Response to the Study on Directors' Duties and Sustainable Corporate Governance by Nordic Company Law Scholars

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1. Introduction

The Study on Directors' Duties and Sustainable Corporate Governance (hereinafter 'The Study') was published on 30 July 2020 and is accompanied by a Commission Inception Impact Assessment and a consultation deadline of 8 October 2020. The Assessment adds very little to the Study and this response is consequently made to the Study by a group of Nordic company law scholars.

2. Resume of Findings

The Study displays a lack of understanding of the nature of legal discourse and presents a biased, unrepresentative and highly politically motivated survey of literature and empirics.

The Study misrepresents fundamental concepts of company law and fails to understand how corporate governance works.

The Study exaggerates the problem of climate change and neglects the many other, equally serious, problems facing both company directors and EU legislators in their obligations to their respective constituencies.

The policy pursued by the Study contravenes both fundamental concepts of ownership rights inherent in European law and the basic policies that underlie the founding treaties of the European Union and its assumptions are equally incompatible with EU secondary legislation on company law and capital markets.

The Study underestimates the many existing measures adopted by EU legislators and their potential to serve as alternatives to its own far-reaching measures in a way that fundamentally would void the principle of subsidiarity and deprive Member States of control with their own economies.

The regulatory options recommended by the Study would seriously harm European business and prevent it from continuing to contribute to the sustainable growth and prosperity that the Union needs to fulfil its overall policies.

On this basis, we find that the Study cannot serve as the basis for contemplating the proposed regulatory initiatives and that any discussion must proceed on a better informed foundation brought about by a free and unbiased discourse.

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3. On the Tone of this Response

Law is said to be petrified politics and it is true that politics will always play a role in understanding law. It is, however, customary in legal discourse to regard politics in a passive way, as a historical fact that caused the law to be in a certain way. So much so, that it is considered almost impolite to address any underlying political tendencies and better to focus on the more technical aspects of the law, how it should be understood, designed and used. According to this traditional view, it is not for legal scholars actively to oppose the political views put forward.

Nonetheless, the present Study is so biased in its approach and so openly and excessively political in furthering a specific regulatory outcome, that we find ourselves compelled to address these shortcomings directly and explicitly besides stating the more traditional legalistic arguments.

4. On the Nature of Legal Discourse

The Study fails to understand the nature of legal discourse.

First of all, legal discourse is not carried out in a single forum, not even in respect of a single area of law such as company law, but is conducted in very different and often very detached fora of scholars congregating according to their individual preferences, political opinion often being one such preference.

Thus, legal scholars can write unopposed by scholars from other fora and undisturbed enjoy mutual citations and support from scholars of their own forum. The existence of academic papers, whether published in books or journals or circulating as working or discussion papers, cannot be taken as proof of their general acceptance. In legal discourse, silence is not acquiescence, but more likely reflects genuine disinterest. That a proposition put forward by a legal scholar stands unopposed is consequently not to be seen as a sign of general acceptance from other scholars of that field.

Secondly, while critical contributions are a well-established and respectable activity by legal scholars, it is not customary in legal discourse to express *support* of the law even when the scholar is personally convinced that it is sound and fair. Such a scholar would prefer simply to restate the law as it is without adding his or hers personal consent; mainly because it is of no importance whether a scholar actually sympathises with the law as it is. After all, it is not for legal scholars to determine the law, but for the legislators.

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Thus, this habit of only voicing criticism, while sympathy remains unspoken, may seriously distort the perception of how the law is perceived in any given aspect. For the inexperienced observer it may look as if the critical views are greatly in majority or even represent a consensus, when in fact they do not.

5. On the Survey of Literature in the Study

The Study is seriously biased in its survey of literature to the point of being useless, which is probably caused by its failure to understand the nature of legal discourse, cf. paragraph 4 above.

The literature presented and quoted by the Study does not represent the overall opinion of company law, but only the segment of scholars who are critical of company law and the concept of a market economy in general, and those who are extremely preoccupied with the problems posed by climate change. Furthermore, the views expressed in the quoted literature are in our opinion often wrong on central concepts of company law and misrepresent the law. We do not argue that our views represent a majority opinion, because we have not the time or the resources to justify such a contention, but we do contend based on our considerable personal experience that the views quoted by the Study does not in any way represent a majority opinion among company law scholars.

It is thus wrong and misleading, when the Study repeatedly tries to convey the perception that its criticism of current company law is backed by the community of legal scholars within this field.[1] It is not.

This is a debilitating fault with the Study, since it by its own admission failed to produce a sufficient response to its interviews and instead relies on its own examination of these, severely biased, sources.[2]

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[1] For example, the Study at p. 23: '**Having established the link** between shareholder primacy, short-termism and environmental unsustainability, (...)' or at p. 31: 'The main factors identified are linked to either regulatory aspects or market practices, **and are generally considered by academics and experts** as root causes of short termism.' [emphasis added]

[2] The Study at p. 5 list these problems, at p. 32 it is mentioned that as little a number as 50 respondents make out af full 91% of the survey, and at p. 40 et seq. it is mentioned that the limited data from the survey has been 'compensated by the large availability of information and data from the literature review and by the findings of the legal review.' As to our view of this survey of literature, see the arguments above.

