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The Levers of Sustainability: The EU Directive on Corporate Sustainability Due Diligence in Comparison to US Law

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ABSTRACT

In February 2022, the European Commission proposed a far-reaching and comprehensive directive on corporate sustainability due diligence (the "Directive"). This Article describes the Directive, compares it to sustainability efforts in the US, and offers observations and critiques about both the Directive and US law. The comparison reveals several primary takeaways. First, likely owing to their significantly different social and political cultures, the EU Directive goes far beyond any US sustainability efforts. Second, and relatedly, the Directive is part of a rapidly progressing EU sustainability framework, which embraces sustainability as a stand-alone goal. In the US, however, considerations of sustainability are almost always framed within a financial paradigm, which distracts policy discussions and stalls regulatory efforts. Third, the Directive applies to companies based on size and industry. Enacting a rule with similar coverage would be difficult in the US because the corporate and securities laws on which sustainability obligations would most likely be based are jurisdictionally fragmented. Finally, in a departure from its usual hesitancy in the area, the US experimented with human-rights due diligence a decade ago, with the so-called conflict minerals rule. The rule failed for a range of reasons—political, structural, and regulatory—which still resonate and provide grounds for caution about the potential of the Directive to significantly improve human rights.

Keywords: EU Directive on Corporate Sustainability Due Diligence; Sustainability; Due Diligence; Comparative Law; Shareholder Primacy; Stakeholder Theory; Conflict Minerals Rule; Fiduciary Duties

Introduction

In February 2022, the European Commission proposed a far-reaching and comprehensive directive on corporate sustainability due diligence (the "Directive").[1] The Directive is currently in the approval stages at the Council of the European Union and the European Parliament.[2] This

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[1] European Commission, Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 [hereinafter the "Directive"]. The Directive builds on human rights due diligence rules in place in some members states. *See* Malcolm Rogge, *Risk, Uncertainty, and the Future of Corporate Human Rights Due Diligence*, Corporate Responsibility Initiative Working Paper Series 2022.81, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4317128&dgcid=ejournal_htmlemail_corporate%3Alaw%3Acorporate%3Afinancial%3Alaw%3Ainterdisciplinary%3Aapproaches%3Aejournal_abstractlink.

[2] European Commission, Corporate Sustainability Due Diligence, Fostering Sustainability in Corporate Governance and Management Systems, https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-

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Article describes the Directive, compares it to sustainability efforts in the US, and offers observations and critiques about both the Directive and US law.

The comparison reveals several primary takeaways. First, there is nothing like the Directive in the US, nor will something like it appear anytime soon. The Directive results from a political and cultural consensus that sustainability is a corporate obligation. In the US, this principle is much more controversial. It is, in fact, a wedge issue between the major political parties. Second, and relatedly, while the Directive is part of a web of integrated sustainability laws, US law remains focused solely on financial matters. Officers and directors owe fiduciary duties to maximize shareholder value (rather than operate sustainably), and there are no sustainability-related disclosure responsibilities. There is a movement in the US to update corporate and securities laws to include sustainability, but there are significant headwinds. While there are signs that US corporations are acting more sustainably, this shift results from pressure from employees, customers, and shareholders rather than regulation.

Third, there is a structural problem with mandating sustainability in the US. The Directive applies to all EU companies over a certain size, as well as companies that do substantial business in the EU. Because of the fragmented structure of US law, which depends on the state of formation and whether a company has public investors, the US could not easily impose such broad-based and even-handed obligations. Finally, the US experimented with a substantive due diligence obligation, Section 1502 of Dodd Frank, which required public companies to trace and report the extent to which their products contained conflict minerals originating from the Congo region of Africa (the "conflict minerals rule").[3] The rule failed—and is no longer enforced—largely because of political resistance, but also because companies failed to engage in meaningful conflict-mineral tracing and disclosure. While the Directive improves upon the conflict minerals rule, it suffers from some of the same problems—some of which are inherent in sustainability due diligence—which threaten to compromise the Directive's effectiveness.

I. The European Commission's Proposal on Corporate Sustainability Due Diligence

The Directive is ambitious in both its substance and scope.[4] This section outlines the requirements of the rule and the companies bound to comply.

