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Sustainable Corporate Governance in the United Kingdom

Environmental Sustainability in Directors' Decision-Making

Constantin Jung

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Fachbereich 3: Wirtschaft und Recht
Nibelungenplatz 1
60318 Frankfurt am Main

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Abstract: English

Environmental sustainability is one of the greatest challenges of this century. It depends on both compliance with environmental protection laws and its integration into directors' decision-making beyond these laws. In this regard, the duty to promote the company's success stipulates in the Companies Act 2006 that directors, who are protected by Business Judgment Rule, shall consider their companies' environmental impacts. Since the stakeholders' interests are regarded as a means to increase shareholder value, directors may pursue their companies' environmental sustainability through a business case. The latest changes to the UK Corporate Governance Code 2018 further encourage directors to consider environmental sustainability in their business decisions. They may also link environmental sustainability to mandatory and voluntary disclosures through publishing their companies' achievements. As a result, directors have broad discretion to pursue environmental sustainability beyond environmental protection laws. However, evidence shows that directors frequently neglect this discretion, the environmental sustainability's resulting business case and that they even cause environmental damages to increase (the short-term) shareholder value. This is due to the social norm of shareholder primacy, which is now exacerbated by Brexit's and the Ukraine war's unclear economic impacts as well as the ongoing COVID-19 pandemic. In this regard, the current approach of the UK's company law in the predominant form of narrative reporting laws is insufficient because of the resulting greenwashing possibilities. This paper's main argument is thus that changes to the current legal framework for directors' decision-making are needed to achieve more environmental sustainability. Accordingly, a new principle for the UK Corporate Governance Code 2018 could lead to a greater consideration of environmental sustainability in directors' decision-making and increased shareholder value in times of rising societal awareness of climate change and a growing trend towards environmental activist shareholders.

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Abstract: German

Ökologische Nachhaltigkeit ist eine der größten Herausforderungen dieses Jahrhunderts. Sie hängt sowohl von der Einhaltung von Umweltschutzgesetzen als auch von ihrer Einbeziehung in die Entscheidungsfindung von 'Directors' über Umweltschutzgesetze hinaus ab. In diesem Zusammenhang schreibt die Pflicht aus Section 172 im UK Companies Act 2006 Nachfolgendes vor: 'A director (…) must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to (…) the impact of the company's operations on the community and the environment', wobei 'Directors' durch die Business Judgement Rule geschützt sind. Da die Verfolgung von Stakeholderinteressen als ein Mittel zur Steigerung des Shareholder Value angesehen wird, können 'Directors' die ökologische Nachhaltigkeit ihrer Unternehmen durch einen Business Case fördern. Die jüngsten Änderungen des UK Corporate Governance Code 2018 unterstützen 'Directors' zudem noch stärker, ökologische Nachhaltigkeit in ihren unternehmerischen Entscheidungen zu berücksichtigen. 'Directors' können zudem auch ökologische Nachhaltigkeit mit obligatorischen und freiwilligen Offenlegungen verknüpfen, indem sie die positiven Beiträge ihrer Unternehmen zur ökologischen Nachhaltigkeit veröffentlichen. Daher verfügen 'Directors' über einen breiten Ermessensspielraum, um ökologische Nachhaltigkeit über Umweltschutzgesetze hinaus zu fördern. Es zeigt sich jedoch, dass 'Directors' ihren Ermessensspielraum sowie den aus ökologischer Nachhaltigkeit resultierenden Business Case häufig vernachlässigen und sogar Umweltschäden verursachen, um den (kurzfristigen) Shareholder Value zu steigern. 'Shareholder Primacy' ist dafür verantwortlich und wird nun durch die unklaren wirtschaftlichen Auswirkungen des Brexit und des Kriegs in der Ukraine sowie durch die anhaltende COVID-19-Pandemie noch verschärft. Folglich ist der derzeitige gesellschaftsrechtliche Ansatz des Vereinigten Königreichs, ökologische Nachhaltigkeit primär durch Gesetze zu fördern, die narrative Berichterstattung erfordern, nicht ausreichend aufgrund der aus dem narrativen Spielraum resultierenden Greenwashing-Möglichkeiten. Das Hauptargument dieses Papers ist daher, dass Änderungen am derzeitigen Rechtsrahmen für die Entscheidungsfindung von 'Directors' erforderlich sind, um mehr ökologische Nachhaltigkeit zu erreichen. Dementsprechend könnte der UK Corporate Governance Code 2018 in Form eines neuen 'Principle' ergänzt werden. Dies könnte zu einer stärkeren Berücksichtigung von ökologischer Nachhaltigkeit bei der Entscheidungsfindung von 'Directors' und zu einer Steigerung des Shareholder Value in Zeiten eines steigenden gesellschaftlichen Bewusstseins für den Klimawandel und eines wachsenden Trends zu sogenannten 'environmental Activist Shareholders' führen.

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1 Introduction

Environmental sustainability ('ES') and the mitigation of climate change, which hinders ES, are some of the main priorities and the greatest issues of this century. The Sustainable Development Goals ('SDGs') of the United Nations ('UN') refer in this context to, ia, ES and combating climate change.[1] Their overall objectives are unachievable without critical contributions from companies[2] because an excessive focus on financial performance has adverse impacts on the achievement of all SDGs.[3] Since companies are the main greenhouse gas emitters through their productions,[4] their contribution is also crucial to achieve the climate neutrality goal of the Paris Agreement[5] ('PA').[6] Thus, companies are not only major contributors to the current environmental crisis and to climate change but also vital in combating these issues.[7]

In this regard, achieving ES not only depends on the effectiveness of environmental protection laws and the companies' compliance with them. It also depends on the extent to which boards of directors ('directors') integrate environmental matters into their decision-making beyond environmental protection laws.[8] In doing so, it is the directors' responsibility to promote environmental concerns.[9] This is due to the fact that the directors are the companies' key decision-makers and therefore in charge of implementing corporate social responsibility[10] ('CSR') practises.[11] Therefore, directors have a major impact on both CSR and on its environmental, social and governance ('ESG') dimensions, including ES.[12]

This paper will examine whether the Corporate Governance provisions on considering the environment of the United Kingdom ('UK') promote ES in directors' decision-making. In this

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1 See, ia, UN General Assembly Resolution 70/1 (21 October 2015) UN Doc A/RES/70/1 paras 2, 9, 14, goal 7, goal 9.4, goal 12.4, goals 13–15.

2 European Commission ('Commission'), Study on Directors' Duties and Sustainable Corporate Governance: Final Report (2020) 30, 41 (*'CG-Study'*).

3 UN General Assembly Resolution 66/288 (11 September 2012) UN Doc A/RES/66/288 para 46.

4 Charlotte Villiers and Georgina Tsagas, 'Accounting for Climate Change: Rethinking the Chaotic Corporate Reporting Landscape and Its Purpose, with the UK's Failure as a Case Study' in Margherita Pieraccini and Tonia Novitz (eds), Legal Perspectives on Sustainability (Bristol University Press 2020) 70.

5 Paris Agreement (adopted 12 December 2015, opened for signature 22 April 2016) (2016) 55 ILM 743, art 4(1).

6 cf Commision, *CG-Study* (n 2) 22, 26.

7 David Millon, 'Corporate Social Responsibility and Environmental Sustainability' in Beate Sjåfjell and Benjamin J Richardson (eds), *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press 2015) 35f, 76f.

8 cf Beate Sjåfjell and others, 'Shareholder Primacy: The Main Barrier to Sustainable Companies' in Beate Sjåfjell and Benjamin J Richardson (eds), *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press 2015) 87.

9 Blanaid Clarke, 'The Role of Board Directors in Promoting Environmental Sustainability' in Beate Sjåfjell and Benjamin J Richardson (eds), *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press 2015) 148f.

10 See Commission, 'A Renewed EU Strategy 2011–14 for Corporate Social Responsibility' (Communication) COM (2011) 681 final, para 3.1 for a definition.

11 Stephen Klomp and Anne Clear, 'Senior Management Perceptions of CSR Impact: Long-Term Investment for Social Good or Necessary Cost?' in Martin Brueckner, Rochelle Spencer and Megan Paull (eds), *Disciplining the Undisciplined? Perspectives from Business, Society and Politics on Responsible Citizenship, Corporate Social Responsibility and Sustainability* (Springer International Publishing 2018) 179.

12 Commision, *Study* (n 2) ix.

context, the paper will focus on directors from listed, public limited companies (omitting group law) because these companies have significant environmental impacts.[13] Initially, the paper will identify the relevant legal framework (part II.). Subsequently, part III will examine the reasons for directors to consider ES, possible justifications and directors' protection. In part IV, the legal, economic and practical barriers to greater consideration of ES in directors' decision-making will be critically analysed (including ESG resolutions in the UK and in the USA of the last annual general meeting season). The fourth part therefore aims to examine to what extent directors can pursue ES in practice. Part V will thereafter discuss whether amendments are needed and, if so, which could achieve more ES. Finally, the research findings will be summarised and a conclusion drawn (part VI.).

2 Legal framework for the consideration of environmental sustainability in directors' decision-making

Although there is no specific obligation stipulating a duty to pursue ES, several provisions can be derived. The accompanying reporting laws, which aim to enhance ES,[14] are subsequently analysed as contributing to decisions in favour of ES measures.

2.1 Companies Act 2006

The Companies Act 2006 of the UK embodies the so-called 'Enlightened Shareholder Value' ('ESV'): Directors shall act in the way they consider (in good faith) would be most probable to promote the companies' success for the shareholders' benefit.[15] 'Success' is defined by the shareholders.[16] Furthermore, the ESV stipulates that directors must have regard to their decisions' long-term consequences and the companies' stakeholders, which are not exhaustively listed.[17] Boeger, Russell and Villiers therefore state that the ESV was the starting point for greater stakeholder-orientated decision-making.[18]

In this context, directors shall have regard to their companies' environmental impacts.[19] This means to give proper consideration and is not fulfilled by applying a box-ticking

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[13] Department for Business, Energy and Industrial Strategy ('BEIS'), 'Consultation on Requiring Mandatory Climate-Related Financial Disclosures by Publicly Quoted Companies, Large Private Companies and Limited Liability Partnerships (LLPs).' (2021) 4, 20 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/972422/Consultation_on_BEIS_mandatory_climate-related_disclosure_requirements.pdf> accessed 28 June 2021.

[14] Beate Sjåfjell, 'Realising the Potential of the Board for Corporate Sustainability' in Beate Sjåfjell and Christopher M Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press 2019) 698. See 3.2.