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6. On the Problem of Climate Change

The problem of climate change is by now well-documented and serious. To fight this problem is among the established goals of the European Union and forms an important part of the policy of the new European Commission.

For this reason it is important to understand the problem and address it adequately. In our opinion, the Study in its single-minded focus on climate change fails to do so.

Despite the gravity of the problem of climate change, it is not the only problem facing us in the European Union or humanity in general; the Union faces other serious problems such as a growing security risk along most of the Union's borders arising from authoritarian regimes, failed states and mass immigration; economic threats against the welfare of our citizens exacerbated by the crisis provoked by Covid-19; a greying of our population necessitating better pensions and health care; etc. Indeed, the threat to humanity from other well-known problems such as a lack of clean drinking water, starvation and malnutrition, poverty, lack of fundamental human rights and gender equality, and persistent curses like typhoid and other lethal diseases, are problems equally deserving of our attention and threatens the lives and livelihoods of just as many people as even the graver scenarios of climate change.

We are aware that the Study does not explicitly say so, but its general tone of urgency, its single-minded focus on the threat of climate change and its implicit suggestion that the gravity of the threat justifies any and all interventions, make it necessary to point out that there is no such urgency or imminent threat of human extinction or planetary collapse. This is not what science is saying. We cannot have a democratic conversation with a gun held at our heads, nor can the legislature of the Union function under the pretence of an emergency that annuls all other rights and concerns. Only authoritarians and fanatics are attracted to emergency measures; they are anathema to a sustainable democratic society.

On the contrary, we need to rationally assess the opportunities and resources at our disposal. This should be the way to approach any contemplated new initiatives within company law as indeed it should be in any other area of legislation.

It is thus important to realise that there are more problems than just that of climate change facing both the individual companies and the European Union, and consequently it is up to both the directors of our private enterprises as it is up to the Commission and the elected politicians that participate in the Union's law-making to address all of these problems and balance them as they see fit.

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7. The Notion of Short-Termism

The notion of 'short-termism' is often invoked in the discourse on company law and corporate governance in a way that is hollow and bereft of analytical meaning. The Study is no exemption to this unfortunate trend.

The notion of 'short-termism' carries a dual meaning which is sometimes conflated making this already vague notion even more inapt for analytical purpose. It may simply refer to actions taken within a short time frame as opposed to actions undertaken during a longer period. This is a purely chronological concept objectively concerned with time. However, the notion is more commonly used as pejorative term to mark a particular action as bad because it provides an undesirable or unintended outcome later, that is, in the long-term. Sometimes the two understandings are conflated so that any action taken within a short time frame is viewed unfavourably even when its outcome is unknown and may be beneficial.

The notion when used in this more common way as a pejorative term is bereft of any operational meaning. It is very well to say that company directors should not display short-termism, but that is not to say *how* the directors should act. Furthermore, it is wrong to suggest that if any undesirable or unintended outcome does appear, it must necessarily be because the actions that preceded them expressed short-termism and that these *ex post* conditions can thus serve as proof of this pre-condition. This is the logical fallacy of *cum hoc ergo propter hoc*.

Following the Financial Crisis of 2008, several reports purported in this way that the crisis was 'caused' by short-termism without ever providing any convincing empirical proof. The Study appears to do the same in respect of the causes of climate change, which is explained as a consequence of director behaviour in private companies.[3] Apparently, the Study suggests that private companies could do more than they already do, but it fails to provide any proof exempt lament the fact that the Union is struggling to reach the various commitments made by its politicians.[4] Why this failure to achieve goals set and negotiated in international politics should be placed at the feet of directors of private enterprises and not involve other responsible actors, such as the politicians who made these commitments, is not made clear.

[3] The Study at p. 22: 'Literature connects short-termism to unsatisfactory response to environmental issues both at individual (i.e. the psychological tendency of individuals to focus on the short-term and consequently neglect sustainability issues) and organisational level' (footnotes omitted). Our view of this 'literature' is expressed in paragraph 5 above.

[4] The Study p. 30 et seq.

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In company law and the related area of capital markets law, the notion of short-termism is particularly inapt. In respect of shares, their value is determined at any given point in time by assessing their long-term value and return at that point in time. There is no short-termism behind investing as it is always done with a view to the long run.

But there is risk, or as a lay man would call it: uncertainty, and consequently company directors may fail to correctly foresee the long-term consequences of their decisions due to uncertainty. But as pointed out above, even where a decision has an undesirable or unintended effect, this is not necessarily proof that the directors were influenced by short-termism, it may just be an honest failure to gauge the many risks involved. For this reason, all civilised jurisdictions observe a standard often referred to by its American term, the Business Judgement Rule, and do not hold directors liable for such honest failure. If, on the other hand, they are found to have acted without due regard to the foreseeable long-term consequence of their actions, they will be held liable.[5]

This response is made by Nordic company law scholars and is naturally provided especially with a view to our national legal systems, which display very strong common traits among the five Nordic countries of Denmark, Finland, Iceland, Norway, and Sweden in respect of corporate governance.[6]

We can safely state that it is clear in our national jurisdictions that short-termism in the sense of deliberately neglecting the future consequences of your actions is contrary to the legal perception of directors' duties as the law stands today and that the law is so clear on this that no change is necessary, statutory or in soft law measures such as codes or guidance, to reinforce this. Furthermore, although we are not experts outside our own jurisdictions it is our clear impression that this equally applies to the jurisdictions of the other Member States.