A. Procedural Status

This Directive is a proposal of the European Commission. To become law, it must be approved by both the Council of the European Union, which consists of the government

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sustainability-due-diligence_en. The European Parliament approved the Directive on June 1, 2023 without major modifications. *See infra* note 7.

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, § 1502 (2010) [hereinafter Dodd-Frank Act].

[4] Aoife White, Alberto Nardelli and Stephanie Bodoni, *Unethical Firms Risk Massive Bills in EU Supply-Chain Crackdown*, Bloomberg (Feb. 21, 2022), https://www.bloomberg.com/news/articles/2022-02-21/unethical-firms-risk-massive-bills-in-eu-supply-chain-crackdown#xj4y7vzkg (quoting Richard Gardiner of Global Witness, as declaring that the Directive is "a watershed moment for human rights and the environment").

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ministers of each member state,[5] and the European Parliament, which consists of 705 members elected within each member state.[6] The European Parliament has approved the Directive.[7] Once approved by the Council of the European Union, the Directive is not immediately binding on EU countries but rather, upon adoption, must be incorporated into the law of EU members states.

B. Substantive Due Diligence Requirements

The centerpiece of the rule is that companies must engage in the necessary due diligence to "identify actual and potential adverse human rights impacts and adverse environmental impacts arising from their own operations or those of their subsidiaries and, where related to their value chains, from their established business relationships."[8]

A company's value chain includes all "activities related to the production of goods or the provision of services by a company, including the development of the product or the service and the use and disposal of the product as well as the related activities of upstream and downstream established business relationships of the company."[9] The above language covers the entire lifecycle of a company's products. Consider a Philips light bulb. All corporate activities and activities by companies in the supply chain for producing the light bulb would be captured. The rule would also capture activities related to disposal of used lightbulbs and any companies engaged in such disposal.

The rule defines "adverse human rights impacts" and "adverse environmental impacts" by reference to its Annex. The Annex, in turn, lists international agreements, the violation or potential violation of which are the subject of the due diligence obligations.[10]

For instance, Part I of the Annex, the human rights annex, lists 21 international human rights agreements and 22 human rights and fundamental freedom conventions. The first is the Universal Declaration of Human Rights. This applies to all members of the United Nations, but

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[5] European Union, Council of the European Union, https://european-union.europa.eu/institutions-law-budget/institutions-and-bodies/search-all-eu-institutions-and-bodies/council-european-union_en.
[6] MEPS European Parliament, https://www.europarl.europa.eu/meps/en/home.
[7] Huw Jones, *EU Parliament Backs Company Checks on Suppliers for Human Rights Abuses*, Reuters (June 1, 2023) ("Parliament voted 366 in favour, with 225 against"), https://www.reuters.com/sustainability/eu-parliament-backs-company-checks-suppliers-human-rights-abuses-2023-06-01/. The EU Parliament's version includes, among other things, some modifications to the size thresholds of companies subject to the Directive. *See* Hogan Lovells, *Human Rights Due Diligence Moves Apace with the EU Parliament Expanded Version of the Proposed CSDDD*, Lexology (June 8, 2023), https://www.lexology.com/library/detail.aspx?g=6cce3e54-3c43-44af-a2bd-fefcf7fe8415; Huw Jones, *EU Lawmakers Back Human Rights, Environmental Checks for Big Companies*, Reuters (April 25, 2023), https://www.reuters.com/business/environment/eu-lawmakers-back-human-rights-environmental-checks-big-companies-2023-04-25/; European Parliament, Amendments adopted by the European Parliament on 1 June 2023 on the Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, https://www.europarl.europa.eu/doceo/document/TA-9-2023-0209_EN.html.
[8] Directive, Article 6(1).
[9] *Id.* at Article 3(g).
[10] European Commission, Annex to the Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 [hereinafter the Annex].

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is not binding.[11] The first article states that "[a]ll human beings are born free and equal in dignity and rights. They are endowed with reason and conscience and should act towards one another in a spirit of brotherhood."[12]

The Directive transforms this aspirational soft-law obligation into hard law. A company would need to conduct due diligence to ascertain whether any of its activities, or activities in its value chain, violate or potentially violate, this principle. As is typical of non-binding international accords, identifying violations will be difficult and subjective.