[15] Companies Act 2006, s 172(1).

[16] HL Deb 6 February 2006, vol 678, cols GC255–GC256.

[17] Companies Act 2006, s 172(1).

[18] Nina Boeger, Roseanne Russell and Charlotte Villiers, 'Companies, Shareholders and Sustainability' 12 <www.bristol.ac.uk/media-library/sites/law/documents/Boeger%20Russell%20Villiers%20BLRP%20No.%207%202020%20Companies%20Shareholders%20Sustainability%20-%20MERGED.pdf> accessed 12 May 2021.

[19] Companies Act 2006, s 172(1)(d).

approach.[20] Hence, directors do not fulfil this duty if they only consider revenues and not their decisions' environmental impacts. Moreover, according to Keay, a reason to explicitly include the environment in the ESV was the promotion of environmental protection measures.[21]

In addition to the ESV, directors must observe environmental protection laws outside company law,[22] judgments and the company's constitution.[23] For instance, shareholders can oblige directors in the articles of association to prioritise the environment over shareholders.[24] The UK's company law even prescribes that if the company's purposes comprise of purposes other than the shareholders' benefits, the directors must achieve these purposes.[25]

This means that the Companies Act 2006 does not embody an obligation to shareholder wealth maximisation and the ignorance of the interests of stakeholders.[26] However, the ESV's wording also clearly lays down that a director's primary duty is to promote the company's success and not to actively protect the environment.[27] The ESV only requires directors to consider environmental matters but it does not oblige them to necessarily act upon these considerations.[28] According to Belcher, the ESV gives directors a 'permission, but not an obligation, to bring stakeholder interests into their thinking'.[29]

A monistic approach to the company's interests is thus enshrined in the UK's company law. The ESV embodies the stakeholders' consideration as a means of promoting the company's success for the shareholders' benefit (as the primary interest taking priority over stakeholders' interests). The ESV also equates a company's interests with its shareholders' interests.[30] Therefore, contrary to a pluralistic approach, a broader range of interests is not embraced by the company's interests.[31]

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[20] HC Deb 17 October 2006, vol 450, col 789.

[21] Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 125.

[22] Min Yan, 'Corporate Social Responsibility versus Shareholder Value Maximization: Through the Lens of Hard and Soft Law' (2019) 40 Northwestern Journal of International Law & Business 47, 66.

[23] Companies Act 2006, s 171(a).

[24] Clarke (n 9) 160 fn 60; Sjåfjell and others (n 8) 128.

[25] Companies Act 2006, s 172(2). Furthermore, see Companies Act 2006, s 172(3) regarding the creditors' interests.

[26] Virginia Harper Ho, 'Enlightened Shareholder Value: Corporate Governance beyond the Shareholder-Stakeholder Divide' (2010) 36 Journal of Corporation Law 59, 73f.

[27] *Butterworths Corporate Law Service*, para CL 25.165E (issue 129).

[28] Alexia Staker and Alice Garton, 'Directors' Liability and Climate Risk: United Kingdom - Country Paper' (2018) 13 <www.smithschool.ox.ac.uk/research/sustainable-finance/publications/CCLI-UK-Paper-Final.pdf> accessed 19 May 2021.

[29] Alice Belcher, 'Legal Creativity and Boardroom Creativity' in Antoine Masson and Gavin Robinson (eds), *Mapping Legal Innovation: Trends and Perspectives* (Springer International Publishing 2021) 241.

[30] Andrew Johnston, 'The Shrinking Scope of CSR in UK Corporate Law' (2017) 74 Washington and Lee Law Review 1001, 1005f; Sjåfjell and others (n 8) 93f, 95f.

[31] cf Sjåfjell and others (n 8) 94f.

In summary, stakeholders' interests are subordinate to the promotion of the company's success for the shareholders.[32] Shareholders' interests are therefore to be prioritised.[33] However, directors may justify environmental expenses (that not only fulfil environmental protection laws but also go further as CSR activities) as a means to increase SHV.[34] Hence, environmental matters can be considered if there is a business case. Although stakeholders' interests do not have an independent value (ES only needs to be regarded when considering the company's success[35]),[36] the ESV nevertheless permits directors to consider CSR and ESG matters in their decision-making.[37] The vagueness of both the 'have regard to'-requirement in the ESV and the missing guidance for this requirement's fulfilment[38] further strengthen directors' discretion.[39]

2.2 UK Corporate Governance Code 2018

The UK Corporate Governance Code 2018[40] does not expressly mention 'climate change' or 'environmental sustainability'. Conversely, it states that companies do not operate isolated and sustainable companies need to develop effective relationships with stakeholders.[41] Since the environment is a company's stakeholder, it indirectly refers to environmental matters.[42]

According to the UK Corporate Governance Code 2018, the board's role is to promote the companies' long-term, sustainable success, generating SHV and contributing to wider society.[43] To meet the companies' responsibilities towards their stakeholders, directors should effectively engage with stakeholders.[44] Directors may thus engage with environmental organisations. It was therefore concluded that the UK Corporate Governance Code 2018 includes ESG issues due to, ia, its increased emphasis on stakeholder relationships.[45] The FRC even explicitly stated that the purpose of the recent

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32 Clarke (n 9) 160f; Andrew Johnston, 'Market-Led Sustainability through Information Disclosure: The UK Approach' in Beate Sjåfjell and Christopher M Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press 2019) 209.

33 Christopher M Bruner, *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* (Cambridge University Press 2013) 34.

34 Keay (n 21) 124f; ibid 35.

35 Villiers and Tsagas (n 4) 80.

36 Paul Davies and Jonathan Rickford, 'An Introduction to the New UK Companies Act' (2008) 5 European Company and Financial Law Review 48, 65f.

37 Boeger, Russell and Villiers (n 18) 20.

38 See Australian Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value* (Senate Printing Unit 2006) para 4.46 criticising the ESV in this regard.

39 Keay (n 21) 92f; Millon (n 7) 60, 61f.

40 FRC, The UK Corporate Governance Code (July 2018) <www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf> accessed 22 June 2021.

41 UK Corporate Governance Code 2018, Introduction.

42 FRC, 'Review of Corporate Governance Reporting: November 2020' (2020) 38 <www.frc.org.uk/getattachment/c22f7296-0839-420e-ae03-bdce3e157702/Governance-Report-2020-2611.pdf> accessed 19 July 2021 ('Review').

43 UK Corporate Governance Code 2018, Principle A.

44 UK Corporate Governance Code 2018, Principle D, Provision 5 sentences 1 and 2.

45 Boeger, Russell and Villiers (n 18) 14.

mention of sustainability and stakeholders is to drive directors to create sustainable value and benefit the environment (alongside the economy) to mitigate environmental issues.[46]

In line with this, the Guidance on Board Effectiveness recommends voluntary frameworks for the consideration of a company's environmental impacts.[47] Finally, the UK Corporate Governance Code 2018 also states that the companies' cultures should be responsive to the stakeholders' views[48] and that the directors should establish a company's purpose.[49] In this regard, the FRC encourages the inclusion of climate change mitigation and other ES matters in a company's purpose.[50]

Hence, the UK Corporate Governance Code 2018 emphasises the contribution of Corporate Governance to sustainable development. This includes sustainable benefits for both shareholders and stakeholders, such as the environment.[51] Nevertheless, the recent emphasis on stakeholders, including workforce engagement mechanisms,[52] does not constitute a shift to a pluralistic approach. This is because the UK Corporate Governance Code 2018 is not a hard law and even states (in line with the principle of separation of powers) that it does not override the Companies Act 2006.[53]

2.3 Summary

Directors shall have regard to their companies' environmental impacts. Furthermore, there are several soft laws encouraging the consideration of ES in directors' decision-making. Therefore, directors may contribute to ES beyond mere compliance with environmental protection laws.

3 Legal and economic reasons for the consideration of environmental sustainability in directors' decision-making

The consideration of stakeholders is essential to increase SHV.[54] This can be proven by the mention of stakeholders in the ESV.[55] In this context, this part will discuss, on the one hand, legal and economic reasons for considering ES and, on the other hand, the Business

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[46] FRC, 'Annual Review of the UK Corporate Governance Code: January 2020' (2020) 1 <www.frc.org.uk/getattachment/53799a2d-824e-4e15-9325-33eb6a30f063/Annual-Review-of-the-UK-Corporate-Governance-Code,-Jan-2020_Final.pdf> accessed 18 June 2021.

[47] FRC, 'Guidance on Board Effectiveness (July 2018)' para 46 <www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF> accessed 14 May 2021 ('Guidance').

[48] UK Corporate Governance Code 2018, Introduction.

[49] UK Corporate Governance Code 2018, Principle B.

[50] FRC, 'Review' (n 42) 7.

[51] FRC, 'Annual Review' (n 46) 1.

[52] UK Corporate Governance Code 2018, Provision 5 sentences 3 and 4.

[53] UK Corporate Governance Code 2018, Introduction.

[54] FRC, 'Review' (n 42) 22; Hajin Kim, 'Can Mandating Corporate Social Responsibility Backfire?' (2021) 18 Journal of Empirical Legal Studies 189, 190 fn 1.

[55] See Companies Act 2006, s 172(1)(b)–(d).

Judgment Rule ('BJR') protecting directors from liability for and judicial reviews of their CSR and ESG decisions (even when they are not economically successful).[56]

3.1 Business case

CSR and ESG activities include environmental expenses. Generally, CSR and ESG activities can enhance a company's reputation, avoid scandals and reduce lawsuits as well as attract both customers and employees. Such activities can further differentiate a company from its competitors and foster its stakeholder relationships.[57] This reasoning is supported by a meta-analysis of 251 studies finding a positive correlation between a company's social performance and its financial performance.[58] Hence, such activities can increase SHV and may therefore be justified via their business case. Since there is a growing societal awareness of the companies' impacts on climate change (not only in capital markets[59] but also amongst customers and employees)[60] and a 'social enforcement' against companies (by institutional investors, which are increasingly subject to ESG laws,[61] and consumers[62]), the aforementioned arguments apply all the more. Conversely, a deficit in CSR or ESG can lead to competitive disadvantages and a poor reputation.