The Study's contention that short-termism is nonetheless rife among directors of companies despite the obligation in national company law of directors to take into account long-term consequences is probably due to its failure to grasp the role of shareholders, which is explored in paragraph 9 below. It is not a view that we share, nor do we believe that current law need any change to prevent short-termism among directors.

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[5] This is because directors' duties involves all foreseeable risks, see further on this in paragraph 11 below.

[6] The unique Nordic CG Model is explored in the 2014 Lekvall Report, available at SSRN.com.

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8. The Notion of Company Interest or Purpose

The Study makes a better case of explaining the notion of 'company interest' by pointing out that this is a vague and often perplexing notion. The same goes for the related concept of a company's 'purpose', when that concept is used as a synonym for the 'interest' or 'raison d'être' of a company and not as a description of the company's line of business (object) as required in article 3, litra b, of the Company Law Directive.[7]

It is correctly observed in the Study that the interest of the company may involve a multitude of stakeholders such as investors, i.e. share- and bondholders; directors, executives and other employees; lenders and other creditors; suppliers and customers; and the local community and the public at large. The organising principle behind this multitude of stakeholders embedded in the notion appears to comprise any one with whom the company has any relationship and thus it is a broad and constantly changing multitude of interests.

It is important to note that the notion of a company interest is mostly applied in company law in a *negative and limiting* way. Directors enjoy considerable discretion as to how they run the company, which is of course necessary as it is impossible to detail in advance how to respond to events as they occur. The formal boundaries of the scope of executive powers is limited only by the object of the company, cf. Company Law Directive article 9. In company law, the notion of company interest is invoked to limit the exercise of this discretion to prevent directors from pursuing interests that are not subject to any legitimate legal relationship with the company, notably to benefit themselves or parties related to them. Thus, that directors must act in the interest of the company may simply mean that they are *not* allowed to enrich themselves or others with company funds or opportunities, but must if called upon to justify their actions point to a legitimate legal relationship served by their action.

A failure to understand this negative application of the notion of company interest or purpose in company law may lead some observers to advocate that a company should make an inventory of interests or purposes that are generally viewed as favourable and declare these to be its core values, interest or purpose. We agree that to make this kind of declaration may sweeten the public perception of the company and lift its sales and so many companies voluntarily make such declarations and should be free to continue do so. It would be wrong, however, to take this one step further by making it a legal obligation of the company to state its interests or purpose,

[7] Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law. Hereinafter the 'Company Law Directive'.

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much in the same way that a company is obliged to state its object in its articles of association by way of the Company Law Directive article 3, litra b.[8]

To follow this suggestion would fundamentally change the application of the notion of company interest or purpose, because it would be seen as an attempt to dictate the content of directors' duties, so to speak, through the backdoor rather than by adjusting these duties directly.

We would generally advocate against tying such declarations to the notion of directors' duties, because we consider it unwise to make the latter subject to a detailed statutory listing of whatever is favoured by legislators at any given time. We refer to the discussion of directors' duties in paragraph 11 below. Equally, we do not believe that a company's interest or purpose should be mandated by statute as we prefer its current understanding of including a wide array of stakeholder interests depending on the particularities of each company. Any statutory requirement to detail it would only serve to reduce the multitude of interests that it would otherwise represent.

In the context of the Study, it is important to note the wide-ranging multitude of stakeholders that may form part of the notion of company interest. This is important because it reflects the equally broad concept of directors' duties. There is nothing in company law that calls for directors to disregard stakeholders or to sacrifice their interests to benefit shareholders. On the contrary, just as the company interest includes a multitude of stakeholders does the concept of directors' duties comprise the same multitude and current company law needs not change to reflect this.

9. The Notions of Profit Maximisation and Shareholder Primacy

The Study appears to accept that the concept of directors' duties in current company law does involve both long-term consequences and a multitude of stakeholders, and yet the Study is adamant that directors fail their statutory duty by favouring shareholders due to a philosophy of profit maximisation and shareholder primacy that

[8] The term 'object' as used in said article is in some languages, including Danish and Swedish, the same as 'purpose' and the two concepts are regularly confused even where language does make a difference. However, in company law the function of the object is to limit the scope of management's right to represent and act on behalf of the company to affairs that concern its line of business, see Company Law Directive art. 9. That a reference to the company's 'interest' is used to ensure that management can justify their actions within the scope afforded them in art. 9 is visible in art. 64, section 3, litra b. Thus, the *object* is used continuously to set the formal boundaries of executive powers, while *interest* is used infrequently to evaluate the use of these powers in certain circumstances where a risk of illegitimate use of these executive powers is deemed particularly high.

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arguably pressures directors to serve shareholders' interest exclusively and makes directors subject to short-termism.[9]

The Study is wrong in its assertion and it is probably due to a failure of properly understanding what is meant by 'shareholder interest', which combined with the inadequate understanding of the other fundamental notions of company law explored above leads the Study astray.

In order to function, a company must attract investment and in order to do that it must offer a return on that investment. The company can offer different returns as it sees fit. Shareholders are investors in the company, as are bondholders. The difference between the two is that shareholders are entitled to the proceeds of the business venture once all other claimants have been paid, whereas bondholders are restricted to receive a certain return on their investment. Consequently, the shareholders carry a greater risk because they only receive a return on their investment when there is surplus after satisfying all other claimants, which include bondholders who are paid alongside other creditors, employees, suppliers, etc. In short: shareholders are residual claimants, who have an unlimited upside but with the highest risk.

