, and any other relevant information that demonstrates the director's awareness and responsibility for the harmful activities.
6. This provision does not absolve the company itself from liability for its actions and impacts. Separate legal proceedings may be initiated against the company in accordance with existing laws and regulations.
7. Directors shall be held individually accountable for their personal involvement in or knowledge of the unsustainable practices, regardless of the company's liability.

[184] See, "Annex".

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ABSTRACT

The master thesis examines the adverse consequences of the profit-driven business model and its impact on environmental and social degradation. The paper begins with an exploration of the root cause of the existing generation's problems, attributing them to the all-encompassing pursuit of profit within the economic and business paradigm. It highlights the urgent necessity for the sustainability transformation in the prevailing business model. The author examines the limited effectiveness of conscientious business leaders' efforts and emphasizes the role of governments and international institutions in implementing binding regulations to ensure the incorporation of sustainable practices within business operations through transformation of corporate governance.

Further research provides analysis of the formulation of corporate purpose and its impact on the business strategy setting and decision-making policy. The paper proposes a novel formulation which integrates the concept of responsibility and ethical conduct within corporate purpose to shape companies' and directors' behaviour and encourage sustainable practices. The author also explores the implications of corporate purpose on directors' duties, advocating for the inclusion of social, moral, and ethic responsibilities as an obligation. Moreover, the paper critically evaluates existing soft law measures and underscores the need for stringent legal mechanisms for the effective enforcement of the current and upcoming binding regulations on the due diligence obligations in supply chains, including the introduction of the criminal liability, to hold companies' directors accountable for their actions in running unsustainable business operations and foster a culture of responsibility within the corporate sector.

Keywords: sustainability, corporate purpose, directors' duties, due diligence, liability and enforcement mechanisms.

SUMMARY

This thesis “Sustainability oriented transformation of corporate governance” is devoted to the analysis of the constraints and solutions in transforming corporate governance to consolidate sustainability as a core consideration of business strategy setting and decision-making policy. The research highlights the necessity of effective regulatory frameworks and proposes a novel formulation of corporate purpose that encompasses the concept of responsibility. Examines the impacts of corporate purpose on the responsibilities of directors, and argues for the incorporation of moral and ethical conduct within corporate purpose to shape companies' and directors’ behaviours. The study advocates for the establishment of robust legal enforcement and liability mechanisms, specifically, the introduction of director’s criminal liability for the company’s engagement in unsustainable business practices.

The research pursues the following objectives: 1) to analyse the scope of present soft law measures, hard law regulations, and alternative approaches in driving substantial change towards sustainability, while identifying the limitations in enforcement and scope that hinder their effectiveness; 2) to explore the need for governments and international institutions to implement binding regulations that ensure the incorporation of sustainable practices within business operations, recognizing that the efforts of conscientious business leaders alone are insufficient to guarantee sustainable development without adverse environmental and societal effects; 3) to examine the role of corporate purpose in shaping the behaviour of businesses and corporate leaders, with a focus on the need to redefine corporate purpose by including a notion of responsibility to conduct business ethically, and prioritize sustainability in their operations, thus addressing the obstacles hindering the transition to a sustainable business model.

The first part of the thesis provides theoretical-philosophical-historical analysis of background information on the integration of sustainability into corporate governance, exploration of the evolution of environmental concerns leading to the need for sustainability and examination of the role of governments in promoting and implementing sustainable development policies. The second part of the research focuses on the practical implementation of sustainability in corporate governance. It includes a comprehensive discussion on corporate purpose and director's duties within sustainability frameworks, the integration of sustainable corporate purpose through the "benefit corporation" model, and the evolving roles of directors in considering sustainability. It also addresses challenges and prospects related to soft and hard law measures, such as reporting duties and due diligence obligations, and evaluates the effectiveness of the Corporate Sustainability Due Diligence Directive. The structure concludes with an examination of the enforcement model for sustainability requirements in corporate governance.

ANNEXES

Annex 1: International Conventions and treaties on Environment and Human Rights Protection:

1. The Convention on the Prevention and Punishment of the Crime of Genocide
2. The Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment
3. The Convention on the Elimination of All Forms of Racial Discrimination
4. The International Covenant on Civil and Political Rights
5. The International Covenant on Economic, Social and Cultural Rights
6. The Convention on the Rights of the Child
7. The Convention on the Rights of Persons with Disabilities
8. The Convention on the Elimination of All Forms of Discrimination Against Women
9. The United Nations Declaration on the Rights of Indigenous Peoples
10. The Universal Declaration of Human Rights
11. United Nations Framework Convention on Climate Change (UNFCCC)
12. Paris Agreement
13. Convention on Biological Diversity (CBD)
14. Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)
15. Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal
16. Stockholm Convention on Persistent Organic Pollutants (POPs)
17. United Nations Convention to Combat Desertification (UNCCD)
18. Convention on the Conservation of Migratory Species of Wild Animals (CMS)
19. United Nations Convention on the Law of the Sea (UNCLOS)
20. International Covenant on Civil and Political Rights (ICCPR)

The responsible authorities shall periodically update the annex to reflect the latest international conventions related to environment and human rights."