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Sustainable Corporate Governance in the EU: Reasonable Global Ambitions?

The European Union (EU) traditionally limited its interventions in the field of corporate governance of companies. Corporate governance is the system of rules, practices and processes by which a company is directed and controlled. Although the EU can legislate in the field of company law, including corporate governance, most rules are adopted by Member States (MS) and are complemented in listed companies by soft law, especially corporate governance codes, adopted at national level.

There are political and technical reasons for this non-intrusive approach by the EU. At the political level, Member States failed from the start to agree on a single set of governance rules for companies. The failure to harmonise substantially company law was clear as soon as the first company law directive of 9 March 1968 which provided only for limited harmonisation. Corporate governance proved especially difficult to harmonise as illustrated by the failure of the Council and later co-legislators to adopt the project of the so-called 5th company law directive on public limited liability companies.[1] The proposal was too close to the German model and did not fit Member States which had various models. As a consequence, harmonisation of company law in the European Union was limited to minimum requirements, in the area of cross-border activities or to EU company forms, such as the *Societas Europea* (SE) which was adopted in 2001 after a long process and provided only a very limited level of harmonisation. The failure of the Commission to secure the adoption in the Council of the European Private Company (*Societas Privata Europea* - SPE) which was introduced in 2008 as another EU legal form is another illustration of the difficulty to harmonise Member States company law. As was to be expected, the requirement for unanimity in the Council proved insurmountable. Top-down harmonisation was also complemented by competition among national company laws thanks to the case law of the European Court of Justice which forced Member States to recognize companies incorporated in another Member State. It is also not surprising that the European legislator requested only in 2006 that listed companies refer to a national corporate governance code.[2] At this time, only Luxembourg had not introduced such a code while the United Kingdom and France where the first Member States to do so, respectively in 1992 and 1995.[3]

The reason for this lack of interventionism are threefold. First, company law, and therefore corporate governance, reflects strong national preferences and are deeply rooted in the culture of Member States. Second, Member States are keen to retain their flexibility in organising their types of companies, especially considering that there is an intense degree of competition among national company laws. Company law is considered a competitiveness tool. Finally, the Commission was for an extended period of time liberal and did not want to interfere too much with national company law.

At a more technical level, difficulties to harmonise corporate governance can be explained by the differences of internal structures and especially by the importance of systems of co-determination, such as the German *Mitbestimmung*, which provide for employee participation in the management organs of medium and large companies. Member States were and still are strongly divided on this approach and many did not want to introduce it. In addition, it is quite difficult to harmonise this field. The European Union has competence under article 153(1)(f) of the Treaty on the Functioning of the European Union (TFEU) to adopt directives setting minimum standards in the field of 'representation and collective defence of the interests of workers and employers, including co-determination'. However, unanimity is required within the Council.[4] These opposite views on company law and the need for unanimity in some fields which are closely linked to corporate governance such as workers' participation have made it almost impossible to harmonise anything in this field. This is also why, Germany, among others, opposed for such a long time the proposal of directive of 2012 on gender balance among non-executive directors of companies listed on stock exchanges. It only changed its view in 2021 with the new coalition. The text has been adopted in March 2022 in the Council and is currently under trialogue.

This is not to say that the EU legislator did not have sometimes an impact on corporate governance. The excep-

1. For an in-depth analysis of the various proposals for a Fifth Company Law Directive See. Thomas Abeltshauser, *Strukturalternativen für eine europäische Unternehmensverfassung: eine rechtsvergleichende Untersuchung zum 5. gesellschaftsrechtlichen EG-Richtlinienvorschlag*, Berlin 1990.

2. Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings, OJ L 224/1, 16.8.2006.

3. AFEP/MEDEF, Report of the Committee on Corporate governance chaired by Mr Marc Viénot, 1999, 33 pp.

4. Article 153(3) TFEU.

tion to the general rule is the takeover directive of 2004, adopted after more than 15 years of negotiations, whose article 3 (c) holds that 'the board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid'.[5] This is an implicit hint at the stakeholder approach and hence corporate governance. Also, the EU Commission supported as soon as 2001 Corporate Social Responsibility (CSR) for European companies.[6] According to the Commission, CSR is a 'a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis'.[7] However, unsurprisingly, this support took only the form of a Communication.

This situation started to change as a consequence of the 2008 great financial crisis. Institutional shareholders were accused of not having monitored enough the banks they were invested in, leading to short termism, excessive risk taking and a financial collapse. The great financial crisis of 2008 also lead to a weakening of liberalism and a call for wider and deeper regulation in all areas of finance. As a consequence, the European Commission also became more active in the area of corporate governance.