All investments are useful, but it is generally believed that equity investment by shareholders is particularly useful, especially for new business ventures, because it is a more 'patient' investment that only requires a return once the company is in fact profitable. For this reason, the European Commission has launched the concept of a Capital Markets Union to further equity investment and special efforts are made to encourage investments in SME's.

The fact that shareholders are the residual claimants of the company means that it is in their interest that the company makes use of its resources efficiently. To produce maximum wealth while using as little as possible of Earth's resources is also in the interest of society. Competition among companies and their strive to be the most efficient has reduced the use of natural resources constantly defying decades of dire predictions of an 'end to growth' while causing less environmental damage compared to the units of growth at the same time. In the fight against climate change, competition among private sector companies to increase efficiency and enhance innovation is necessary. Shareholders as residual claimants of the company are allied in this effort, not opponents as they are portrayed in the Study.

[9] The Study's paragraph 3.2.1 at p. 32 et seq., again based on a reference to 'studies'.

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The concept that companies should try and maximise their 'profits' is nothing more than a confirmation of the need of the company to use its resources in the most efficient way. Equally with the notion that the company is run in the interest of shareholders. These concepts do not mean, what the Study apparently thinks, that the company and its directors should pursue higher profits in the interest of shareholders regardless of any future consequences or even break the law in the process. What they do mean is that shareholders have a direct interest in making the company as efficient and thereby as profitable as possible and that for this reason shareholders are well positioned to monitor and if necessary discipline management if they fail to use resources in this way.

Curiously, the concept that a company should seek to 'maximise' its profits appears to be taken more serious by its opponents than by its adherents, probably because the latter appreciates that the concept has poor operational value. Almost any action taken by the company may be explained as an attempt to maximise profits if only in the long-term. It is obvious that it is a poor choice to mistreat employees for the sake of a short-term saving if this makes the company produce sub-standard goods that impair its sales. As another example company directors may suggest to switch to renewable energy although it involves a short-term cost, because it would provide a long-term gain or simply because the switch may been welcomed by its customers or among young executives thus enabling the company to increase its sales or improve recruitment. The point is that maximisation of profits cannot be equalled with short-termism.

As mentioned above, the price of a share reflects its long-term value. It is not in the interest of shareholders to pursue short-term benefits at the costs of long-term benefits. Short-termism would only make sense in a single game scenario where the shareholder could retire with the money and not return, but investing is a continuous game, especially among the institutional investors that now dominate as company owners, and any pressure applied to directors to neglect future earnings in lieu of short-term payments would be self-defeating. Even in the rare event of a single game, any shareholder pressuring management to forego future earnings to fund short-term pay outs would lose out on these future earnings and would not be able to recoup them by selling the shares, since the valuation of the shares would reflect the deteriorating situation of the company.

Consequently, the proposition that shareholders should systematically favour short-time pay-outs to future earnings simply does not make sense, especially with the prevalence of institutional investors such as pension funds with an inherent commitment to long-term investment.

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As explained in paragraph 8 above, the company interest does not only comprise shareholders, but a multitude of stakeholders besides that. It is equally a misunderstanding to see 'shareholder primacy' as a statement of the fact that only shareholders are important in company law.

Shareholder primacy, to the extent that this concept is used nowadays at all, concerns governance, i.e. *who* can decide; it does not concern *what* to decide.

Because shareholders are the ultimate claimants of the company, who has a vested interest in running the company as efficiently and thereby as profitably as possible *in the long-term*, they are in most jurisdictions also vested with the powers to appoint and dismiss directors.

It is exactly because shareholders *per se* have a long-term interest in the efficient use of the company's resources, that *they* are the ultimate decision-makers and not the directors.

Strangely, the Study appears to believe that *directors* as opposed to shareholders have an incentive to act in the long-term interest of the company and would do so if not restrained by shareholders.[10] We find that proposition unnecessarily naive. Company law displays a long history of trying to solve what economist like to call the Principal-Agent Problem. The problem hinges on the rude experience that directors are in fact not long-term oriented, but motivated by short-time enrichment and if left unsupervised prone to divert company funds to their own pockets or use them for self-aggrandising projects like unnecessary investments and empire-building takeovers. Their tenure in top management is usual short, and it keeps getting shorter, and once their contract is terminated or they move on to another position they have no interest in the financial long-term prospects of the company.

It was exactly to combat this preference for short-termism by company directors that could hurt shareholders' interest in the long-term profitability of the company that induced the advancement of shareholding-schemes for top-management and other key employees. This observation seems to have escaped the Study, which appears to view these schemes as detrimental.[11] It must be acknowledged that the propensity of directors to enrich themselves at the expense of others have frequently resulted in

[10] The Study at p. vi describes the 2nd key problem driver to be the growing pressure from short-term investors that prevents them from acting sustainable.
[11] The Study, p. 36.

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these schemes being abused to unduly favour directors at the costs of all other shareholders, but if anything it testifies to the risk of leaving directors in charge of the company without any monitoring or disciplining by profit seeking shareholders.