Climate change is the environmental challenge of our time, but it is not directly addressed through the substantive due diligence requirement. The Annex, Part II, includes 12 "Internationally Recognized Objectives and Prohibitions Included in Environmental Conventions."[13] The conventions are not as far-reaching as one might imagine. They have to do with, among other things, the handling of hazardous waste, mercury, and other chemicals.

The Directive addresses climate change from a different angle. It requires certain companies (discussed below) to adopt a plan to conform to the Paris Agreement:

> "Member States shall ensure that companies referred to in Article 2(1), point (a), and Article 2(2), point (a), 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."[14]

> "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."[15]

In sum, covered companies would be required to adopt a plan for operating their business in conformity with the Paris Agreement and a plan for reducing emissions if emissions are a principal risk or impact of the company.

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[11] *See* United Nations, Declaration on Human Rights Defenders, https://www.ohchr.org/en/special-procedures/sr-human-rights-defenders/declaration-human-rights-defenders#:~:text=The%20Declaration%20is%20not%2C%20in,on%20Civil%20and%20Political%20Rights, ("The Declaration is not, in itself, a legally binding instrument. However, it contains a series of principles and rights that are based on human rights standards enshrined in other international instruments that are legally binding").
[12] United Nations, Universal Declaration of Human Rights, https://www.un.org/en/about-us/universal-declaration-of-human-rights.
[13] Annex, Part II.
[14] Directive, Article 15(1).
[15] *Id.* at Article 15(2). The Directive also links the corporation's climate change plan to compensation: "Member States shall ensure that companies duly take into account the fulfilment of the obligations referred to in paragraphs 1 and 2 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." *Id.* at Article 15(3).

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What constitutes "due diligence" into companies' adverse human rights and environmental impacts is defined in Articles 5 through 11.[16] The core obligation is that companies develop a code of conduct. Ostensibly, this code of conduct companies adopt will demand compliance with the international agreements listed in the Annex. The company is then tasked with implementing policies and procedures to ensure compliance with that code. The most natural way to accomplish this would be through a certification system. Internally, department heads and managers would be required to certify compliance with the code of conduct. Members of the value chain would be contractually required to act in accordance with the code of conduct and to so certify.[17]

The problem with relying on certifications is that they may not be taken seriously. In particular, far-flung members of a company's value chain might falsely certify compliance so as not to lose business. Likely for these reasons, the Directive views certifications alone as insufficient. It notes that "contractual assurances should be accompanied by appropriate measures to verify compliance."[18] Appropriate measures include "suitable industry initiatives or independent third-party verification."[19] Some have characterized this aspect of the rule as an audit requirement. It adds an outside set of eyes to the company's due diligence process.

Better Factories Cambodia is an example of the type of industry initiative[20] that the Directive likely has in mind. The organization inspects and issues reports regarding factory conditions in Cambodia.[21] These reports could be used by EU companies to verify certifications by subcontractors about factory working conditions.

The idea is that the code of conduct, together with certifications and audits to assure compliance (likely along with other risk-mitigation efforts),[22] will cause companies and their value chains to identify and then eliminate adverse human rights and environmental impacts. Crucially, as part of this process, these entities will be required to shed problematic practices. The Directive specifies the steps companies must take in doing so.

As part of their duty to mitigate the impact of these activities, companies must implement a "corrective action plan."[23] When the problem stems from a member of the company's value chain, there are several paths forward. At the very least, the company is prohibited from renewing a contract with the offending party.[24] If the law allows, companies must also suspend their commercial relations with the offending party, and where the impact is severe, sever the relationship.[25]

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[16] *See id.* at Article 4(1).
[17] *See id.* at Article 7(2)(b).
[18] *Id.* at Article 8(5).
[19] *Id.* at Article 8(5).
[20] Better Work, Better Factories Cambodia, https://betterwork.org/where-we-work/cambodia/.
[21] Human Rights Watch, *"Work Fast or Get Out," Labor Rights Abuses in Cambodia's Garment Industry*, (discussing Better Factories Cambodia and its limitations), https://www.hrw.org/report/2015/03/11/work-faster-or-get-out/labor-rights-abuses-cambodias-garment-industry.
[22] See *infra* Part II.A.3.b (discussing internal controls generally).
[23] Directive, Article 8(3)(b).
[24] *See* Directive, Article 7(5).
[25] *See id.*