Regarding substantive regulation, the banking sector was first subject to reforms designed to reduce risk taking and improve corporate governance. Then, the Commission published in 2011 a Green Paper on 'The EU Corporate Governance Framework' calling for an improvement in the performance of board of directors and shareholders' engagement.[8] The Commission also appointed a 'Reflection Group on the Future of EU Company Law' which issued many recommendations in 2011. Among them was the invitation, often trough options for the Member States, to promote long-term thinking among companies.[9] These reports led, among others, to the amendment of the directive on shareholders' rights in 2017[10] to encourage of long-term shareholder engagement and to the adoption in 2014 of a communication to improve corporate governance.[11]

The Commission became more active at the same time on CSR. It adopted in 2011 'A renewed EU strategy 2011-14 for Corporate Social Responsibility'.[12] A new definition of CSR was provided as: 'the responsibility of enterprises for their impacts on society'. The Commission called on companies to have in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders. As part of this agenda, the Commission increased in 2013 and 2014 the disclosures on sustainability required by large undertakings, public-interest companies and listed companies for instance by adopting the Non-Financial Reporting Directive (NFRD).

Since 2018, a strong push has occurred in 'green finance' and sustainable corporate governance. The Commission adopted an 'Action Plan: Financing Sustainable Growth'[13] in 2018, an 'European Green Deal' in 2019,[14] and a Communication on 'Strategy for Financing the Transition to a Sustainable Economy' in 2021.[15] This has led in the area of sustainable governance to the introduction in 2021 of a proposal of Directive on Corporate Sustainability (CSRD) amending the 2014 NFRD and the introduction of a proposal of directive on Corporate Sustainabililty Due Diligence in 2022.

The European Commission is taking the lead globally by launching those initiatives at an incredible pace. The reason for such a speed is that the EU wants to become the global standard in terms of sustainable finance and sustainable corporate governance. This change, from an incremental to an ambitious approach, has several probable causes.

The first reason is Brexit. The United Kingdom (UK) was usually a powerful counterbalancing force pushing against EU legislation, even often softening them ex-ante, when they were deemed too ambitious or not business friendly, especially in finance and company law. This influence disappeared immediately after Brexit. A more ambitious and federalist, agenda especially promoted by France, became more influential in Brussels. As a consequence, the EU started to promote and, more than before, export through extraterritorial application an 'European economic and social model', in opposition to the much more liberal views of the UK and also of the United States.

The second reason is the important level of Euroscepticism. This has led to the appointment of a 'Political European Commission' (2019-2024), led by Ursula von der Leyen, with a very ambitious approach. The EU Commission wants to be seen acting in the most important fields

5. Directive 2004/25/EC of the european parliament and of the council of 21 April 2004 on takeover bids, JO L 142/12, 30.4.2004.

6. European Commission, Green Paper, Promoting a European framework for Corporate Social Responsibility, Brussels, 18.7.2001 COM(2001) 366 final.

7. European Commission, Green Paper, Promoting a European framework for Corporate Social Responsibility, Brussels, 18.7.2001 COM(2001) 366 final.

8. European Commission, Green Paper, The EU Corporate Governance Framework. European Commission, Brussels, 5.4.2011 COM(2011) 164 final.

9. The Reflection Group Report is available on-line at: http://ec.europa.eu/ internal_market/company/docs/modern/reflectiongroup_report_en.pdf and at: http:// papers.ssrn.com/sol3/papers.cfm?abstract_id=1851654.

10. Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, OJ L L132/1, 20.5.2017.

11. Commission Recommendation of 9 April 2014 on the quality of corporate governance reporting ('comply or explain'), OJ L 109/43, 12.4.2014.

12. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, A renewed EU strategy 2011-14 for Corporate Social Responsibility, Brussels, 25.10.2011 COM(2011) 681 final.

13. Communication from the Commission 'Action Plan: Financing Sustainable Growth', COM(2018) 97 final, 8.3.2018.

14. Communication of the Commission, The European Green Deal, COM/2019/640 final, 11.12.2019.

15. Communication from the Commission 'Strategy for Financing the Transition to a Sustainable Economy, COM(2021) 390 final, 6.7.2021

for European citizens and especially on climate change, social issues and human rights. Non-Governmental Organisations (NGOs), various activists as well as the press are putting pressure on the Commission and Member States to do more in those fields. The *Zeitgeist* has changed. In this situation, businesses are having more difficulties to challenge legislative initiatives for fear of reputational damage.