In this regard, directors can explicitly link CSR and ESG activities to increasing long-term SHV (strategic CSR – for instance, the development of carbon-neutral products). This would even be in line with the directors' duty to consider their decisions' likely long-term consequences.[63] It was also estimated that further investments in energy efficiency could result in an annual saving of £6 billion in the UK's entire commercial and industrial sectors in 2030.[64] Therefore, companies can invest in their production lines and infrastructure to both save internal costs and contribute to ES.[65] Additionally, directors can justify expenses

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56 cf Andrew Keay and others, 'Business Judgment and Director Accountability: A Study of Case-Law over Time' (2020) 20 Journal of Corporate Law Studies 359, 359f; Kim (n 54) 192.

57 cf Jingchen Zhao, 'Promoting More Socially Responsible Corporations through a Corporate Law Regulatory Framework' (2017) 37 LS 103, 110f; Zhihong Wang, Tien-Shih Hsieh and Joseph Sarkis, 'CSR Performance and the Readability of CSR Reports: Too Good to Be True?' (2018) 25 Corporate Social Responsibility and Environmental Management 66, 68.

58 Joshua D Margolis, Hillary A Elfenbein and James P Walsh, 'Does It Pay to Be Good … And Does It Matter? A Meta-Analysis of the Relationship Between Corporate Social and Financial Performance' (2009) 2, 28 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1866371> accessed 22 September 2021. See also Yan (n 22) 80 fn 134, 135 regarding older studies (including studies that found negative or no correlations).

59 See 4.3. See also Tom G Kelly, 'Institutional Investors as Environmental Activists' (2021) 0 Journal of Corporate Law Studies 1, 1–23 <www.tandfonline.com/doi/full/10.1080/14735970.2021.1881356> accessed 8 July 2021.

60 EY, 'Will There Be a "Next" If Corporate Governance Is Focused on the "Now"? EY Long-Term Value and Corporate Governance Survey' (2021) 11 <https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/long-term-value/ey-corporate-governance-survey-march-2021.pdf?download> accessed 22 September 2021.

61 See, with regard to the European Union, Commission, 'Overview of Sustainable Finance' (*European Commission*) <www.ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/overview-sustainable-finance_en> accessed 22 September 2021. See, with regard to the UK, n 217.

62 Sjåfjell and others (n 8) 110; Kelly (n 59) 21.

63 Companies Act 2006, s 172(1)(a).

64 BEIS, 'The Clean Growth Strategy: Leading the Way to a Low Carbon Future' (2017) 62 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/700496/clean-growth-strategy-correction-april-2018.pdf> accessed 27 May 2021.

65 cf Millon (n 7) 68.

on ES in order to partially mitigate financial and business risks (eg, physical or transition risks due to climate change), which is even expected by the FRC in connection with reporting of them.[66] Environmental expenses supporting the local community (where a company's workforce lives) can further motivate a company's workforce.

However, the need for a business case does not always lead to decisions promoting ES. Initially, there are studies questioning the CSR's positive impact on financial performances[67] and the short-term costs can be too high. This especially applies to financially distressed companies due to the COVID-19 pandemic ('pandemic') and the Ukraine war.[68] Furthermore, the CSR and ESG activities' monetary long-term value is difficult to determine. Since scientists are divided about climate change's impacts, activities combating climate change can be particularly difficult to justify and the business case is inherently lower for companies not selling products directly to consumers or selling low-cost products.[69] The business case therefore depends on the company's industry and is low in, eg, the gambling industry.

Finally, since companies have numerous stakeholders, there exists more than one business case. It is thus possible that directors focus more on another business case and pay less attention to the business case of ES. A recent example is workforce engagement mechanisms, which continue to receive increased attention due to the pandemic and the UK Corporate Governance Code 2018's amendments.

3.2 Interlinking CSR and ESG achievements with reporting duties and voluntary reporting

CSR and ESG reporting duties aim to enhance ES.[70] For instance, it was estimated that the UK's reporting duties on greenhouse gas emissions would save four million tonnes of CO2 emissions by 2021.[71] In this context, directors may link CSR and ESG activities, promoting ES, to their reporting duties.

These reporting duties are laid down in, on the one hand, reporting laws requiring narrative reporting.[72] For instance, the non-financial information statement[73] aims to interlink long-term profitability with environmental protection[74] and the consideration of environmental issues in directors' decision-making.[75] On the other hand, there are also non-narrative

66 FRC, 'Review' (n 42) 38. See also 3.2.

67 See n 58.

68 See 4.2.

69 Millon (n 7) 72f, 74.

70 n 14.

71 Department for Environment, Food & Rural Affairs, 'Leading Businesses to Disclose Greenhouse Gas Emissions' (*GOV.UK*, 20 June 2012) <www.gov.uk/government/news/leading-businesses-to-disclose-greenhouse-gas-emissions> accessed 22 September 2021.

72 See, ia, Companies Act 2006, s 414CZA(1). Furthermore, see FCA, Listing Rules (Release 20 Jun 2022) <www.handbook.fca.org.uk/handbook/LR.pdf> accessed 21 June 2022, 9.8.6 R(8)(a); 9.8.7 R and UK Corporate Governance Code 2018, Provision 5 sentence 1.

73 Companies Act 2006, ss 414CA and 414CB.

74 European Parliament and Council Directive 2014/95/EU of 22 October 2014 amending Directive 2013/34/EU as Regards Disclosure of Non-Financial and Diversity Information by Certain Large Undertakings and Groups [2014] OJ L330/1, recital 3 sentence 2.

75 Clarke (n 9) 158.

reporting laws. For instance, quoted companies must disclose their energy consumption and greenhouse gas emissions.[76]

In addition to this, directors' decisions also include whether and how their CSR and ESG decisions are disclosed.[77] Therefore, they may voluntarily and positively report on CSR and ESG activities to reduce information asymmetries, attract consumers and to increase SHV.[78] Investors even demanded better climate-related information regarding the new Task Force on Climate-Related Financial Disclosures ('TCFD') disclosures.[79] Another example of disclosures, which were linked to an increase in SHV, is DuPont. DuPont reduced its internal environmental costs from $1 billion to $560 million in six years after its first environmental impact disclosures.[80]

Directors may hence justify CSR and ESG activities through the fulfilment of reporting obligations. They can also voluntarily report on the companies' achievements to increase SHV. However, narrative reporting also leads to incentives to obscure the actual corporate actions. This will be analysed in part V.

3.3 Summary

Since expenses on CSR and on ESG can increase SHV, directors, protected by the BJR, may justify ES expenses through a business case. Directors can also link ES expenditures to corporate reporting. Hence, they have broad discretion and can promote ES beyond environmental protection laws. However, the need to link CSR and ESG activities to a business case can also lead to a lack of ES in directors' decision-making. This is reinforced by narrative disclosures due to greenwashing and boilerplate possibilities. Furthermore, the BJR also protects directors from judicial reviews of their environmentally harmful decisions (provided that, ia, environmental protection laws were not violated). Therefore, the stakeholders mentioned in the ESV can often be ignored without sanctions[81] and the global financial crisis also proved that the BJR does not guarantee sustainable decisions.[82]

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[76] See Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, SI 2008/410, sch 7 pt 7 para 15.

[77] Alice Belcher, *Directors'-Decisions Directors' Decisions and the Law: Promoting Success* (Routledge 2014) 149.

[78] See, eg, Melrose Industries, 'Climate Change' (*Melrose*, 31 December 2020) <www.melroseplc.net/sustainability/our-key-principles/climate-change> accessed 26 June 2021. Furthermore, see Marna De Klerk, Charl de Villiers and Chris van Staden, 'The Influence of Corporate Social Responsibility Disclosure on Share Prices: Evidence from the United Kingdom' (2015) 27 Pacific Accounting Review 208, 209, 214, 223f; Suzanne Bowerman and Umesh Sharma, 'The Effect of Corporate Social Responsibility Disclosures on Share Prices in Japan and the UK' (2016) 13 Corporate Ownership & Control 202, 206, 214.

[79] FCA, 'Proposals to Enhance Climate-Related Disclosures by Listed Issuers and Clarification of Existing Disclosure Obligations: PS20/17' (2020) para 3.92 <www.fca.org.uk/publication/policy/ps20-17.pdf> accessed 9 July 2021.

[80] Charlotte Villiers, *Corporate Reporting and Company Law* (Cambridge University Press 2006) 234. See also Constantin Jung, 'Sustainable Corporate Governance in the United Kingdom: What is the Catch?' (2022) 5 Strathclyde Law Review 48, 54 <www.strath.ac.uk/media/1newwebsite/departmentsubject/law/documents/studentlawreview/fifthedition/SLR(2022)_Jung.pdf > accessed 21 June 2022.

[81] Nicholas Grier, 'Enlightened Shareholder Value: Did Directors Deliver?' (2014) 2 JRev 95, 108; Nick Grant, 'Mandating Corporate Environmental Responsibility by Creating a New Directors' Duty' (2015) 17 Environmental Law Review 252, 256. See also Sjåfjell and others (n 8) 119.

[82] Keay and others (n 56) 360.

The discretion analysed in this part may therefore also be exploited to justify environmentally harmful decisions for increasing (the short-term) SHV.

4 Legal, economic and practical barriers to greater consideration of environmental sustainability in directors' decision-making

The duty to promote the company's success is owed neither to the share price nor to the shareholders – this fiduciary duty is owed to the company.[83] Nevertheless, it must be distinguished between obligations legally owed by directors to their companies and 'obligations' economically owed to shareholders and the free market.[84] It is hence questionable to what extent directors exercise their discretion to pursue ES in reality.

4.1 Shareholder primacy, its adverse impacts and evidence

Short-termism means striving for 'fast' financial profits to the detriment of long-term, future interests.[85] It leads to a lack of consideration of ES and its business case. It also results in fewer decisions increasing long-term SHV through strategic CSR and it often causes environmental damages to increase the short-term SHV.[86] However, pursuing SHV should not lead to short-termism[87] and the ESV of the UK's company law discourages short-termism:[88] Directors must have regard to their decisions' long-term consequences, as listed first in the ESV.[89] Additionally, as analysed,[90] directors shall have regard to their company's environmental impacts and expenses on ES can even enhance the long-term SHV.

However, both long-termism and the environment are only listed as secondary factors in the ESV.[91] North therefore concluded that this can encourage a director to favour short-term returns for shareholders (even if these returns are neither in the company's long-term interests nor environmentally sustainable).[92] In this context, the social norm of shareholder primacy ('SHP'), inherently strong in the UK due to the ESV and the monistic approach,[93]

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83 Companies Act 2006, s 170(1). See also John Kay, 'The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report' (URN 12/917, 2012) Principle 4 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf> accessed 19 June 2021.