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C. Reporting Requirements

The Directive includes a reporting requirement. Some covered companies will be required to report under Articles 19a and 29a of Directive 2013/34/EU.[26] Others will be required to produce an annual report describing their due diligence.[27] Article 19a of 2013/34/EU requires "sustainability reporting,"[28] which contemplates a comprehensive report that tracks the Directive's due diligence obligations. Companies are required to provide—

"a description of:

(i) the due diligence process implemented by the undertaking with regard to sustainability matters, and, where applicable, in line with Union requirements on undertakings to conduct a due diligence process;

(ii) the principal actual or potential adverse impacts connected with the undertaking's own operations and with its value chain, including its products and services, its business relationships and its supply chain, actions taken to identify and monitor those impacts, and other adverse impacts which the undertaking is required to identify pursuant to other Union requirements on undertakings to conduct a due diligence process;

(iii) any actions taken by the undertaking to prevent, mitigate, remediate or bring an end to actual or potential adverse impacts, and the result of such actions;"[29]

D. Director Sustainability Duties

The Directive also links sustainability due diligence to the fiduciary duties of the board of directors.[30] Namely, the directors are "responsible for putting in place and overseeing the [company's] due diligence actions."[31] The Directive also imposes a broad obligation on directors to "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."[32] This sustainability-linked concept of fiduciary duties serves as a principles-based backstop to the due diligence requirements, which are otherwise tied to the treaty obligations specified in the Annex.

E. Enforcement and Liability

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[26] Directive (Eu) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464 [hereinafter Corporate Sustainability Reporting Directive].

[27] Directive, Article 11.

[28] Corporate Sustainability Reporting Directive, Article 19a.

[29] *Id.* at Article 19a(2)(f). Article 29a has identical language except that it applies to consolidated groups of entities. *Id.* at 29(a)(2)(f).

[30] Directive, Articles 25, 26.

[31] *Id.* at Article 26(1).

[32] *Id.* at Article 25(1). This is not a significant departure from the law of member states. *See* Paul Krüger Andersen et al., *Response to the Proposal for a Directive on Corporate Sustainability Due Diligence by Nordic and Baltic Company Law Scholars*, Nordic & European Company Law, LSN Research Paper Series No. 22-01, 10 ("national company law of the Member States already respects sustainability and sustainability").

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The Directive envisions public and private enforcement (what the Directive refers to as civil liability). Under Article 18, each member state is to have a supervisory authority with the power to investigate compliance, impose fines for noncompliance, and issue injunctions.[33] Fines will be tied, not only to the offense, but to the net turnover (discussed below) of the offending entity.[34]

The companies are also liable for damages to private parties caused by their failure to conduct appropriate due diligence, when that failure causes damages "that should have been identified, prevented, mitigated, brought to an end or its extent minimised" through due diligence.[35]

To mitigate the risk of excessive liability, companies are not liable for damages caused by "indirect partner[s]" in their value chain if the damages occurred despite the company having taken reasonable steps to verify compliance with its code of conduct.[36]

F. Companies Obligated to Comply

The Commission estimates that the Directive will directly cover about 17,000 companies, 13,000 from the EU and 4,000 third-country companies.[37]

Although these figures seem large at first blush, the Commission estimates that the Directive will apply to only 1% of EU companies.[38] It divides these companies into two categories.[39] EU companies with more than 500 employees and a net turnover[40] of more than EUR 150 million are subject to the entirety of the Directive.[41] Companies with more than 250 employees and a net turnover of more than EUR 40 million[42] are included only if they are in a "high-impact sector." The definition of high-impact sectors is pulled from OECD guidance.[43] It includes the extractive sector (mining, oil, and gas), the mineral supply chain, agricultural supply