The EU legislator has become very active in the field of sustainable corporate governance (1). However, it is doubtful that these new global ambitions will succeed (2).

1. Developments on Sustainable Corporate Governance in the European Union

The EU legislator is currently very active in the field of sustainable corporate governance. The traditional approach of imposing disclosure (1.1) is also complemented by the adoption of substantive regulations (1.2).

1.1 Disclosure regulation

The EU legislator started to be active on CSR after the burst of the Internet bubble in 2001. In 2003, the Fourth Accounting Directive was amended to provide a requirement that 'To the extent necessary for an understanding of the undertaking's development, performance or position, the analysis (in the Management Report) shall include… where appropriate, non-financial key performance indicators relevant to the particular business including information relating to environmental and employee matters'.[16]

After the 2008 great financial crisis, the EU legislator strengthened non-financial disclosure. The Accounting Directive was amended in 2013 in order to force large companies and public-interest entities active in the extracting and logging of prime forest industries to report payments to governments.[17] The Transparency Directive was also amended in 2013 in order to cover listed companies with the same requirement.[18] These provisions were not designed to inform shareholders but rather civil societies in emerging economies to allow them to fight corruption by giving NGOs access to critical information on the flow of money by concerned EU companies.

In 2014, the EU legislator adopted requirements for large companies to disclose non-financial and diversity information (NFRD).[19] Article 19a on Non-financial statement, and article 29a on Consolidated non-financial statement of the 2013 Accounting directive as amended by the NFRD, request that '1. Large undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year shall include in the management report a non-financial statement containing information 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 matters, including… (e) non-financial key performance indicators relevant to the particular business.'

As part of the 2018 sustainability agenda of the Commission, the Non-Financial Reporting Directive of 2014 is being subject to significant amendments by a proposal of directive of 2021 on corporate sustainability reporting (CSRD).[20] The proposal deals with the update of the NFRD first because of complaints by investors on issues of quality and comparability. To ensure the reliability of the disclosure, the Commission is proposing an audit requirement for sustainability information. Auditors will have to provide a 'limited' assurance requirement. It is a significant change compared to the current situation but does not go as far as imposing a 'reasonable' assurance requirement. The scope of the information will also be extended. Non-financial statement will need to contain more detailled information relating to environmental matters, social and employee-related matters, respect for human rights, anti-corruption and bribery matters. The scope of the NFRD will be extended as to companies but special rules have been provided for SMEs in order to reduce the regulatory burden for them. The proposal has been adopted by both the Council and the European Parliament and is currently being discussed in the trilogue. Finally, as part of these reforms, the Commission has adopted in a Communication of 2019 on reporting climate-related information the concept of 'double materiality'.[21] Companies have to report about how sustainability issues affect their business and about their own impact on people and the environment. This concept has been incorporated in the proposed CSRD.

16. Article 46(1)(b) the Fourth Accounting Directive (and now Article 19(1) of Directive 2013/34). Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings, OJ L 178/16, 17.7/2003.
17. Art. 41-48. Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ L 182/19, 29.6.2013.
18. Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC, OJ L. 294/13, 6.11.2013.
19. 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, OJ L 330/1, 15.11.2014.
20. Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, Brussels, 21.4.2021 COM(2021) 189 final, 2021/0104 (COD).
21. Communication from the Commission, Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01), OJ C 209/1, 20.6.2019.

As part of this disclosure agenda, the European Commission is also supporting the development of 'EU Sustainability Reporting Standards'. This task has been entrusted to the European Financial Reporting Advisory Group (EFRAG). EFRAG was set up in 2001 to assist the European Commission in the endorsement of International Financial Reporting Standards (IFRS) by providing advice on the technical quality of the IFRS. The adoption of the first standards is scheduled for 2023. In April 2022, EFRAG published more than ten standards (*European Sustainability Reporting Standards*) for the implementation of the CSRD. Those standards are subject to consultation until 8 August 2022. Among these standards is the ESRS G1 Governance, risk management and internal control which deals directly with corporate governance. In order to have a Common classification system for sustainable investments, the EU legislator has also adopted a 'Green Taxonomy' in 2020.[22] A social taxonomy is expected in 2022.[23] Also the Sustainable finance disclosure regulation (SFDR) of 2019 strengthens the protection for end-investors by standardising and enhancing ESG-related disclosures.[24]

Disclosure is the traditional tool of the EU legislator in order to promote sustainable governance. However, the European Commission is moving towards also imposing substantive requirements on companies incorporated or active in Europe.