10. The Empiric Evidence

As the Study acknowledges that according to company law the company interest includes a multitude of stakeholders and equally that directors' duties as stated in national company law obliges directors to pursue the long-term profitability of the company, the Study finds it necessary to back-up its claim that directors are nonetheless subject to short-termism by referring to economic empiric evidence that it claims support this contention.

We are not convinced by the evidence provided. According to the Study and its use of empirical data among the 12 Member States considered in the Study, Slovakia, Belgium, Portugal and the Netherlands should be the most short-term oriented,[12] and yet we find it difficult to see these four Member States as representatives of any shared ultra-liberal shareholder primacy regime or, in fact, any shared regime at all. As far as we know, their approach to corporate governance is quite divergent. When Member States actually do share a common model of corporate governance, as the two Nordic Member States of Finland and Sweden do, the data provided by the Study places them at opposite sides of the continuum, placing Sweden next to Hungary and embed Finland between Slovenia and Portugal. Equally, we doubt that Poland and Hungary are more inclined to sustainability than other Member States, although this is what the Study claims to prove.[13]

Although we prefer to make reference to the separate response provided by Caspar Rose that carries a convincing critique of this evidence, we point to the following more general observations on the selected data provided in the Study.

The empiric evidence is based on the notion that some three decades ago, company directors suddenly began to behave contrary to the duties laid down by company law and became subject to short-termism induced by a new adherence to the concept of shareholder primacy.[14] This line of thought is eerily reminiscent of the proposition, mostly associated with the far-left, that Western societies suddenly took a wrong

[12] The Study, p. 12.

[13] Ibid. The Study does not state so directly, but it does argue that the economic data represented in this way can be used to gauge how well companies can pursue sustainability.

[14] The Study p. 9 et seq.

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turn around 1980's as symbolised by the election of Ronald Reagan and Margaret Thatcher ushering in what is sometimes referred to as a neo-liberal economy.

What happened was that the failed and increasingly stagnated economy of the 1970's was replaced by a stronger and more efficient economy based on financial markets. Companies and especially their directors were subjected to competitive pressure that invigorated the economy and created new growth. What ended was the cosy and protected environment of chief executives and the era of three-martini lunches.

We find it difficult to follow the Study's claim that the past three decades have seen a deterioration of our economy. Even taking into account the crises of the last three decades, GDP has grown considerably increasing the capability of Member States to distribute welfare to their population, and the technological developments made possible by innovation and competition has been staggering.

What the Study shows, relying on the curated evidence, is that return on investment to shareholders has increased marginally, while expenditures in form of investment and R&D has declined similarly over the same period. As is well known, correlation is no proof of causation. As the Study itself acknowledges, expenditure in absolute terms has increased and so the *relative* increase in the return to shareholders as part of companies' overall use of capital may equally demonstrate a more efficient use of the company's resources, which to some extent is probably the inevitable result of a technological innovation that has made the capital intensive real assets of companies play a decreasing role. Furthermore, the empirical evidence of shareholder return does not show a linear trend as one would expect if it was caused by a persistent external driver like shareholder pressure, but it varies according to the funding needs of the company and thus suggests that directors efficiently distribute the funds available to them taking into account the present needs of the company. It should be reminded that in all Nordic EU and EEA Member States and probably in most other Member States as well, it is expressly forbidden directors to authorise any distributions of funds that may be needed to fund the company's foreseeable costs. That directors should neglect these provisions is difficult to believe and is not supported by this evidence.

Considering that the Study takes a stern view of returning excess capital to shareholders and efficiency measures like downsizing the workforce and outsourcing,[15] one wonders whether the Study is actually advocating that companies should hoard

[15] Ibid., where reference is made to an alleged shift from 'retain-and-invest' to 'downsize-and-distribute'.

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capital, keep employing redundant workers and stop engaging in cross-border outsourcing activities and pursue a more protectionist policy? The Study's approach to these issues betrays a fundamental lack of understanding of the market economy that is the foundation of the Union and the benefits that competition brings. Money paid out to shareholders are not stacked in deep vaults by wealthy shareholders but are reinvested, and enterprises that are inefficient should be replaced by enterprises that can use our resources, human as well as material, in a better and more meaningful way.

We are surprised of the apparent hostility to shareholders as a group and the idea that to serve shareholders' interest is to increase inequality and somehow unfairly benefit the ultra-rich '1 per cent'.[16] It is sentiments that we mostly associate with anti-market ideologies that are difficult to reconcile with the framework of a free market economy, private ownership rights and innovation and progress through competition upon which the European Union is based. It openly conflicts with adopted policies of the Union in secondary legislation like the Shareholders' Rights Directive amendment (SRD2),[17] which as explained in the Commission's 2012 Action Plan[18] strives to continue the aim of the first SRD to *encourage* shareholder engagement and standing vis-a-vis management, notably to engage institutional investors in respect of voting and active commitment with management as part of a good stewardship effort.

Furthermore, considering that institutional investors, notably pension funds investing either directly or through other professional investors, now are the prevailing owners of shares in most Member States, the argument that shareholders constitute a tiny elite is plainly wrong.

Considering that the Study's claim of a sudden and abject turn to short-termism by management is contradicted by both the logic of finance and the black letter law of Member States, the empirical evidence to corroborate its claim is insufficient to produce the conclusion that European companies are in urgent need of the very drastic measures that the Study recommends.