84 Georgina Tsagas, 'Section 172 of the Companies Act 2006: Desperate Times Call for Soft Law Measures' in Nina Boeger and Charlotte Villiers (eds), *Shaping the Corporate Landscape: Towards Corporate Reform and Enterprise Diversity* (Hart Publishing 2018) 134.

85 See Kim M Willey, *Stock Market Short-Termism: Law, Regulation, and Reform* (Springer International Publishing 2019) 23–29 for an overview of the definitions.

86 cf Commission, 'Action Plan: Financing Sustainable Growth' (Communication) COM (2018) 97 final, ch 4.2.

87 Keay (n 21) 115. However, the company's success is defined by its shareholders and can also constitute short-term benefits. See n 16.

88 Belcher (n 29) 241.

89 Companies Act 2006, s 172(1)(a).

90 See 2.1. and 3.1.

91 See Companies Act 2006, ss 172(1)(a) and 172(1)(d).

92 Gill North, 'Are Corporate Governance Code Disclosure and Engagement Principles Effective Vehicles for Corporate Accountability: The United Kingdom as a Case Study' (2018) 23 Deakin Law Review 177, 195f.

93 Grant (n 81) 254f, 259; Millon (n 7) 61, 64f; Johnston (n 30) 1031; Villiers and Tsagas (n 4) 80.

was found to be the main barrier to (companies') ES.[94] It has its roots in the SHV theory and in the agency theory. This social norm insists on maximising (short-term) returns for the company's shareholders (measured by a company's share price) and therefore limits directors' discretion.[95] It leads to a perceived obligation to SHV maximisation with a common focus on short-term returns due to the investors' impatience, shareholders often having a short-term focus, the resulting pressure and the financial markets.[96] SHP was hence found to be a key driver in short-termism (despite the ESV's contrasting emphasis) and the lack of companies' ES.[97]

SHP and its perceived (because the legal framework does not prescribe focusing only on SHV at the stakeholders' expense)[98] obligation to maximise SHV is based on the ESV because the ESV stipulates the prioritisation of shareholders' interests and the obligation to promote the company's success for the shareholders' benefit.[99] This is further reinforced by the threat of takeovers. This threat results in increasing share prices (to reduce the likelihood of takeovers) and the satisfaction of shareholders' expectations (which is often an increase in the share price) so that shareholders do not sell their shares due to takeover bids.[100] Moreover, the convergence of directors' interests (agents) with those of the shareholders (principals) and the attempts to reduce agency costs can be regarded as catalysts for SHP. This includes directors' remuneration through shares in the company.[101] Moreover, it includes quarterly reporting.[102] The prohibition of such disclosures is therefore being considered in the European Union.[103]

As a result, SHP exerts pressure on directors to prioritise short-term returns for the shareholders regardless of directors' discretion.[104] This market pressure for short-termism (and profit maximisation) has direct, adverse impacts on the SDGs,[105] contributing to environmentally harmful decisions and to climate change.[106] It results in environmental damages for increasing SHV (eg, secret groundwater pollution to save costs for waste disposal) and in reduced environmental expenditures,[107] such as decreased investments in

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94 Sjåfjell and others (n 8) 112, 125, 145f. See also Millon (n 7) 37 regarding 'ethical' CSR; Commision, *CG-Study* (n 2) 23, 30.

95 Sjåfjell and others (n 8) 83f; Johnston (n 32) 216 fn 102; Sjåfjell (n 14) 697f.

96 Yan (n 22) 59; Andrew Johnston and others, 'Corporate Governance for Sustainability Statement' (*The Harvard Law School Forum on Corporate Governance*, 7 January 2020) <www.corpgov.law.harvard.edu/2020/01/07/corporate-governance-for-sustainability-statement> accessed 13 May 2021. cf also Millon (n 7) 78.

97 n 94.

98 See part 2. The social norm of SHP must thus be differentiated from the duty to promote the company's success (see n 95).

99 See 2.1. See also Johnston (n 30) 1035.

100 Simon Deakin, 'The Coming Transformation of Shareholder Value' (2005) 13 Corporate Governance: An International Review 11, 13–15; Keay (n 21) 115. However, see Millon (n 7) 64 regarding amendments to takeover rules and their persisting disadvantages.

101 Willey (n 85) 169f; Commission, *CG-Study* (n 2) 35f. See also Deakin (n 100) 14; Sjåfjell and others (n 8) 84.

102 Kay (n 83) para iv; Yan (n 22) 59.

103 Commission, *CG-Study* (n 2) 34, 42, 53.

104 Sjåfjell and others (n 8) 112.

105 See Commission, *Study on Directors' Duties and Sustainable Corporate Governance: Final Report - Annex I* (2020) 1–5 for examples ('*CG-Study-Annex*').

106 Commision, *CG-Study* (n 2) 22–26, 30. See also Willey (n 85) 196f, 209.

107 See, eg, n 110.

plastic footprints.[108] This market pressure also results in cost pressure, as in the case of bp, where it led to several environmental damages, such as the oil spill in 2010.[109] Another example of the SHP's potential consequences is a study revealing that 94% of the participating directors voted to cut an old-growth forest (due to a legal loophole) to increase SHV.[110]

Although SHP and short-termism have also been counteracted since the global financial crisis (and sustainability laws have been strengthened),[111] there is evidence of SHP's prevalence: A recent European study found SHP and rising short-termism in, ia, listed UK companies.[112] Furthermore, a submission to the Labour Party's policy-making process compiled various statistics evidencing short-termism in the UK and criticised the shareholder-centric model as leading to short-termism due to shareholder pressure and maintaining shareholder returns at the environment's expense. [113]

Short-termism was also found to be an issue in the UK's equity markets in the Kay Review in 2012.[114] Additionally, misinterpretations of the ESV (the short-term maximisation of the company's share price) by directors were found in this review.[115] The SHP's prevalence is also reflected by a recent survey. The majority of participating directors stated that they experienced short-term earnings pressure from shareholders.[116] For instance, hedge funds, which are responsible for 72% of the UK's market turnover,[117] often buy shares to hold them for merely a few months and therefore exert pressure on directors to increase the short-term SHV in the UK.[118]

The BEIS Committee also quoted a survey stating that directors experience more pressure to work towards a horizon of two years and to deliver short-term results.[119] A Labour Government's position even concludes that the UK's corporate sector 'is unfit for

108 Commission, *CG-Study-Annex* (n 105) 4.

109 Kay (n 83) para 1.22.

110 Additionally, 88% also voted to emit a dangerous toxin instead of investing in an additional, costly technology to limit emissions. See Jacob M Rose, 'Corporate Directors and Social Responsibility: Ethics versus Shareholder Value' (2007) 73 Journal of Business Ethics 319, 323–325 <http://link.springer.com/content/pdf/10.1007/s10551-006-9209-z.pdf> accessed 22 September 2021 regarding Fortune 200 directors.

111 For instance, the interim management statements were removed from the Listing Rules (see FCA, 'Removing the Transparency Directive's Requirement to Publish Interim Management Statements: PS14/15' (2014) 4f <www.fca.org.uk/publication/policy/ps14-15.pdf> accessed 22 June 2021) and new disclosure laws, such as the TCFD disclosures, were enacted and are proposed (see 3.2. and 5.2 for more details). The latest revision of the UK Corporate Governance Code also aims to increase the stakeholders' consideration in directors' decision-making (see n 46).

112 See Commision, *CG-Study* (n 2). However, the growth in shareholder pay-outs (as a percentage of the listed companies' net income) has slowed in recent years (see ibid 20).

113 See Prem Sikka and others, 'A Better Future for Corporate Governance: Democratising Corporations for Their Long-Term Success' (2018) 2, 21–25 <http://visar.csustan.edu/aaba/LabourCorpGovReview2018.pdf> accessed 22 September 2021.

114 Kay (n 83) paras ii, iv, vii, 1.6–1.9, 1.30–1.32.

115 ibid paras 1.13, 8.2.

116 EY (n 60) 15.

117 Kay (n 83) para 5.5.

118 Grant (n 81) 258.

119 BEIS Committee, *Corporate Governance* (HC 2016–17, 702) para 19 quoting FCLTGlobal, 'Rising to the Challenge of Short-termism' (2016) 5 <www.fcltglobal.org/wp-content/uploads/fclt-global-rising-to-the-challenge.pdf> accessed 24 July 2021.

purpose'[120] because companies still pursue short-term profit maximisation in times of climate change (due to shareholder pressure and at the environment's expense).[121]

4.2 COVID-19 pandemic, Brexit, the Ukraine war and an (impending) economic crisis

Another key issue for ES is that SHP is now accompanied by an (impending) economic crisis due to the pandemic. A recession worse than the global financial crisis and increasing corporate insolvencies are forecasted.[122] The pandemic's adverse economic impacts, which are still unpredictable due to the SARS-CoV-2's variants, could amplify economic short-term thinking to offset losses and to increase the short-term SHV.[123] Environmental matters could be deprioritised and returns prioritised.[124] The business case for more environmentally friendly products could also be more difficult to justify due to its (short-term) costs.

However, the pandemic has also compelled many directors to reconsider their companies' purposes and stakeholder relationships.[125] A study examining the stock price reactions of more than 6,700 companies (from January – May 2020) concluded that the declines in stock returns were milder among companies with, ia, greater pre-pandemic CSR activities.[126] The pandemic could therefore lead to an increase in CSR and ESG activities. Directors could conclude that their companies' 'survival' depends on a balance between returns and stakeholders (which could be further reinforced by a change in consumer behaviour and the awareness of climate change).[127] Nevertheless, directors could also focus more on (short-term) returns to the detriment of ES.

The economic situation of the UK is also aggravated by Brexit's unclear, ongoing economic impact and the Ukraine war. An economic outlook of the Organisation for Economic Co-operation and Development ('OECD') forecasts that the UK could suffer the largest reduction in potential output growth amongst the G7 countries due to Brexit.[128] The current low interest rates further contribute to lower budgets for CSR and ESG activities.[129]

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[120] Labour Party, 'Rewriting the Rules: Labour's Vision for Corporate Governance, Accountability, and Regulation' (2019) 4 <https://labour.org.uk/wp-content/uploads/2019/11/rewriting-the-rules.pdf> accessed 15 June 2021.

[121] ibid 4–6.

[122] Stephen Allinson, 'The Corporate Insolvency and Governance Act 2020 and Other Developments: A Brave New Insolvency and Restructuring World?' (2020) 5 Corporate Rescue and Insolvency 155, 156.