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[33] Directive, Article 18(5).
[34] *Id.* at Article 17.
[35] *Id.* at Article 22(1)(b).
[36] *Id.* at Article 22(2). The Directive suggests that an indirect partner is an entity in a company's value chain with which it does not have a contract. An example would be a supplier to one of the company's suppliers. *Id* at Whereas Clause 36.
[37] *Id.* at 16.
[38] *Id.* at 14.
[39] The Directive applies to all companies "which are formed in accordance with the legislation of a Member State." *Id.* at Article 2.
[40] Net turnover is defined in Article 3(m)(i) through cross-reference to the Corporate Sustainability Reporting Directive, which defines the term as "the amounts derived from the sale of products and the provision of services after deducting sales rebates and value added tax and other taxes directly linked to turnover." Corporate Sustainable Reporting Directive, Article 2(a)(5).
[41] Directive, Article 2(1)(a).
[42] *Id.* at Article 2(1)(b).
[43] OECD Responsible Business Conduct, OECD Guidelines for Multinational Entities, http://mneguidelines.oecd.org/sectors/. Although the finance industry is included in the OECD Guidance, the sector is not included as a high-impact sector in the Directive. Thus, financial industry participants are only bound if they qualify under the largest tier. In addition, such companies are only required to conduct due diligence when they provide "credit, loan or other financial service" before initiating the relationship. Directive, Article 6(3).

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chain, and the garment supply chain.[44] Companies in these high-impact sectors only must conduct due diligence sufficient to uncover and eliminate "severe adverse impacts" that are relevant to their sector.[45] They are also exempt from Article 15, which as discussed above, requires a climate-action plan to comply with the Paris Agreement.

Similar criteria apply to third-country companies.[46] The Directive applies to those companies with a EUR 150 million net turnover within the EU.[47] Those with EU net turnover between EUR 40 million and EUR 150 million,[48] and in one of the high impact categories, are subject to due diligence obligations only with respect to severe adverse impacts within their sector.[49] Articles 25 and 26, which impose sustainability obligations on corporate directors, do not apply to non-EU companies.[50] As above, the smaller category of companies are also exempt from Article 15.[51]

Note that while the Directive directly applies to the aforementioned companies, it indirectly applies to all companies in these companies' value chains (and, potentially, companies in those companies value chains).[52] For the covered companies to meet their obligations, companies in their value chains will be required to certify the absence of adverse impacts and to potentially audit their operations. To offset these costs, the Directive requires that companies that are directly subject to the due diligence requirement support smaller and medium-sized enterprises (SMEs) in their value chains "where compliance with the code of conduct or the corrective action plan would jeopardize the viability of the SME."[53]

In sum, the Directive embeds due diligence regarding adverse human rights and environmental impacts into the operations of large EU companies, third-country companies that do a great deal of business in the EU, and companies that operate in sectors with value chains that are known to be problematic. It also requires that large companies, whether formed in the EU or in a non-member state, to take steps to comply with the Paris Accord.

G. Other EU Sustainability Obligations

Although this Article focuses on the Directive, it is noteworthy from a comparative perspective that it is part of a network of emergent rules that creates a sustainability framework

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[44] *Id.* at Article 2(1)(b).
[45] *See id.* at Article 6(2).
[46] *See* Luca Enriques & Matteo Gatt*i, The Extraterritorial Impact of the Proposed EU Directive on Corporate Sustainability Due Diligence: Why Corporate America Should Pay Attention,* Oxford Business Law Blog (April 22, 2022), https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/extraterritorial-impact-proposed-eu-directive-corporate (discussing extraterritorial application of the Directive).
[47] *Id.* at Article 2(2)(a).
[48] *Id.* at Article 2(2)(b).
[49] *See id.* at Article 6(2).
[50] *See id.* at Article 25(1).
[51] *See id.* at Article 15(1).
[52] It would apply to these twice-removed companies where a value-chain member would need a sub-certification to allow it to certify to the company conducting the due diligence. Depending on the complexity of companies' value chains, there could potentially be layers on layers of sub-certifications. The Directive anticipates this sort of "contractual cascading." *Id.* at Article 7(2)(b).
[53] *Id.* at Article (8)(3)(e).