1.2 Substantive regulation

As a way to prepare future actions, a report has been published as part of an EU-funded project on *Sustainable Market Actors for Responsible Trade* (SMART).[25] The report, prepared by a team led by Norwegian academics, identifies shareholder primacy as a major obstacle to sustainable companies. It advocates that companies should have a an overall objective of creating sustainable value within the planetary boundaries and that the board should have a duty to ensure that the company's business model is consistent with this objective. This position is very isolated even in Scandinavian countries. The European Commission also commissioned to Ernst & Young a study on directors' duties and sustainable corporate governance.[26] This study was published in July 2020 and argued that the corporate governance of companies had to be changed in order for them to be 'sustainable'. The report argued that companies were biased towards short-termism. To adress this, the EY report suggested to change directors' duties to include sustainability criteria and duties to stakeholders. This scientific quality of the EY study was heavily contested, and rightly so, by academics such as Harvard professors[27] as well as John C. Coffee from Columbia law school.[28] Nevertheless, the Commission started to work on a proposal of directive on Sustainable Corporate Governance. Political pressure to introduce a proposal of directive came also from the European Parliament through a resolution of 17 December 2020 on sustainable corporate governance.[29]

Because of strong opposition from some Member States as well as a rare two negative opinions by the Regulatory Scrutiny Board of the Commission, the pre-proposal was shelved by the Commission in February 2022. The content of the ante-proposal was not disclosed but could have included apparently mandatory board strategies to set concrete environmental targets by companies.

Therefore the only current proposal of the Commission is a directive on Supply Chain Liability labelled directive on 'Corporate Sustainability Due Diligence' (CSDD) published on the 23rd of February 2022.[30] The European Parliament had drafted and adopted its own proposal in order to influence the future text of the Commission.[31] The Commission text is very much inspired by the French Duty of Vigilance Act of 2017, the German Act on Corporate Due Diligence Obligations for the Prevention of Human Rights Violations in Supply Chains (*Lieferkettensorgfaltspflichtengesetz - LkSG*) of 2021 and the Dutch law on child labour (*Wet zorgplicht kinderarbeidm*) of 2019.

The scope of the directive is wide and includes large and medium sized enterprises since it includes companies with more than 500 employees on average and with a net worldwide turnover of more than 150 million euros in the last financial year for which annual financial statements have been prepared. Companies below this threshold are covered, provided they have more than 250 employees on average and a net worldwide turnover of more than 40 million euros in the last financial year for which annual financial statements have been prepared, provided also that at least 50% of this net turnover was generated in sectors where risks are considered higher such as the textile and fashion industry.

22. Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, OJ UE L 198/13, 22.6.2020.
23. Final Report on Social Taxonomy, Platform on Sustainable Finance, February 2022.
24. Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, OJ L 317, 9.12.2019.
25. Beate Sjafjell, Jukka T. Mahonen, Tonia A. Novitz, Clair Gammager, Hanna Ahlstrom, 'Securing the Future of European Business: SMART Reform Proposals' (7 May 2020). University of Oslo Faculty of Law Research Paper No. 2020-11, Nordic & European Company Law Working Paper No. 20–08, available on SSRN: https://ssrn.com/ abstract=3595048
26. EY, 'Study on directors' duties and sustainable corporate governance', Final Report dated July 2020.
27. Mark J. Roe, Holger Spamann, Jesse M. Fried, Charles C.Y. Wang, 'The European Commission's Sustainable Corporate Governance Report: A Critique', Law Working Paper N° 553/2020, April 2021.
28. https://www.law.ox.ac.uk/business-law-blog/blog/2020/11/ec-corporate-governance-initiative-series-european-commission
29. European Parliament resolution of 17 December 2020 on sustainable corporate governance (2020/2137(INI)).
30. Proposal for a directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, Brussels, 23.2.2022 COM(2022) 71 final, 2022/0051 (COD).
31. European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)), 10 March 2021.

Companies within the scope of the directive need to take appropriate measures to identify actual or potential adverse human rights and environmental impacts in their own operations, in their subsidiaries and at the level of their established direct or indirect business relationships in their value chain. The value chain includes their subsidiaries but also contractors with whom exist an 'established business relationship'. The scope is very wide since it covers any business relationship, direct or indirect, which is, or which is expected to be lasting, in view of its intensity or duration and which does not represent a negligible or merely ancillary part of the value chain.