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[16] The Study p. 26 et seq.

[17] 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.

[18] Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies, 12 December 2012, COM/2012/0740 final.

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11. On Expanding and Detailing Directors' Duties

The Study recommends that the statutory provisions on directors' duties in national company law are expanded and detailed to involve sustainability issues, if necessary by an amendment of the Company Law Directive.

As stated so far, we are not convinced that company directors are subject to short-termism and we find no pressing reason to change the way our national company law legislation deals with directors' duties.

To restate what is mentioned above, we believe that our national company law already entails an obligation for company directors to act in the long-term interest of the company and to take into due consideration all future risks, including those pertaining to sustainability, and balance the involved risks and interests. A failure to observe this obligation can entail personal liability and the risk of damages, which we believe has a far stronger disciplinary effect than any pressure from shareholders.

In the Nordic jurisdictions, the standard of directors' duties is not mainly expressed by a statutory provision, but is based on more general principles and these principles have over time been used and developed by our courts. This has served us well.

We are aware that other jurisdictions have experimented with legislation that expands and details the content of directors' duties so they form rather long reiterations of political aspirations. We are not impressed. Sometimes black letter law is a blunt tool compared to broadly based principles espoused over time by courts based on real life examples. Whenever a statutory provision is added a new layer of detail, lawyers wonder what has been left out and why, thus adding to the uncertainty that the new details were supposed to mitigate.

We would much prefer to keep our well-functioning and time-honoured open principles of directors' duties as they are and hope that respect of the Principle of Subsidiary enshrined in Art. 5 of the Treaty will ensure that.

12. On Enforcement of Directors' Duties

The Study recommends that the circle of plaintiffs that can enforce directors' duties is expanded to include that of 'stakeholders' beyond the shareholders, directors and creditors, incl. receivers in insolvency proceedings, that today enjoy this right.[19]

[19] The Study's paragraph 3.2.7 at p. 38 et seq.

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Regardless of how the duties of directors are formulated in national company law as discussed in paragraph 11 above, we consider this a recipe for disaster.

The Study appears to be aware that among the 'stakeholders' that it would empower in this way, only employees today have standing in the company law of some Member States, incl. our Nordic jurisdictions.[20] The reason why only this group of stakeholders enjoys a better position than other stakeholders is, of course, that only employees form a clear and identifiable group with a clear relationship to the company. This insight should caution against expanding legal standing vis-a-vis the company to a broader group no so easily identifiable.

Despite wanting to promote the legal standing of the multitude of stakeholders in enforcing the duties of directors in companies, the Study does not explain how the stakeholders should be identified and delineated. Who should be counted as a stakeholder and who should decide that?

Is the legal standing to be assigned any and all individuals that may happen to have some kind of relationship with the company or is legal standing to assume a 'representative' nature and thus befall any association or NGO that happen to enjoy the necessary political connections, which would open our business life for levels of corruption and political interference that we have so far managed to escape in our jurisdictions?

To grant legal standing to persons entirely outside the company is to invite all sorts of interference in private enterprise, incl. outright blackmail and coercion, and it will increase litigation risk to a level that it is impossible to insure against. It is dangerously naive to think that enforcement action would only be exercised by rational people legitimately concerned about the environment. It would be equally open to all fanatics and opponents of a market economy. There is already suspicion that foreign powers hostile to the success of the European Union use our democratic institutions and media to create disturbance; this would provide them with another and much more potent weapon.

The Study also fails to grasp that the low level of enforcement of directors' duties by the courts is only the tip of the iceberg.[21] Directors' duties are mostly enforced by demotion or dismissal, which is usually carried out as discretely as possible. It is consequently wrong to assume, as the Study does, that there is any problem with

[20] The Study p. 37.
[21] The Study p. 38.

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enforcement. On the contrary, the continuing trend of shrinking tenure of CEO's would suggest that enforcement works well.

Finally we observe that the Study makes the observation that a failure to engage stakeholders may undermine the company's 'social license'.[22] We note that this is not a legal concept, since companies do not require any prior political approval to operate. It used to be part of company law, mostly in pre-democratic times, but was generally abandoned as an idea in the 19th Century where it was replaced by a system according to which everybody were entitled to form a company and pursue business simply by observing the statutory and objective conditions in statutory law on capital and registration. The right of every individual to take up business without obtaining any prior political permission or license is today safeguarded by article 16 of the EU Charter.[23]

13. On Promoting Longer Shareholding Periods

The Study appears to regard longer shareholding periods as favourable.[24] It is not clear to us why that would be the case.

As pointed out in paragraph 7 above, the notion of short-termism has a dual meaning: either it is a pejorative term to signify a failure to anticipate correctly the long-term consequences of one's actions or it is a purely chronological concept describing actions carried out within a shorter timeframe.

The fact that a shareholder only owns the shares for a brief period may be described as short-term in the chronological sense, but it does not in any way imply that this is bad in the pejorative meaning of short-termism. The two concepts are logically unrelated and should be kept apart.

The valuation of shares is always taking into account the long-term value of the investment, which is a continuous process for publicly traded shares. EU-law has been designed to ensure that it remains an efficient and trustworthy exercise, notably supported by the obligations on pre-trade and post-trade transparency in MiFIR articles 3 et seq.[25] These rules are further backed up by the provisions in MAR articles 12 and 15 to prohibit market manipulation and article 17 on issuers' continuous dis-

[22] The Study p. 37.