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for EU companies. The framework includes the Taxonomy Regulations, which defines sustainable business activities,[54] SFDR, which imposes ESG disclosure obligations on asset managers, [55] and CSRD, which revises the sustainability disclosure obligations of EU companies.[56]

II. US Corporations and Sustainability

The bold EU framework stems from broad agreement that corporations are socio-economic entities that have an obligation to act ethically and sustainably. As evidence, businesses themselves overwhelmingly supported regulation of sustainability due diligence.[57] No such consensus exists in the US. The social responsibility of business is a hotly contested topic. Conventional wisdom since the 1980s maintained that executives should run corporations to maximize shareholder profits. This so-called shareholder primacy approach contrasts with the stakeholder approach. While the former is deeply embedded in corporate culture, it is currently under significant stress as more and more have turned to the latter, which holds that companies should be run for the benefit of all stakeholders, not just shareholders.

The law has not kept up with the shifting intellectual current. It remains rooted in shareholder primacy as there is no legal obligation for directors or companies to act sustainably, let alone an obligation to conduct sustainability due diligence and eliminate problematic practices. The following sections discuss US law, the potential to reform it to include sustainability obligations, and the hurdles involved.

A. Fragmentation of US Business Law

One significant issue when it comes to sustainability efforts in the US is the bifurcation between state and federal law. State law addresses the fiduciary duties of officers and directors. Federal law addresses the reporting obligations of public companies. Neither currently imposes sustainability obligations although both have that potential.

1. State Law Fiduciary Duties

A key innovation in the Directive is linking fiduciary duties to sustainability. In the US, there is no such link. Officers and directors in the US are subject to the fiduciary duties of

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[54] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the Establishment of a Framework to Facilitate Sustainable Investment, and amending Regulation (EU) 2019/2088, https://eur-lex.europa.eu/eli/reg/2020/852/oj.
[55] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on Sustainability-related Disclosures in the Financial Services sector, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088.
[56] Directive (Eu) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464.
[57] *See* European Commission, *supra* note 2 ("70% of the businesses who responded to the public consultation sent a clear message: EU action on corporate sustainability due diligence is needed."). Although the concept of sustainability appears well accepted, the details remain sharply debated. *See, e.g* Andersen et al., *supra* note 32, at 4 (raising strong objections to the Directive, while at the same time remarking that the initiative is of "great importance, and the Commission's initiative is therefore commendable").

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loyalty and care. The duty of loyalty requires that they put the corporation's and the shareholders' interests above their own. The duty of care requires that they represent those interests in a competent manner. Although the test for compliance is complex, the basic standard of liability for the duty of care is gross negligence.[58]

Sustainability issues arise in connection with the duty of care. The pattern is that shareholders allege that an executive's decision fails the gross negligence standard. The executive then defends that the challenged action was not ill-conceived, but taken to serve stakeholder (rather than shareholder) interests. The defense always fails. The most famous example is *Dodge v. Ford.*[59] In the case, the board of directors of Ford decided against paying special dividends to its shareholders even though the company was profitable enough to do so. Henry Ford, the corporation's controlling shareholder, argued that the company retained the money so that it could hire more people, increase wages, and decrease the prices of its cars—not to earn profits, but to serve the community. Ford's commitment to sustainability (at least his rhetoric in court) was ahead of its time—

"Counsel for Dodge: [D]o you still think that those profits were awful profits?

Ford: Well, I guess I do, yes.

Counsel: And for that reason you were not satisfied to continue to make such awful profits?

Ford: We don't seem to be able to keep the profits down.

Counsel: ... Are you trying to keep them down? What is the Ford Motor Company organized for except profits, will you tell me, Mr. Ford?

Ford: Organized to do as much good as we can, everywhere, for everybody concerned.... And incidentally to make money.

Counsel: Incidentally make money?

Ford: Yes, sir.

Counsel: But your controlling feature ... is to employ a great army of men at high wages, to reduce the selling price of your car ... and give everybody a car that wants one.

Ford: If you give all that, the money will fall into your hands; you can't get out of it."[60]

The court rejected Ford's magnanimous rationales, and held that Ford and his company had to serve shareholders. As a result, *Dodge v. Ford* has come to stand for the proposition that

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[58] *See* Aronson v. Lewis, 473 A.2d 805 (Del. 1984).
[59] 204 Mich. 459, 170 N.W. 668 (Mich. 1919).
[60] A. Nevins & F. Hill, Ford: Expansion and Challenge, 1915-1933, 99-100 (1957).