They must take appropriate measures to prevent potential adverse impacts identified and adequately mitigate them, where prevention is not possible. Disengagement is possible if the company cannot influence the behaviour of its suppliers but only as last-resort action. The directive provides for civil sanctions issued by a supervisory authority and for private enforcement through civil liability. In practice, small and medium-sized enterprises included in the value chain will be covered by the Directive.

Three provisions are directly related to corporate governance and might have originated from the failed project of Sustainable Corporate Governance Directive. Article 25 harmonises at the EU level the directors' duty of care of EU companies covered by the directive. When fulfilling their duty to act in the best interest of the company, directors should take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term. Although the Commission presents this definition as a clarification, it is anything but so. This standard does not correspond to any Member State law. It is rather an attempt at a top-down harmonisation in a key area of company law left usually to Member States. Article 26 relates to the setting up and the oversight of due diligence. It requires that the directors take due consideration for relevant input from stakeholders and civil society organisations when putting in place and overseeing the due diligence actions of the company. This calls in practice for an involvement of NGOs into the decision making process of companies. A major shift in capitalism.

Finally, article 15 on 'Combating climate change' requires companies to adopt a plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement of 2015. In case climate change is or should have been identified as a principal risk for, or a principal impact of, the company's operations, the company should include emission reduction objectives in its plan. Variable remuneration should be linked to the contribution of a director to the company's business strategy and long-term interests and sustainability.

Furthermore, EFRAG's ESRS G1 *Governance, risk management and internal control standard* could have a substantial impact. Although it provides only for disclosure as part of the new CSRD and is without prejudice to existing Member States' company law, it requires companies to state their position in relation to a governance model that gives a considerable role to stakeholders and sometimes even treats shareholders as just one category among others of stakeholder. This is in fact hard law in being as companies will have to justify on an ongoing basis deviations from the model proposed by EFRAG.

The proposal of directive constitutes an attempt to harmonise corporate governance in the EU and a complete breach with the previous period. It is also a challenge to the traditional liberal view of capitalism. The activism of the Commission and of the EU legislator in the field of sustainable governance is certainly laudable in principle. However, the approach of the Commission on sustainability raises serious issues.

2. Reasonable global ambitions ?

The European Union is aiming at establishing global standards in the field of sustainable corporate governance (2.1). It is not impossible but doubtful that it will succeed in this very ambitious goal. In addition, the risk is that the EU would be putting European companies at a competitive disadvantage with excessive regulations (2.2).

2.1 European law as a global standard on sustainable governance

The EU is aiming at establishing global standards in sustainable governance through extra-territorial application and to influence international standards.

Contrary to the NFRD, the CSRD provides for extraterritorial application. The proposed CSRD disclosure rules would have applied both to EU and non-EU domiciled companies that have any type of transferable securities listed on EU regulated markets. This includes debt securities. Many foreign companies, including banks, have debt listed on EU stock exchanges. This means that, for instance, large third country banks will be subject to the rules as they often have debt securities listed on an EU regulated market. The Commission assumes that such third country companies will prefer to subject themselves to the CSRD rather than lose access to the EU financial markets. This belief might be wat too optimistic and foreign companies may prefer to list their debt securities, even issued in euros, in London. Delisting of shares is even more likely. Equivalence measures are being provided in the CSRD to reduce the regulatory burden but they still imply that the third country legislation is rather similar to the one of the EU. This extraterritorial approach invites reciprocity of extraterritorial treatment on the part of foreign jurisdictions increasing the cost of cross-border business.

The amendments adopted by the EU Parliament's Committee on Legal Affairs (JURI) to the CSRD would extend the scope to large companies to third countries with commercial activities ('*sale of goods*') in the EU. This additional criterion for the extraterritorial application of the CSRD is unlikely to be accepted by the Council in the trilogue because of a strong opposition of several Member States

The CSDD is also aiming at extraterritorial application. First, the directive would apply to third country companies operating in the Union, based on a similar turnover criterion as the European ones. Article 2 of the proposed directive provides that third country companies are subject to this new regime if they generated a net turnover of more than 150 million euros in the Union in the financial year preceding the last financial year or they generated a net turnover of more than 40 million euros but not more than 150 million euros in the Union in the financial year preceding the last financial year, provided that at least 50% of its net worldwide turnover is done in one or more of the high risk sectors. The threshold proposed is very low and will cover a significant number of foreign companies. Those companies will be subject to substantive requirements relating to EU legislation. This is designed at ensuring a level playing field but it is also an attempt at exporting EU standards which might not be appreciated in all jurisdictions. In order to ensure the enforcement of such rules, article 16 of the proposed directive requires that third country firms designate a legal or natural person as its authorised representative, established or domiciled in one of the Member States where it operates. It is doubtful that these 'authorised representatives' will be able to make sure that the requirements of the directive are applied abroad if those companies or countries are not cooperative.