[23] Charter of Fundamental Rights of the European Union. Hereinafter the 'EU Charter'.

[24] The Study at p. viii presents longer shareholding periods as a solution to the 2nd key problem driver.

[25] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

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closure obligation that provides the investing public with all price relevant information,[26] and by further reporting obligations in the Transparency Directive. This EU legislation ensures that whenever a shareholder trades, the price of the shares are at any given moment the best possible price in respect of all available information. An inexperienced observer may think it reckless to buy and sell a share quickly without first studying the issuer's situation, but EU law ensures that it is perfectly sensible to rely on the current market price as a reliable estimate of the share's long-term value, which is a tremendous help to the institutional investors who often have to trade shares in many companies on different markets without time to study each issuer closely.

We are not convinced that a long shareholding period is evidence of any deeper engagement with the company by the shareholder, it might as well be evidence of the contrary: a passive and negligent shareholder, who is disinterested in monitoring management performance.

For example was cross-holdings by banks a widespread phenomenon in Germany, which was widely recognised as a problem of governance, because these holdings were mainly passive and did not allow for the shareholder engagement to promote efficiency that is usually seen as beneficial in a market economy. Consequently, German tax law was modified in 2002 to allow the break-up of these passive cross-holdings and ensure a freer and thus also more frequent exchange of shares.

We do not believe that there is sufficient proof, or in fact any proof at all, for going in the opposite direction and mandate longer shareholding periods.

14. On Prohibiting Earning Guidance and Quarterly Reporting

The Study appears to view earning guidance and quarterly reporting as detrimental to companies' sustainability efforts and recommends their abolition.[27] We note that these measures are today voluntary and disagree.

[26] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC. Hereinafter 'MAR'.
[27] The Study at p. viii suggests to discourage or outright ban these measures.

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We do, however, agree with the amendment of the Transparency Directive that some years ago abolished what was then an obligation to publish quarterly financial reports.[28] Some listed companies may find them useful, others may not, and so legislators should allow companies to use them on a voluntary basis as is the case today.

Our views on these interim disclosures of a financial nature differ from those of the Study probably because we believe that disclosure of financial information is important to ensure an efficient use of resources, which helps rather than restrains sustainability efforts. When shareholders invest, they should know which company is doing its best. It is difficult to entertain a complaint that listed companies should not have the voluntary option to make quarterly reportings, when the same listed companies are subject to a mandatory disclosure obligation according to MAR article 17 that applies every single day of the year.

There is no reason to hide the financial performance of a company, on the contrary the EU legislation mentioned in paragraph 13 above is intended to ensure the disclosure of such financial information and its integrity.[29] EU legislators are also working on improving disclosure of non-financial metrics and sustainability issues and disclosure of how companies cope with these obligations are important to investors. Full disclosure in a free society is preferable to secrecy and there is no point in working on non-financial and sustainable disclosure if their effects on the company are to be kept in the dark. If there is a concern that the obligations under EU law impair the position of European companies in the global economy, reducing transparency will not make the problem disappear but might prevent EU legislators from understanding the problem and consider more efficient solutions.

15. On Political Interference in Business Strategy

The Study appears to favour public regulation of the content of the business strategies of private enterprises.[30]

We disagree, mainly because we see this as an unnecessary and unwarranted political interference. Taking into account all relevant risks, incl. those pertaining to sustainability and climate change, is already part of directors' duties, cf. paragraph 11

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[28] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, as amended by Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013. Hereinafter the 'Transparency Directive'.

[29] See footnotes 25-28 above.

[30] The Study at p. viii sees integration of sustainability aspects into business strategy as necessary in respect of the 3rd key problem driver.

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above. When a business strategy is being made, directors will have to take into account these matters and no political interference is necessary.

To mandate that certain politically favoured subjects form part of the business strategy of private enterprises is likely to cause more harm than doing any good. Contrary to the Study, we have little faith in politicians running companies and deciding on their business strategy. Europe has within the living experience of most adults experienced planned economies and the results were unhappy, both for humanity and for the environment. To let politicians dictate the content of the business strategies of private enterprises will either be irrelevant if there is no public monitoring of these issues or, if there is such a monitoring, it will open up for direct political interference that risk repeating these unhappy results.

16. On Board Composition and Remuneration

The Study appears to favour regulation of how boards are composed and remunerated.[31] We disagree as we find this not only unnecessary and unwarranted, but also to constitute an unjustified infringement of the fundamental property rights of individuals as protected under the EU Charter article 17 and the 1950 European Convention on Human Rights and Fundamental Freedoms.

On the issues of fundamental human rights in EU law and international law, we refer to the separate response provided by Søren Friis Hansen & Troels Lilja for an in-depth analysis.

In this response, we simply want to point out how companies are governed and why it matters.

In most EU Member States, incl. all Nordic EU and EEA Member States who for historical reasons share the same distinct system of corporate governance,[32] shareholders appoint the executive management of a company. This is a collective task of shareholders exercised when they are convened as a general meeting. EU law, notably the Directives on Shareholders' Rights, and national company law provide a substantial body of regulation to ensure that the general meeting afford equal representation to all shareholders and that the proceedings are well-informed, trustworthy, and fair.

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[31] The Study at p. ix sees these measures as necessary in respect of the 4th and 5th key problem driver.