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US corporations exist to maximize shareholder value and corporate executives must use their power to that end.[61]

Despite this well-accepted legal doctrine, many argue that executives can serve other interests if they frame the defense of their challenged actions differently. For example, if Ford had plausibly argued that he wished to reinvest corporate profits, rather than payout dividends, so as to increase the profits for the company, he would have likely won his case.

Along the same lines, the courts instruct executives to manage firms for long-term value, and taking long-term value seriously often means taking stakeholder, in addition to shareholder interests, into account. For example, it is in the shareholders' interest to treat employees well, because if they fail to do so, employees will shirk or quit. Because of the interrelationship between stakeholder and shareholder interests, many actions that serve stakeholders actually benefit shareholders as well.[62] Nevertheless, the articulated rationale for any corporate action must be shareholder value. Executives cannot choose to treat employees well because they believe that it is the right thing to do; they must do so—or at least claim to do so— because they believe treating employees well serves shareholders.[63]

If corporations wish to have broader flexibility to act according to stakeholder interests, they can choose to incorporate as a so-called benefit corporation. Whereas the purpose of a typical US company is to maximize shareholder value, executives in a benefit corporation commit to running the corporation in the interest of all its stakeholders.[64]

Thus, with the exception of benefit corporations, US corporate law does not incorporate sustainability into director fiduciary duties. It rejects it. Legally, sustainability can only be a factor in an executive's decision if it increases long-term value for shareholders.

2. State Law Due Diligence Obligations

Fiduciary duty law includes an obligation that board members monitor corporate conduct. More specifically, the so-called *Caremark* duty requires that directors put an internal reporting system in place to inform them about the corporation's compliance with its legal obligations.[65] *Caremark* can be interpreted as a substantive due diligence obligation in that it requires the board

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[61] For a more recent example, *see* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010), discussed in Jeff Schwartz, *De Facto Shareholder Primacy*, 79 Md. L. Rev. 652, 669-670 (2020).

[62] *See* Leo E. Strine, et al., *Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy*, 106 Iowa L. Rev. 1885, 1887 (2021) ("many corporate fiduciaries believe that companies are most likely to create sustainable profits if they act fairly toward their employees, customers, creditors, the environment, and the communities the company's operations affect").

[63] For a more extension discussion of the overlap between shareholder primacy and stakeholder theory, Schwartz, *supra* note 61, at 659-72.

[64] Del. Code Ann. tit. 8, § 365(a) ("The board of directors shall manage or direct the business and affairs of the public benefit corporation in a manner that balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation.").

[65] *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

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to take the steps necessary to understand the organization it oversees.[66] Thus, a board has a *Caremark* obligation, for example, to monitor corporate compliance with environmental laws, labor laws, and sexual harassment laws.[67]

Caremark is similar to the Directive, but what distinguishes the Directive from *Caremark* is that the latter only applies to national or international laws that, according to their terms, directly apply to US corporations. The Directive expands this due diligence obligation to international treatises that were formerly understood as soft law. It also, importantly, obligates companies to change their practices.

Some have argued that *Caremark* should be expanded. An influential former jurist, Leo Strine, along with his coauthors, have argued that *Caremark*, should include an obligation for boards to ensure that companies operate sustainably.[68] Such an expansion would carry *Caremark* toward the Directive's rule, but so far ideas like this have gained little traction.

3. Federal Securities Law

All US companies are subject to the fiduciary laws of their state of incorporation. While all US companies are also subject to the federal securities laws, only those that sell shares to the public (i.e., public companies) are subject to the requirement to periodically disclose financial statements and related information. Sustainability has typically not been a part of these disclosures. As with corporate law, however, there has recently been a push to change that.

a. SEC Proposed Climate Change Disclosure Rules

In March 2022, the securities regulator in the US, the Securities and Exchange Commission (SEC), proposed rules to mandate public company disclosure related to climate change.[69] Broadly speaking, the rules would require disclosure of two categories of climate-related information. The first category relates directly to climate-change risk. Public companies would be required to disclose the risk that climate change poses to its business.[70] As the SEC explains,

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[66] *See id.* at 970 ("[C]orporate boards may [not] satisfy their obligation to be reasonably informed concerning the corporation, without assuring themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance.").