[123] cf Hongwei He and Lloyd Harris, 'The Impact of Covid-19 Pandemic on Corporate Social Responsibility and Marketing Philosophy' (2020) 116 Journal of Business Research 176, 177.

[124] cf Boeger, Russell and Villiers (n 18) 19f.

[125] FRC, 'Review' (n 42) 40.

[126] Wenzhi Ding and others, 'Corporate Immunity to the COVID-19 Pandemic' (2021) 141 Journal of Financial Economics 802, 802f, 817f.

[127] He and Harris (n 123) 177–179. See also Grant Thornton, 'Corporate Governance Review 2020' (2020) 37 <www2.grantthornton.co.uk/rs/445-UIT-144/images/Corporate_Governance_Review_2020.pdf?utm_source=mkto&utm_medium=email&utm_campaign=2020-11-00-Download-Gov-CGR-1322> accessed 9 June 2021.

[128] OECD, *OECD Economic Outlook: May 2021 (Preliminary Version)*, vol 2021 (OECD 2021) 28.

[129] Johnston (n 30) 1039.

As a result, even institutional investors with long-term perspectives are under increased pressure and could demand more short-term returns.[130]

4.3 Shareholder rights as a 'double-edged sword'

Shareholders (especially institutional investors) not only can attempt to pressure directors for (short-term) returns. They can also attempt to pressure directors to pursue more ES.[131] Additionally, there are also shareholders who are environmentalists and do not alter their demands for ES due to economic crises.

In this context, shareholders can increase the consideration of ES in directors' decision-making through various means. For instance, they can bring derivative claims against directors on behalf of their companies if the directors do not consider the environment in their decisions.[132] Shareholders may further remove a director,[133] appoint a new director due to the company's articles of association [134] or propose candidates[135] who consider the environment more strongly.[136] Shareholders may further alter the company's articles of association [137] and can, eg, oblige directors to prioritise the environment over shareholders.[138] They may also vote against a directors' remuneration policy[139] or reject the approval of the directors' remuneration report via an advisory vote.[140] Shareholders may further require the company to put their own environmental resolutions to be moved at the annual general meeting.[141] Furthermore, the shareholders may instruct the directors by special resolution[142] and institutional investors may also informally engage with directors, eg, at private meetings.[143]

Examples of these non-exhaustive rights of the last annual general meeting season are Chevron's shareholders (who voted for a shareholder proposal to reduce the emissions from its products)[144] and Rio Tinto's shareholders (who voted against a remuneration report due to, ia, its environmental damage to the Juukan Gorge).[145] Another example is

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130 Sjåfjell and others (n 8) 134, 122.

131 Kelly (n 59) 2.

132 Andrew Keay, 'The Duty to Promote the Success of the Company: Is It Fit for Purpose in a Post-Financial Crisis World?' in Joan Loughrey (ed), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar 2013) 84f.

133 Companies Act 2006, s 168(1).

134 Companies (Model Articles) Regulations 2008, SI 2008/3229, sch 3 para 1 art 20(a). See also Companies Act 2006, s 160.

135 Companies Act 2006, s 338. See also UK Corporate Governance Code 2018, Provision 18.

136 Ho (n 26) 93.

137 Companies Act 2006, ss 21(1) and 171(a).

138 n 24.

139 See Companies Act 2006, s 439A.

140 Companies Act 2006, ss 439(1) and 439(5).

141 See Companies Act 2006, ss 338, 339 and 340. See also Companies Act 2006, ss 338A, 340A and 340B.

142 Companies (Model Articles) Regulations 2008, SI 2008/3229, sch 3 para 1 art 4(1).

143 North (n 92) 180.

144 Shariq Khan, 'Chevron Investors Back Proposal for More Emissions Cuts' *Reuters* (Bengaluru, 26 May 2021) <www.reuters.com/business/energy/chevron-shareholders-approve-proposal-cut-customer-emissions-2021-05-26> accessed 27 May 2021.

145 Neil Hume, 'Rio Tinto Suffers Huge Revolt over Pay' *Financial Times* (London, 6 May 2021) <www.ft.com/content/199fbd0c-7cc0-4af0-b1a0-a4286fdd1280> accessed 3 June 2021.

ExxonMobil's shareholders (who unseated two directors to force the board to consider climate change and its risks better at the annual general meeting 2021).[146] Moreover, institutional investors' engagements were responsible for Tesco's recent health commitments.[147]

According to the UK Stewardship Code,[148] institutional investors are even expected to consider environmental factors (and particularly climate change) in their investment decisions.[149] They should enable stewardship, leading to both long-term value for their clients and the environment.[150] There are also increasing initiatives to encourage institutional investors to consider ESG matters and, eg, BlackRock announced to remove its securities from companies generating over 25% of their profits from thermal coal production.[151] Asset managers are also subject to increasing ESG legislation[152] and voluntarily commit to ESG initiatives, such as the Net Zero Asset Managers initiative.[153]

However, shareholders can, in principle, lawfully pursue their own financial objectives and are not obligated to exercise their rights for a stronger integration of ES in directors' decision-making.[154] The aforementioned shareholder rights may therefore also be exercised by the growing number of shareholders[155] seeking short-term returns.[156] It was therefore criticised that shareholder rights were the cause of the lack of companies' (economic and environmental) sustainability.[157] As long as a company does not cause any environmental scandals, has a strong financial performance and fulfils the minimum legal requirements of environmental protection laws, interventions by shareholders are even less likely.

Furthermore, ESG initiatives are voluntary and the UK Stewardship Code is merely a non-mandatory soft law,[158] leaving the actual consideration of ESG matters to the signatories' discretion.[159] As analysed,[160] institutional investors with a long-term horizon are also under

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[146] Derek Brower, 'ExxonMobil Shareholders Hand Board Seats to Activist Nominees' *Financial Times* (London, 26 May 2021) <www.ft.com/content/da6dec6a-6c58-427f-a012-9c1efb71fddf> accessed 27 May 2021.

[147] ShareAction, 'Tesco Makes Further Health Commitments in Response to Investor Engagement' (*ShareAction*, 5 May 2021) <www.shareaction.org/tesco-makes-further-health-commitments-in-response-to-investor-engagement> accessed 3 June 2021.

[148] FRC, The UK Stewardship Code (2020) <www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf> accessed 22 June 2021.

[149] UK Stewardship Code, Introduction.

[150] UK Stewardship Code, Principle 1. See also UK Stewardship Code, Principle 7.

[151] BlackRock's Global Executive Committee, 'Sustainability as BlackRock's New Standard for Investing' (*BlackRock*, January 2020) <www.blackrock.com/corporate/investor-relations/2020-blackrock-client-letter> accessed 24 June 2021.

[152] See, eg, European Parliament and of the Council Regulation 2019/2088/EU of 27 November 2019 on Sustainability-Related Disclosures in the Financial Services Sector [2019] OJ L317/1.

[153] See The Net Zero Asset Managers initiative, '273 signatories with USD 61.3 trillion in AUM' (*The Net Zero Asset Managers initiative*, 31 May 2022) <www.netzeroassetmanagers.org> accessed 21 June 2022.

[154] Sjåfjell and others (n 8) 135; Boeger, Russell and Villiers (n 18) 17.

[155] Commision, *CG-Study* (n 2) 33f.

[156] Grant (n 81) 256; Sjåfjell and others (n 8) 130.

[157] Boeger, Russell and Villiers (n 18) 16, 25f.

[158] UK Stewardship Code, Annex (UK regulatory requirements).

[159] Boeger, Russell and Villiers (n 18) 15f.

[160] n 130.

pressure nowadays. Shareholder engagement also causes additional costs for institutional investors in economically weak times[161] and activist shareholders pursuing ES are only a minority amongst shareholders. Rather, shareholders in UK companies are increasingly based overseas[162] and mainly orientated towards short-term profits because they often have minimal links to the companies' stakeholders.[163]

Moreover, the aforementioned rights require, ia, a certain number of voting rights or majorities. These conditions are difficult to fulfil, especially in companies with dispersed shareholders (and only a few activist shareholders). Due to the decreasing share proportion of long-term orientated shareholders,[164] it is questionable whether they can prevail against short-term orientated shareholders.[165] These circumstances are further exacerbated by the shareholders' heterogeneity.[166] In some cases, it is even impossible for shareholders to adopt ESG resolutions, such as at Facebook's annual general meeting, because one shareholder holds the majority of the voting shares.[167] Furthermore, an exit via the shares' sale is the simplest solution for many shareholders dissatisfied with the company's ES (instead of a costly or even impossible engagement with little expected benefits).[168]

As a result, shareholder rights do not guarantee environmentally friendly outcomes and can be considered as a 'double-edged sword'. Shareholders are therefore not expected to promote broader social welfare.[169] Finally, although shareholders can play a key role in ES, directors, who shall promote the company's success 'for the benefit of its members as a whole'[170] and not for a few shareholders,[171] are the companies' ultimate decision-makers. Sales J held in this context that a (major) shareholder can try to influence the directors to reduce commercial lending practices to companies that are environmentally harmful. Decisions concerning a company's management were nevertheless found to be matters for the judgment of its directors.[172]

4.4 Summary

There are serious barriers to the constant use of directors' discretion to promote ES. These barriers often lead, despite directors' protection and strong reasons to consider ES, to a neglect of ES in directors' decision-making. Hence, there is the danger that directors will

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161 Kelly (n 59) 19, 21.

162 Office for National Statistics, 'Ownership of UK Quoted Shares: 2018' (2020) 7 <www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2018/pdf> accessed 27 May 2021.

163 Sikka and others (n 113) 29.

164 Johnston (n 32) 212.

165 Ho (n 26) 86.

166 Yan (n 22) 55.

167 Patrick Temple-West and others, 'Amazon, Chevron, Exxon and Facebook Face Shareholder Showdowns' *Financial Times* (New York, 26 May 2021) <www.ft.com/content/d891b0ff-a618-4c5c-a09c-99e211286dfa> accessed 27 May 2021.

168 Kelly (n 59) 19.

169 Sikka and others (n 113) 18f.

170 Companies Act 2006, s 172(1).

171 HL Deb 6 February 2006, vol 678, col GC256.

172 *People & Planet (R on the application of) v HM Treasury* [2009] EWHC 3020 (Admin), 2009 WL 3829362 [5], [9[[34]. See also Staker and Garton (n 28) 38.

use their discretion to pursue increasing (the short-term) SHV by making environmentally harmful decisions (rather than pursuing ES more strongly).