Second, foreign companies that are integrated in the value chain would also be subject to the CSDD. This will pose difficulties, particularly in relation to the number of codes to be applied.[32] Lastly, parent companies of subsidiaries established in the EU and which would be subject to the CSDD will be indirectly covered. However, the US may not appreciate that its parent companies are, even indirectly, subject to EU standards when they have a subsidiary in the EU, as one author has very accurately noted.[33]

The EU was successful in imposing to American companies its approach on Data Protection with the General Data Protection Regulation 2016/679 of 27 April 2016 on data protection and privacy (GDPR).[34] However, there were fewer and larger actors and they could not realistically leave the EU market since they are global in nature and are facing difficult access in some large jurisdictions like India or China as they want to keep their data for themselves out of protectionist or sovereignty reasons. The situation of the CSDD is very different. The GDPR logic might not work for a large number of foreign firm who might feel that it is not worth the trouble to sell goods in the EU.

The EU is also trying to influence global standards in order to export at least some of its standards on sustainable finance and governance. The EU was a strong promoter and the largest jurisdiction to adopt the International Financial Reporting Standards (IFRS). The goal of the EU was to avoid that the US *Generally Accepted Accounting Principles* (US GAAP) become the *de facto* international financial accounting standards for listed companies. The EU did not succeed in having the US adopt the IFRS but the IFRS still became the global accounting standard since it has been adopted in more than 144 jurisdictions for all or most companies. However, this clear and resounding European success was made possible because there was an evident similar interest in other jurisdictions and it was achieved at the price for the EU of becoming a standard taker since it could not afford to deviate from these standards.

As to the International Sustainability Reporting Standards, the EU would like to become a standard giver and not a standard taker. Therefore, it is pushing EFRAG to develop EU Sustainability Reporting Standards as fast as possible even at the price of reducing consultation time to the bare minimum. The EU Commission hopes to set the standards ahead of other jurisdictions and especially ahead of the US and of the IFRS International Sustainability Disclosure Standards. The US have been lagging behind because of the Trump administration whose opposition to multilateralism has also hampered international developments. Therefore, an international window of opportunity has opened for the EU. If this approach is successful, the high quality standards that the EU wishes to develop could become a model for the rest of the world.

In order to develop those international standards, the IFRS foundation, with the strong support of the International Organization of Securities Commissions (IOSCO), established in 2021 an International Sustainability Standard Board (ISSB) to develop IFRS Sustainability Disclosure Standards. The EU is very active in the ISSB. For instance, the chair of the ISSB, since 1st of January 2022, is Emmanuel Faber. Mr Faber was the CEO of Danone and a promoter of sustainable finance and corporate governance. Under its management, Danone became a *société à mission*, a company who has objectives in the social, societal, and environmental fields set out in its by-laws. However, his commitment to sustainability led to poor financial performance and, under the pressure of activists investors, he was removed by the board of directors in 2021. All jurisdictions recognize the need to tackle climate change. However, it might be difficult for the EU to export

32. https://www.law.ox.ac.uk/business-law-blog/blog/2022/05/proposed-eu-directive-corporate-sustainability-due-diligence-why-non

33. https://www.law.ox.ac.uk/business-law-blog/blog/2022/04/extraterritorial-impact-proposed-eu-directive-corporate

34. Regulation (EU) 2016/of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation), JO L 119/1, 4.5.2016.

successfully its standard at the international level as many other jurisdictions might prefer a progressive approach as they want to balance these imperatives with their desire to catch up with developed economies.

It actually already appears that the ISSB standards are less prescriptive than those that EFRAG is starting to disclose. It is also unlikely that the US will endorse the ISSB standards and are developing currently their own approach. Although, this is still work in progress, it seems unlikely at this stage that the international standards will be a reflection of the EU ones.

This ambitious approach by the EU also ignores the need to balance these ambitions with the need to maintain a competitive economy in the European Union.