[32] See footnote 6 above.

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As pointed out in paragraph 9 above, shareholders are residual claimants of the company and thus have a direct interest in ensuring that companies are run as effectively as possible within the law. It is *the* most important part of the parcel that constitutes the ownership of a share to exercise the right to appoint directors and dismiss them if they fail to use the company's resources in the most efficient way.

As pointed out in the same context, directors cannot be expected to pursue efficiency in the same way as shareholders, because they do not *qua* directors share in the surplus generated from an efficient use of the company's resources and are apt to appropriate these resources for themselves instead. To determine the remuneration of directors is consequently *the* most important instrument available to shareholders to realign directors' personal incentives with the aim of achieving efficiency.

Consequently, the Study here suggests to interfere with the two most important instruments available to govern companies. Even if one disregards the issue of fundamental rights, any such interference must be necessary in order to be justified. It is not.

As pointed out above in paragraph 6 above, although serious the problem of climate change is not the only problem facing European companies. There is no good reason why company boards should be bloated up by members representing special interests. EU company law legislation should strive for efficiency, not act as an employment agency for consultants with expertise in sustainability or other equally worthy matters. A company board does not have to comprise experts on all things that matter, not even all things that matter to the company. All that is required is for the board to be aware of the risks that face the company. Personal expertise within each and every subject is unnecessary.

Equally, there is no good reason to believe that it is possible by external regulation, be that recommendations or legislation, to detail how a company's efforts with respect to sustainability should be reflected in the remuneration of directors, what metrics to be used or how these efforts should compare with other worthy causes the company may pursue, e.g. gender equality or employee welfare to name but a few. We do not share the Study's trust that legislators or self-regulatory bodies as parties external to the company can design remuneration formulas that are superior to those devised by the company itself with full and intimate knowledge of its affairs and under the supervision of efficiency striving shareholders to prevent any unduly self-enrichment by management. It is no argument that since shareholders already take sustainability into consideration it should not matter to them that it is codified in statute, because that ignores the effect of codifying some issues and mentioning them

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specifically in statutory regulation while leaving other equally important issues unmentioned.

Consequently, we strongly recommend that EU law does not interfere in the two most important instruments for shareholder to exercise their property rights and enjoy the full benefits thereof: that of board composition and that of remuneration.

17. On the Principle of Subsidiarity

The Study argues that regulation by EU law, either binding or not, is necessary, because only EU regulation can provide a level playing ground and prevent competitive pressure arising from different approaches to such regulation among Member States.[33]

If these assertions are upheld as the necessary threshold to set aside the principle of subsidiarity in the EU Treaty art. 5, then the principle is effectively void and cannot offer the protection that Member States were guaranteed to regulate their own affairs as far as possible.

As noted in the many reports on corporate governance, the last one being the 2011 Report of the Commission's Reflection Group, corporate governance is an area of company law that is tightly integrated into national law and customs and is for that reason unsuited for harmonisation. Member States have developed their own approaches and have often been inspired by each other, thus allowing for useful experimentation and cross-pollination. As the Reflection Group remarks, the many different systems of corporate governance 'should not be viewed as an obstacle to free enterprise within a single market, but as a treasure trove of different solutions to a wide variety of challenges that has been experienced and overcome.'[34]

In our opinion it would take a much more important purpose and much better evidence of its necessity to justify subjecting the different systems of corporate governance of the Member States to this kind of interference.

[33] The Study p. 45 et seq.

[34] Report of the Reflection Group on the Future of EU Company Law, Brussels, 5 April 2011, p. 11.

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18. Concluding Remarks

In this response we have voiced strong opposition to the recommendations of the Study and the policies that underpin them, stronger than we would normally do.

We do so, because we find that the Study is motivated by policies that are incompatible with the basic well-functioning market principles embedded in the founding Treaties and displayed in the secondary legislation that makes up EU law. These are principles of private property rights, efficiency and innovation by competition, shareholder rights, and cross-border economic activity by establishment, service or out-sourcing. These principles have provided a steady growth and prosperity within the European Union, even when taking into account the occasional crises. The experience of the first half-century of European community has been that the more efficient the economy of a Member State is, the higher degree of welfare and sustainability can it afford.

We believe that in order to combat climate change it is important to harness the powers of the private sector and that the best way of doing this is to regulate in a way that is compatible with the market and avoid measures that restrict competition and innovation.

EU legislators already work on such market compatible solutions, e.g. non-financial disclosure and a taxonomy, to ensure that what is disclosed is clear, consistent, and informative. We also have a substantial regime for exchange trading of emission-permits and other measures are contemplated that internalise costs that are today external to the companies. All of these new market compatible measures to further sustainability dovetail with older provisions of existing law such as disclosure regimes of trading venues and company law principles of directors' duties to take into account foreseeable risk. These efforts carry great promises and should be allowed to work.

The Study acknowledges this important contribution only in passing and dismisses it as a failure.[35] This is unfair to a regime that is still nascent and not entirely operational and as mentioned above we refute the literature and empirical data that the Study relies upon in its dismissal of these important measures.

[35] The Study p. 38 et seq. and again at p. 45 describing these legislative efforts as 'too patchy and lack[ing] strength.'

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As much as we oppose the recommendations of the Study, we support these initiatives as the right way forward.

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