5 Changes to the current legal framework

Due to the aforementioned barriers, this part will examine whether and, if so, which changes to the provisions on directors' decision-making could be needed to achieve more ES.

5.1 Need for changes

The UK has reduced its carbon emissions by over 40% since 1990, while its economy has grown.[173] However, it was found that it performed merely 'well' on 24% of all SDGs.[174] The government also acknowledged that combating climate change requires further efforts.[175] New research predicts a 6.5% decline in the UK's GDP by 2050 based on a 2.6°C temperature increase.[176] A report of the Climate Change Committee also demands a comprehensive strategy to combat climate change.[177] Moreover, the UK's net carbon account for 2050 must now[178] be at least 100% lower than 1990's baseline.[179] Furthermore, the sixth carbon budget's target is a 78% reduction in national emissions by 2035 in comparison to 1990's levels.[180] Amendments are therefore indispensable. This is globally also confirmed by the climate reports of the UN[181] and the IPCC.[182]

In this regard, as analysed,[183] companies have a crucial role to contribute to both the PA and the SDGs (as well as to combat climate change). Consequently, this also applies to directors because they are responsible for their companies' CSR and ESG activities. Negative examples of these contributions are environmental disasters caused by

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[173] HM Government, 'Green Finance Strategy: Transforming Finance for a Greener Future' (2019) 5 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/820284/190716_BEIS_Green_Finance_Strategy_Accessible_Final.pdf> accessed 7 July 2021.

[174] UK Stakeholders for Sustainable Development, 'Measuring Up: How the UK Is Performing on the UN Sustainable Development Goals' (2018) 4 <www.7593a251-ce64-48ce-ada7-0d0b99945b7c.filesusr.com/ugd/30312f_61bb4e30058c4d849d644a8ff8cc039f.pdf> accessed 29 June 2021.

[175] HM Government, 'Voluntary National Review of Progress towards the Sustainable Development Goals' (2019) 5f <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/818212/UKVNR-web-accessible1.pdf> accessed 28 May 2021.

[176] Swiss Re Institute, 'The Economics of Climate Change: No Action Not an Option' (2021) 1, 11 <www.swissre.com/dam/jcr:e73ee7c3-7f83-4c17-a2b8-8ef23a8d3312/swiss-re-institute-expertise-publication-economics-of-climate-change.pdf> accessed 16 June 2021.

[177] Climate Change Committee, *Progress in Adapting to Climate Change: 2021 Report to Parliament*, vol 2 (2021) 7.

[178] Climate Change Act 2008 (2050 Target Amendment) Order 2019, SI 2019/1056, art 2(2).

[179] Climate Change Act 2008, s 1(1).

[180] Carbon Budget Order 2021, SI 2021/750, art 2.

[181] See Report of the Secretariat 'Nationally determined contributions under the Paris Agreement' (2021) UN Doc FCCC/PA/CMA/2021/8.

[182] See IPCC, 'Sixth Assessment Report' (*IPCC*) <www.ipcc.ch/assessment-report/ar6> accessed 19 September 2021.

[183] 1.1.

companies, such as bp's oil spill, or environmental damages caused for increasing SHV.[184] A positive example is Walmart's promise regarding its reduction of greenhouse gases (which was higher than Obama's Clean Power Plan set out to achieve).[185]

Furthermore, a company's ES depends not only on environmental protection laws but also on the integration of environmental matters into directors' decision-making beyond these laws[186] and territorial environmental protection laws often remain insufficient.[187] Evidence of this is the historical lack of their enforcement and improvement in developing countries.[188] Additionally, the current legal framework is co-responsible for the social norm of SHP and its adverse environmental impacts.[189] Therefore, amendments to company law and Corporate Governance are imperative to achieve more ES.[190] They would be a symbiotic and necessary complement to environmental protection laws.

5.2 Reporting duties

After a consultation regarding obligatory TCFD disclosures by publicly quoted companies (to achieve net zero emissions in the UK),[191] BEIS announced to enshrine mandatory TCFD-aligned requirements for the largest companies (and financial institutions) in law[192] and published its consultation response.[193] The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 – was enacted in this context and came into force

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184 See n 105–110.

185 Walmart, 'Walmart Launches New Reusable Bag Campaign; Announces 93 Million Metric Tons of Supplier Emission Reductions through Project Gigaton and Announces New Sustainable Textile Goals' (*Walmart*, 10 April 2019) <www.corporate.walmart.com/newsroom/2019/04/10/walmart-launches-new-reusable-bag-campaign-announces-93-million-metric-tons-of-supplier-emission-reductions-through-project-gigaton-and-announces-new-sustainable-textile-goals> accessed 17 May 2021. See hereto Kim (n 54) 190 fn 4.

186 n 8.

187 For instance, numerous environmental protection laws only apply territorially and their territorial scopes can therefore be circumvented by companies utilising different locations due to globalisation (see Kim (n 54) 190). Further obstacles to national environmental protection laws are *the forum non conveniens doctrine*, the distinct legal personality of parent companies and the rare lifting of the corporate veil. See Jennifer A Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (Cambridge University Press 2006) ch 5 regarding these further obstacles.

188 UN Human Rights Council 'A Framework for Business and Human Rights Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises' (7 April 2008) UN Doc A/HRC/8/5 paras 12, 34f.

189 See 4.1.

190 Johnston (n 30) 1004f; Boeger, Russell and Villiers (n 18) 33; Johnston and others (n 96) having the same opinion.

191 See n 13.

192 BEIS, 'UK to Enshrine Mandatory Climate Disclosures for Largest Companies in Law' (GOV.UK) <www.gov.uk/government/news/uk-to-enshrine-mandatory-climate-disclosures-for-largest-companies-in-law> accessed 11 November 2021.

193 BEIS, 'Consultation response: Mandatory climate-related financial disclosures by publicly quoted companies, large private companies, and LLPs' (2021) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1029354/tcfd-consultation-government-response.pdf> accessed 14 November 2021.

on 6 April 2022. Companies subject to the Listing Rules are also in scope of this new framework.[194]

Moreover, the consultation on providing the FRC's successor body – Audit, Reporting and Governance Authority ('ARGA') – contained the proposal to provide ARGA with, ia, investigative and sanctioning powers regarding directors' reporting obligations. This consultation also addressed the disclosure of an audit and assurance policy.[195] A '3-Year Plan' was revealed in this context in 2022.[196] Due to the aforementioned amendments, it is questionable whether these upcoming amendments would generally be sufficient to achieve more ES in the future.

However, the current sustainability approach in the form of information disclosures does not change the necessity for further amendments.[197] This is because most of the disclosures are narrative. Although narrative disclosures can be beneficial, as with the extended auditor's report,[198] they can be exploited because directors can decide how these narrative disclosures are drafted, in principle.[199] A critical example of this is the sustainability report of a steel and mining company: It highlights the prohibition of discharging chemical products into sewage systems as one of the company's 'Fundamental Environmental Requirements', although this merely reflects environmental protection laws.[200] Another example is the annual report of a betting and gaming company that stated it would compensate the company's carbon emissions by financing a biogas project but did which not provide descriptions of the project status or any figures at this time.[201]

Numerous studies[202] and legal scholars[203] therefore criticise narrative disclosures for window-dressing, greenwashing and boilerplate possibilities. For example, the ASB criticised CSR reports for containing 'immaterial clutter'.[204] According to a study using

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194 See also Gareth Rees and others, 'New Climate-Related Financial Disclosures for Private Companies and LLPs' (*The Harvard Law School Forum on Corporate Governance*, 19 June 2022) <www.corpgov.law.harvard.edu/2022/06/19/new-climate-related-financial-disclosures-for-private-companies-and-llps/#more-146768> accessed 21 June 2022.

195 BEIS, Restoring Trust in Audit and Corporate Governance: Consultation on the Government's Proposals (CP 382, 2021) chs 5.1, 3.2. See also Jung (n 80) 62.

196 See FRC, 'Financial Reporting Council: Draft 3-Year Plan' (2022) <https://www.frc.org.uk/getattachment/50d6616f-e43d-49ad-9916-a9f03f0e49a9/FRC-3-Year-Plan-2022-25.pdf > accessed 20 June 2022.

197 Johnston (n 32) 216f having the same opinion.

198 FRC, 'Extended Auditor's Reports: A Further Review of Experience' (2016) 4 <www.frc.org.uk/getattachment/76641d68-c739-45ac-a251-cabbfd2397e0/Report-on-the-Second-Year-Experience-of-Extended-Auditors-Reports-Jan-2016.pdf> accessed 4 June 2021. See also Jung (n 80) 58.

199 Belcher (n 77) 161f.

200 EVRAZ, 'For a Better Future: Sustainability Report 2020' (2021) 51 <www.evraz.com/upload/iblock/bb9/EVRAZ_SR_2020_eng_final.pdf> accessed 7 July 2021.

201 However, a clear ES strategy was announced for 2021 and the sustainability section of the homepage was updated. See Flutter Entertainment, 'Changing the Game: Annual Report & Accounts 2020' (2021) 36, 9 <www.flutter.com/sites/paddy-power-betfair/files/Annual%20reports/annual-report-and-accounts-2020.pdf> accessed 25 June 2021. See in this context Jung (n 80) 60.

202 See, eg, Wang, Hsieh and Sarkis (n 57) 66–77; Kemi C Yekini, Kamil Omoteso and Emmanuel Adegbite, 'CSR Communication Research: A Theoretical-Cum-Methodological Perspective from Semiotics' (2021) 60 Business & Society 876, 877–903 including further studies. See also Jung (n 80) 59.

203 See, eg, Johnston (n 32) 217; Villiers and Tsagas (n 4) 92f including further references.

204 ASB, 'Rising to the Challenge: A Review of Narrative Reporting by UK Listed Companies' (2009) 3, 11 <www.iasplus.com/en/binary/uk/0910narrativereporting.pdf> accessed 4 June 2021.

semiotics, 44% of the reporting on community projects were doubtful.[205] Another study found that companies with weak CSR performance used complicated language to mitigate reactions to the negative information disclosed.[206] The FRC further criticised companies for focusing on positive information, insufficiently explaining how to achieve emission targets and often not providing comparisons with previous targets.[207]

This criticism is further reinforced by annual reports' increasing lengths, which can be used to generate an information overload to obscure information.[208] Finally, there is often an absence of third-party assurances in ES disclosures and many verifications are inadequate (eg, the TCFD disclosures required by the new Listing Rules did not require a third-party assurance).[209] In summary, increasing and improving reporting obligations of the UK's company law is important but alone insufficient to ensure that directors seriously consider ES.