2.2 The European Union as a competitive economy

The issue of competitiveness was usually key in the EU approach. The Lisbon Strategy of 2000 wanted to make the EU 'the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion'. This time seems far away. Sustainability is becoming the priority, although not the only one. According to a recent academic research, the Sustainable Finance Action Plan has not resulted in measures that can be regarded as the expression of an autonomous sustainable finance objective.[35] International competitiveness is not forgotten but is presented as naturally flowing from the existence of a 'sustainable economy' to be achieved by the European Green Deal of 2019. However, the risks to the international competitiveness of EU companies seems underestimated. The strong opposition from Scandinavian countries, which are not known for promoting non sustainable development, is of particular concern. Contrary to a widespread belief in France, they are very liberal on economic issues and are very open to international trade. This is how they ensure the financing of their generous welfare state. A loss of competitiveness would have consequences for its financing. Their determined opposition is not a surprise and should certainly be noted.

The EU legislator is implicitly admitting the problem. This is actually one of the reasons why several of the proposed directives are imposing an extraterritorial approach. This is supposed to create an international level playing field by forcing EU standards on foreign jurisdictions either through direct application or through an equivalence mechanism controlled by the Commission.

However, this ambitious approach could also back fire. For instance, in the case of the proposed directive on 'Corporate Sustainability Due Diligence', it is envisioned that companies should, as a last resort, terminate the business relationship, if they have failed in their attempt at bringing actual adverse impacts to an end or minimising them without success. This might be easier said than done. For instance, there might not be alternatives for some critical raw materials that would be needed in the EU. The current situation in Europe shows that dependencies cannot always be easily untangled. In addition, issues of European or national sovereignty, including from the civil and military side, might come into play.

As to the model of directors' duties promoted by the European Commission, it would leave directors of European companies subject to the directive in a very uncomfortable situation. First, the list of international standards and treaties that companies will have to abide is extremely wide. It is doubtful that medium sized companies would be able to comply, or even know, those provisions with a sufficient degree of granularity. It is not even sure for the large ones. As one author has noted, these treaties and international standards were designed for states, not for private companies, and might be difficult for them to enforce.[36] This might lead companies to be forced to 're-shore' their value chains within the EU at the price of a loss of competitiveness.

Second, companies would be indirectly tasked with enforcing the Paris agreement although most Member States find it already difficult to uphold it. France was recently condemned for climate inaction by the highest administrative court for failure to act sufficiently.[37] A much more effective tool to establish a level playing field would be a carbon tax.

Third, board of directors will be obliged to consider the short and long term impact on company stakeholders, human rights, the environment and climate when making decisions. Combined with the need to deliver a profit, which should remain their primary goal if they want to be sustainable long term, it will lead them to address potentially conflicting objectives in an impossible way. In addition, these impacts are knowledge that board do not always have as these are complex issues.

These provisions, combined with the drive towards 'green finance', point in the direction of a planned economy. The historical record for such an approach is poor to say the least, apart from after the Second World War where the need for reconstruction would have guaranteed growth anyway. Many Member States are liberal and will oppose this approach.

Conclusion

The EU is moving at an incredible speed in order to develop an European model of Sustainable Corporate Governance and best in class standards in 'Green Finance'. All these developments are built on a political agenda and too often lack or disregard academic evidence and reasonable input from business. This is very clear in the case of the CSDD which incorporates in some part a poor report by

35. See, Veerle Colaert, 'The changing nature of financial regulation Sustainable finance as a new policy goal' Working Paper No. 2022/04 (April 2022).

36. https://www.law.ox.ac.uk/business-law-blog/blog/2022/04/corporate-sustainability-due-diligence-and-shifting-balance-between

37. Conseil d'État, 19 November 2020, n° 427301, *Grande Synthe*.

EY. Also, academics views are split about whether green finance requirements developed by the EU will improve the situation, with some authors recently taking a sceptical view[38] while other being more positive.[39] The need to address climate change is clear. The debate is about the tools and the speed. Those ambitions are legitimate but the EU legislator seem to underestimate the costs and might even backfire on European businesses. Trying to establish a global model for Sustainable Corporate Governance and Finance and export it might not work.