5.3 Engagement with an environmental organisation

Legal scholars discuss possible amendments to increase sustainability in directors' decision-making, such as the enshrinement of a duty to develop a sustainability strategy.[210] Another proposal suggested the establishment of a new body, accompanied by a duty of environmental care for directors. This body would set environmental targets for companies and have disciplinary powers.[211] Furthermore, the Labour Party proposed that directors should promote the company's success for both shareholders' and stakeholders' benefits, including the environment.[212] A similar proposal is advocated by the Better Business Act Initiative.[213]

5.3.1 Proposal

A new principle for the UK Corporate Governance Code 2018 can be derived from the aforementioned ideas. Companies would be required to publish a statement explaining the application of this principle in their annual reports.[214] The principle could read as follows:

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205 Yekini, Omoteso and Adegbite (n 202) 877–903 regarding FTSE100 companies.

206 Wang, Hsieh and Sarkis (n 57) 66–77 regarding public companies of the United States of America. However, this did not apply to the International Organization for Standardization's environmental standards.

207 FRC, 'Climate Thematic: November 2020' (2020) 8f <www.frc.org.uk/getattachment/ab63c220-6e2b-47e6-924e-8f369512e0a6/Summary-FINAL.pdf> accessed 13 July 2021.

208 Wang, Hsieh and Sarkis (n 57) 67.

209 FCA (n 79) paras 3.64–3.69. See also BEIS, 'Frameworks for Standards for Non-Financial Reporting' (Research Paper 2020/052, 2020) 53 <http://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/935097/frameworks-for-standards-for-non-financial-reporting.pdf> accessed 27 July 2021; n 314.

210 Johnston and others (n 96); Boeger, Russell and Villiers (n 18) 24f.

211 Grant (n 81) 262–264.

212 Labour Party (n 120) 7.

213 Better Business Act Initiative, 'The Better Business Act' (*Better Business Act*, 9 April 2021) <www.betterbusinessact.org/wp-content/uploads/2021/04/The-Better-Business-Act-2021.pdf> accessed 7 July 2021.

214 Listing Rules, 9.8.6 R(5).

'The board should prepare and agree with a state-recognised environmental organisation on at least five environmental sustainability objectives for the company. These objectives should include, ia, climate change mitigation targets, such as science-based emissions reduction targets (including scope 1, 2 and 3 targets), if available. These objectives should be achievable, measurable, material and updated regularly. They should go beyond mere compliance with environmental protection laws. In fulfilling the duty under section 172 of the Companies Act 2006, the board should consider each company's individual environmental sustainability objectives. The agreed objectives should be published on the company's website. Both achievements and deviations from them should be explained. If an agreement with an environmental organisation is not achieved and science-based emissions reduction targets are not set, the board should explain the reasons and its own environmental sustainability objectives on the company's website.'

Apart from science-based emissions reduction targets,[215] such objectives could include, ia, to produce products primarily from a high proportion of recycled and sustainable materials. Guidance concerning the objectives could be published by, eg, the Office for Environmental Protection ('OEP'). Some objectives could relate to the proportion of a company's turnover derived from environmentally sustainable economic activities. The European Union's Taxonomy-Regulation requires such disclosures from companies (obliged to publish a non-financial information statement).[216] The UK is expected to enact its own, similar legislation in the near future.[217]

An example of a company that adopted a similar approach is Tesco. It has partnerships with, ia, the environmental organisation Hubbub. Furthermore, Tesco announced, ia, funds for the Cerrado region to become a zero-deforestation region for soy (with detailed information about the project).[218] Furthermore, Tesco was the first FTSE100 company to commit to science-based targets in line with the PA's 1.5C target.[219] Another example is

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[215] See Science Based Targets, 'Ambitious Corporate Climate Action' (*Science Based Targets*, 21 June 2021) <www.sciencebasedtargets.org> accessed 20 June 2022.

[216] European Parliament and Council Regulation (EU) 2020/852 of 18 June 2020 on the Establishment of a Framework to Facilitate Sustainable Investment, and Amending Regulation (EU) 2019/2088 [2020] OJ L198/13, art 8(2)(a).

[217] See, ia, FCA, 'Sustainability Disclosure Requirements (SDR) and Investment Labels: DP21/4' (2021) <www.fca.org.uk/publication/discussion/dp21-4.pdf> accessed 10 February 2022, FCA, 'Enhancing Climate-Related Disclosures by Asset Managers, Life Insurers and FCA-Regulated Pension Providers: PS21/24' (2021) <www.fca.org.uk/publication/policy/ps21-24.pdf> accessed 10 February 2022. In addition to this, see also FCA, 'A Strategy for Positive Change: Our ESG priorities' (*FCA*, 12 April 2022) <www.fca.org.uk/publications/corporate-documents/strategy-positive-change-our-esg-priorities> accessed 21 June 2021, BEIS, 'Open Consultation Update to Green Finance Strategy: Call for Evidence' (*GOV.UK*, 12 May 2022) <www.gov.uk/government/consultations/update-to-green-finance-strategy-call-for-evidence/update-to-green-finance-strategy-call-for-evidence-accessible-webpage#consultation-questions> accessed 21 June 2021.

[218] See Tesco, 'Tesco Announces Support for Funding to Protect Cerrado Region in Brazil' (*Tesco*, 6 December 2019) <www.tescoplc.com/news/2019/support-for-funding-to-protect-cerrado-region-in-brazil> accessed 25 June 2021; Tesco, 'Food Waste: Environment' (*Tesco*, 19 October 2020) <www.tescoplc.com/sustainability/taking-action/environment/food-waste> accessed 25 June 2021.

[219] See Tesco, 'Climate Change' (*Tesco*, 21 June 2021) <www.tescoplc.com/sustainability/planet/climate-change> accessed 21 June 2022.

adidas. It established detailed environmental data recording and aims to achieve annual targets for, ia, water consumption and printing paper consumption.[220]

5.3.2 Benefits

ES would be considered more seriously in directors' decision-making. This would enhance the achievements of the SDGs and the PA. The SHV can even increase through, ia, the possibility to positively report on the objectives achieved. Moreover, all other analysed benefits apply.[221] The examples analysed earlier[222] demonstrate how the proposed principle could also improve poor narrative reporting through measurable and updated targets. The low ranking of many companies in Tortoise Media's 'Responsibility100 Index' regarding climate action is a further indication that the principle could support the ES of these companies.[223] Moreover, the objective's measurability would complement the reporting obligations concerning non-financial key performance indicators[224] and the TCFD disclosures' fourth pillar.[225] The annual objectives would discourage box-ticking approaches (as observed in minutes regarding the consideration of the factors listed in the ESV).[226]

As a result, the UK's company law would be more pluralistic without enshrining radical changes. Although combating climate change is urgent, a 'softer' amendment (due to changes to the UK Corporate Governance Code 2018 instead of the Companies Act 2006) would be more in line with the UK's flexible and relatively non-interventionist approach.[227] Since the UK Corporate Governance Code 2018 even emphasises stakeholder relationships, the principle would complement its recent changes. It is also more likely not to be watered down, in contrast to the announcement to enshrine a mandatory workforce representation on boards.[228] This principle could therefore receive more political acceptance than a sudden, drastic change.[229]

Due to the application via the Listing Rules, the principle would go further than voluntary certifications, such as the B Corporation certification, or the voluntary establishment of a Community Interest Company.[230] Additionally, by developing the objectives with an

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220 adidas, 'Green Company Performance Analysis 2020' (2021) <www.adidas-group.com/media/filer_public/f8/10/f8105750-28cb-4a13-9e2c-7031785b2c92/adidas_gcr_2020_en.pdf> accessed 22 September 2021.

221 See 3.1. and 3.2.

222 See 5.2.

223 Tortoise Media, 'Responsibility100 Index' (*Tortoise*, 29 April 2021) <www.tortoisemedia.com/intelligence/responsibility> accessed 20 June 2022.

224 See, eg, Companies Act 2006, ss 414C(4) and 414CB(2)(e).

225 BEIS (n 13) 13, 25.

226 Tsagas (n 84) 136; David Hunter, 'The Arrival of B Corps in Britain: Another Milestone Towards a More Nuanced Economy?' in Nina Boeger and Charlotte Villiers (eds), *Shaping the Corporate Landscape: Towards Corporate Reform and Enterprise Diversity* (Hart Publishing 2018) 261. See also Joan Loughrey, Andrew Keay and Luca Cerioni, 'Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance' (2008) 8 Journal of Corporate Law Studies 79, 106.

227 See Tsagas (n 84) 141–146 for the justification of her proposal to enshrine a stakeholder dialogue principle in the UK Corporate Governance Code 2016. See also Boeger, Russell and Villiers (n 18) 20. However, see Millon (n 7) 78. Boeger, Russell and Villiers (n 18) 22 for a differing view.

228 BEIS Committee (n 119) para 141.

229 Tsagas (n 84) 142 regarding her proposal.

230 Companies (Audit, Investigations and Community Enterprise) Act 2004, s 26; Companies Act 2006, s 6.

environmental organisation and the development of science-based emissions reduction targets, it would not be left to the directors alone to establish objectives. This would also reduce the possibility of intentionally setting low objectives.

Requiring science-based emissions reduction targets and also the official state recognition of environmental organisations would ensure the organisations' integrity and agreements on achievable objectives. Furthermore, the organisations have substantial expertise in the science of ES. The lack of expertise was criticised in the context of the FRC's reviews on climate change reporting[231] and could also be the case with the ARGA. This expertise would also reduce greenwashing. Furthermore, the OEP could publish non-achievements and misleading information through a name-and-shame mechanism as an incentive to achieve the objectives.

5.3.3 Challenges

It could be difficult to balance (often conflicting) interests, such as the shareholders' interests with those of the environment (or ES with the other stakeholders' interests).[232] Furthermore, the ES objectives could lead to short-term decreases in SHV due to their costs. This places additional burdens on financially distressed companies. For this reason, even the TCFD disclosures' additional costs during the pandemic were criticised in the context of the new Listing Rule,[233] despite investors' demand for them and the positive cost-benefit analysis.[234]

The objectives could also increase agency costs because directors could exploit the objectives to pursue personal aims and to enhance their own reputation due to their greater discretion to pursue ES.[235] However, the proposed principle would neither alter shareholder rights nor the ESV. Shareholders would therefore continue to have great power over directors. Moreover, the position of only one stakeholder (the environment) would be strengthened (which is indispensable) and not the position of several stakeholders.

Since directors should prepare the ES objectives, they must have expertise. This can lead to difficulties in finding directors with relevant backgrounds. It also causes costs for directors' training[236] and the objectives' preparation. Conversely, greater involvement of directors also means that the objectives are company-specific. The intended dialogue with the environmental organisation can further help to predict upcoming market trends,[237] such as new products, and new technologies. However, it must be ensured that the organisation does not receive confidential information.

Listed companies already have difficulties in implementing a workforce engagement mechanism. According to a review of the FRC from November 2020, more than 30% of 280

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[231] Villiers and Tsagas (n 4) 83f.
[232] FRC, 'Guidance' (n 47) para 43.
[233] FCA (n 79) paras 3.97–3.99.
[234] ibid paras 3.92, 3.96.
[235] Ding and others (n 126) 817. See also Kim (n 54) 194f.
[236] cf Staker and Garton (n 28) 16; Villiers and Tsagas (n 4) 90.
[237] FRC, 'Guidance' (n 47) para 42.

FTSE350 companies did not adopt any of the new workforce engagement mechanisms and only 0.6% chose its strongest form (a workforce director).[238] However, if a company breaches a Listing Rules (eg, through misleading disclosures of how a principle was applied), the FCA is able to, ia, impose a fine[239] or to delist the company.[240] Additionally, positive disclosures about the companies' achievements can lead to market pressure and the acceptance of the principle amongst other listed companies. Since more than 80% of the FTSE350 companies expressed in 2020 that their reasons for their existence were beyond mere returns,[241] a high acceptance of the principle can be expected. This is further reinforced by the societal awareness of ES and corporate pledges to reduce emissions.[242]

Voluntary measures can also be effective as threats (if the threats are credible) to change a conduct before legislators impose hard laws.[243] For instance, Norway introduced a mandatory gender quota for boards of public limited companies after companies had failed to comply with a voluntary quota.[244] Thus, if many companies do not satisfactorily apply the principle, it could still be enshrined in the Companies Act 2006 with strict penalties. However, an enshrinement in the Companies Act 2006 could result in a lack of resources for the environmental organisations and the subsequent need to introduce a new body.

In addition to the aspects mentioned above, it must be noted that SHP has multiple roots, which was already examined.[245] The principle's mere enshrinement in the UK Corporate Governance Code 2018 is unable to entirely solve the complex issues of ES and SHP. For instance, only 10% of the FTSE350 companies used environmental or climate change metrics in their executive remuneration between April 2019 – April 2020.[246] Thus, directors' remuneration incentives should be more closely aligned with ESG goals.[247] Reporting laws also require amendments to achieve greater ES, such as credible, extended external assurances. Legal scholars also discuss other amendments, such as an explicit statement in company law regarding companies' societal purpose and interests.[248] Finally, there must be an official process to ensure that only certain environmental organisations are 'state-recognised'.

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238 FRC, 'Review' (n 42) 30.

239 Financial Services and Markets Act 2000, s 91(1).

240 Financial Services and Markets Act 2000, ss 77(1) and 77(2).

241 Grant Thornton (n 127) 6.

242 FRC, 'Review' (n 42) 38.

243 See Heike Mensi-Klarbach, Stephan Leixnering and Michael Schiffinger, 'The Carrot or the Stick: Self-Regulation for Gender-Diverse Boards via Codes of Good Governance' (2021) 170 Journal of Business Ethics 577, 587–589 <http://link.springer.com/content/pdf/10.1007/s10551-019-04336-z.pdf> accessed 22 September 2021 regarding self-regulation of gender diversity on boards through CG codes.

244 Norwegian Public Limited Liability Companies Act, s 6-11a (*Lov om allmennaksjeselskaper*). See Linda Senden, 'The Multiplicity of Regulatory Responses to Remedy the Gender Imbalance on Company Boards' (2014) 10 Utrecht Law Review 51, 56f.

245 See 4.1.

246 Grant Thornton (n 127) 2, 7, 37.

247 cf Yan (n 22) 59.

248 Sjåfjell and others (n 8) 145.

5.4 Summary and the European Union's 'Sustainable Corporate Governance Initiative'

Corporate Governance should, in accordance with Sir Adrian Cadbury's definition, be increasingly concerned 'with holding the balance between economic and social goals' and align 'the interests of individuals, corporations, and society' closer.[249] Otherwise, the SDGs' and the PA's achievements could be jeopardised**.** This applies all the more because after the European's 'Sustainable Corporate Governance Initiative' was announced,[250] a proposal on corporate sustainability due diligence was recently adopted.[251] According to this proposal,

> '*Member States shall ensure that, when fulfilling their duty to act in the best interest of the company, directors of companies (…) [in scope] 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.*'[252]

Furthermore,

> '*Member States shall ensure that companies (…) shall 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. This plan shall, in particular, identify, on the basis of information reasonably available to the company, the extent to which climate change is a risk for, or an impact of, the company's operations.*'[253]

In addition to that

> '*Member States shall ensure that, 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 includes emission reduction objectives in its plan*'[254]

and it shall be ensured that

> '*companies duly take into account the fulfilment of the obligations (…) when setting variable remuneration, if variable remuneration is linked to the contribution of a director to the company's business strategy and long-term interests and sustainability.*'[255]

These legislative efforts of the European Union should further encourage the UK to reconsider amendments to be competitive in the future. In this context, the principle proposed by this paper would both promote ES in directors' decision-making and suit the UK's approach. Disclosures, naming-and-shaming, science-based emissions reduction

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249 Foreword by Sir Adrian Cadbury in Magdi R Iskander and Nadereh Chamlou, *Corporate Governance: A Framework for Implementation* (World Bank 2000) vi.

250 Commission, *CG-Study-Annex* (n 105) 149–165.

251 Commission, 'Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937' COM (2022) 71 final.

252 ibid art 25(1).

253 ibid art 15(1).

254 ibid art 15(2).

255 ibid art 15(3).

targets and the environmental organisations' expertise could aid the serious application of the principle. As a result, companies would internalise their externalities to a greater extent and their commercial functioning would not be overshadowed by ES.[256]

Nevertheless, the proposed principle is also not free of obstacles and should be considered as an advent for further necessary changes. This is because more than 99% of all UK companies are medium- or even small-sized and employ fewer than 250 employees.[257] Although listed companies have a role model function that can influence society as a whole,[258] amendments applying only to listed companies are therefore merely a starting point. As a next step, the proposed principle could also be embodied in the Wates CG Principles, which refer to stakeholder engagement and companies' environmental impacts.[259]

6 Conclusion and prospects

This paper examined whether UK's Corporate Governance provisions on considering the environment promote ES in directors' decision-making. As analysed,[260] companies have a crucial role to contribute to both the PA and the SDGs. Consequently, this also applies to directors because they are responsible for their companies' CSR and ESG activities. Negative examples of these contributions are environmental disasters caused by companies, such as bp's oil spill, or environmental damages caused for increasing SHV.[261] A positive example is Walmart's promise regarding its reduction of GHG (which was higher than Obama's Clean Power Plan[262] set out to achieve[263]).[264]

The legal framework, accompanied by both the business case of ES and corporate reporting, and the BJR ensure a broad discretion to pursue ES. Nevertheless, the consideration of ES is not always guaranteed and directors are also protected from judicial reviews of environmentally harmful decisions. For instance, it is possible to discuss a decision's adverse environmental impact and nevertheless decide in favour of this decision for increasing SHV (provided it complies with environmental protection laws and the company's constitution).[265] The directors had regard to their company's environmental impact in this example. However, in accordance with the law, the directors decided to harm

[256] cf Grant (n 81) 264f.

[257] Climate Change Committee (n 177) 238.

[258] Beate Sjåfjell and Linn Anker-Sørensen, 'Directors' Duties and Corporate Social Responsibility (CSR)' in Hanne Søndergaard Birkmose, Mette Neville and Karsten Engsig Sørensen (eds), *Boards of Directors in European Companies: Reshaping and Harmonising Their Organisation and Duties* (Kluwer Law International 2013) 155.

[259] FRC, The Wates Corporate Governance Principles for Large Private Companies 2018 (December 2018) Principle Six <www.frc.org.uk/getattachment/31dfb844-6d4b-4093-9bfe-19cee2c29cda/Wates-Corporate-Governance-Principles-for-LPC-Dec-2018.pdf> accessed 21 June 2022.

[260] See 1.1.

[261] See 4.1.

[262] United States Environmental Protection Agency, 'Overview of the Clean Power Plan' (2015) 1–8 <https://archive.epa.gov/epa/sites/production/files/2015-08/documents/fs-cpp-overview.pdf> accessed 22 June 2021.

[263] Kim (n 54) 190 fn 4.

[264] Walmart (n 185).

[265] Loughrey, Keay and Cerioni (n 226) 106; Staker and Garton (n 28) 39.

the environment to increase SHV.[266] This is because it is at the directors' discretion to exercise their business judgment in determining how best to promote the company's success.[267] In addition to this, further legal, economic and practical barriers (SHP, the pandemic, Brexit, the Ukraine war and shareholder rights) can lead to continuing or even more environmental damages in the future due to greater pressure to increase (the short-term) SHV to the detriment of ES.

Hence, the UK's Corporate Governance provisions on considering the environment can only partially promote ES in directors' decision-making. This paper therefore proposed an amendment to the UK Corporate Governance Code 2018 as a starting point to support the UK's current disclosure approach. This principle would require an engagement with an environmental organisation to agree on company-specific and scientific ES objectives because climate change's urgency, the SDGs and the PA do not only require changes to environmental protection laws. Consequently, ES would be considered more seriously in directors' decision-making. This proposal should be taken into account in the next revision of the UK Corporate Governance Code 2018. In this regard, further research should also consider the impact of the integration of ESG factors in the remuneration of directors as well as the future impacts of green financing, sustainable investing, sustainability disclosure requirements, investment labels and the UK's relevant initiatives.

[266] Peter Neil Taylor, 'Enlightened Shareholder Value and the Companies Act 2006' (PhD thesis, Birkbeck 2010) 174 <www.silo.tips/download/birkbeck-college-enlightened-shareholder-value-and-the-companies-act-thesis-subm> accessed 12 July 2021.

[267] *Regentcrest plc (in liq) v Cohen* [2001] 2 BCLC 80 (Ch) [120]. See hereto David Drake, 'Directors' Duties' in Victor Joffe and others (eds), *Minority Shareholders: Law, Practice and Procedure* (4th edn, Oxford University Press 2011) para 2.17.

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