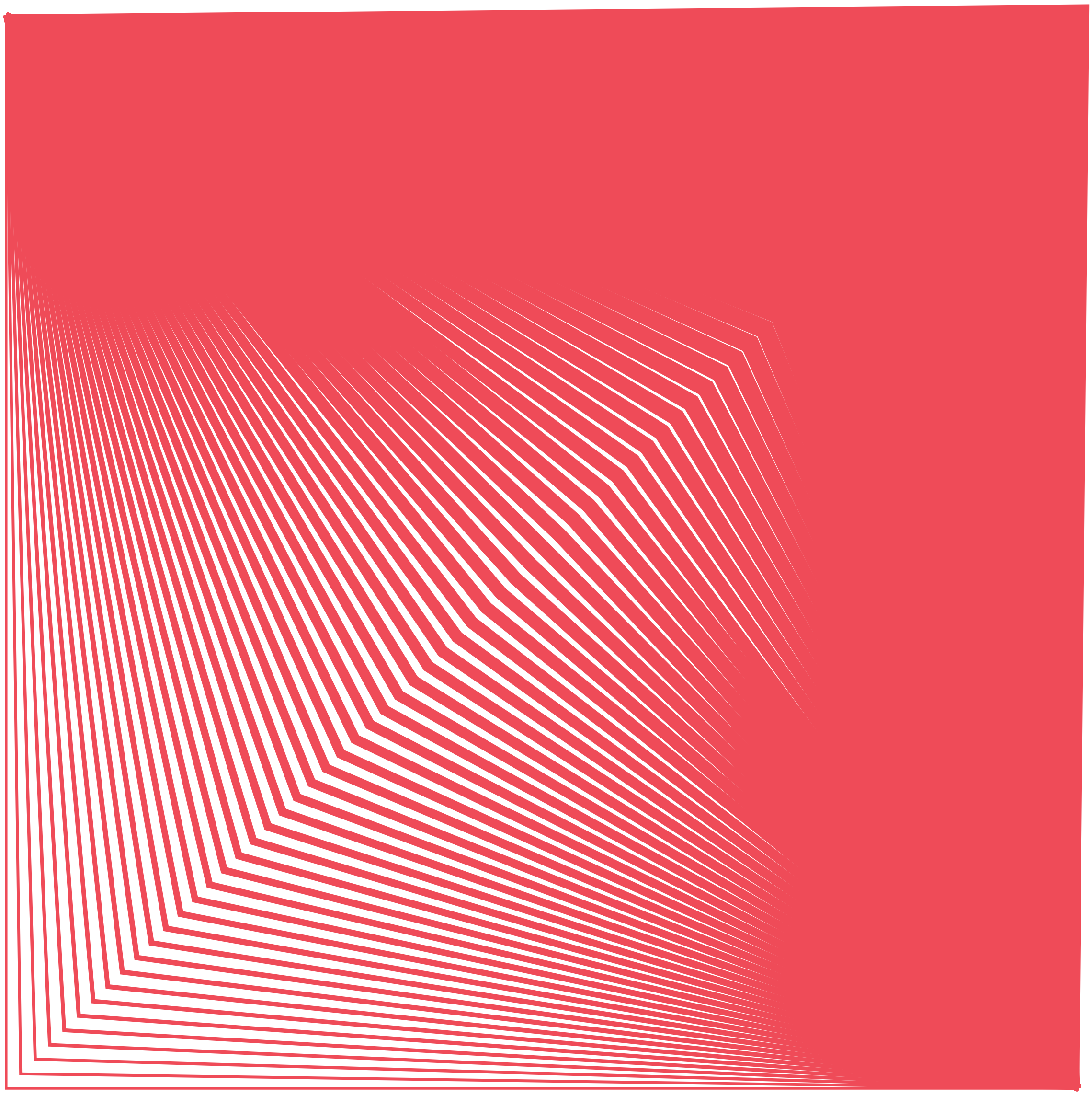
The famed 'Brussels effect', which has worked in certain fields such as GDPR, might not this time.[40]

The EU might discover that it is more isolated than it is thinking as the economic dynamics of the world are shifting. The risk is that Europe might end up protectionist and overregulated compared to other large jurisdictions who are growing fast and might pose ultimately an economic systemic risk.

38. See for instance, J.P. Krahnen, J. Rocholl, M. Thum, 'A primer on green finance: From wishful thinking to marginal impact', SAFE White Paper No. 87, October 2021.

39. See for instance, Sebastian Steuer, Tobias H. Troger, 'The Role of Disclosure in Green Finance', Law Working Paper N° 604/2021, December 2021.

40. Anu Bradford, *The Brussels Effect, How the European Union rules the world*, Oxford University Press, 2020, 404 pp.



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