[67] *See, e.g., In re* McDonald's Corp. S'holder Derivative Litig., 2023 WL 2293575 (Del. Ch. Mar. 1, 2023) (dismissing a *Caremark* claim involving sexual harassment laws).

[68] Leo E. Strine, et al., *supra* note 62, at 1895 ("a corporation's plan to fulfill its legal compliance obligations should not be viewed as separate and distinct from the corporation's plan to operate in a sustainable, ethical manner with fair regard for all the corporation's stakeholders. Rather, when viewed through the correct prism, there should not be two plans for these related objectives, because the objectives are not in fact meaningfully distinct; there should be just one integrated scheme."). *See also* Stavros Gadinis & Amelia Miazad*, Corporate Law and Social Risk,* 73 Vand. L. Rev. 1401, 1459 (2020) (arguing that "courts should recognize ESG as an essential part of boards' monitoring mission").

[69] SEC, The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 (2022).

[70] *Id.* at 21334

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> "Climate-related risks can affect a company's business and its financial performance and position in a number of ways. Severe and frequent natural disasters can damage assets, disrupt operations, and increase costs. Transitions to lower carbon products, practices, and services, triggered by changes in regulations, consumer preferences, availability of financing, technology and other market forces, can lead to changes in a company's business model."[71]

If companies are exposed to any of the above risks (or other climate-related risks that it identifies), it must disclose that it in its annual reports.[72] As is typical in the securities laws, this climate-change risks would only need be disclosed if material.[73] The meaning of materiality is notoriously (and purposefully) vague, but at the most general level is defined as information that is important to a reasonable investor.[74]

Note that the rules are focused on how climate change impacts the financial position of companies, not about climate change per se. According to the SEC, "We are proposing to require disclosures about climate-related risks … because this information can have an impact on public companies' financial performance or position and may be material to investors in making investment or voting decisions."[75] Such framing allows the SEC to argue that the new disclosure requirements fall within its mission to protect investors and do not represent administrative creep. As one critic (and former SEC Commissioner) chided in critique of the rule, the SEC does not stand for the "Securities and Environmental Commission."[76]

The second category of new disclosure requirements have an even more tenuous tie to investor protection. Under the proposed rules, companies would be required to disclose their greenhouse gas ("GHG") emissions and the GHG emissions in their value chain.[77] The rule divides GHG disclosure obligations into Scope 1 (direct emissions), Scope 2 (indirect emissions "resulting from the generation of electricity purchased and consumed by the company"), and Scope 3 emissions (indirect emissions not captured under Scope 2).[78] Scope 3 emissions include, for example, "emissions associated with the production and transportation of goods a registrant purchases from third parties, employee commuting or business travel, and the processing or use of the registrant's products by third parties."[79]

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[71] *Id.* at 21336-337.
[72] *Id.* at 21334.
[73] *Id.* at 21334.
[74] *See* Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).
[75] *See* 87 Fed. Reg. at 21335; *see also id.* at 21335-336 ("Investors need information about climate-related risks—and it is squarely within the Commission's authority to require such disclosure in the public interest and for the protection of investors—because climate-related risks have present financial consequences that investors in public companies consider in making investment and voting decisions.)"
[76] SEC Commissioner Hester M, Peirce, We are Not the Securities and Environment Commission - At Least Not Yet (March 21, 2022), https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321#_ftn19.
[77] 87 Fed. Reg. at 21468.
[78] *Id.* at 21344.
[79] *Id.* at 21344-45.

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Scope 1 and 2 GHG emissions must be disclosed and disaggregated into constituent gases.[80] Scope 3 emissions only need be disclosed if material or if the company has ESG emissions goals or targets that include Scope 3 emissions.[81]

The SEC's proposed rule also contains supporting disclosure obligations, including requirements to disclose how the board monitors climate-related risks, how such risks impact or are likely to impact the company's "strategy, business model, and outlook," how the company identifies, assesses, and manages climate-related risks, including the extent to which such processes are integrated into the company's risk-management framework, and the company's "climate-related targets or goals, and transition plan, if any."[82] The result of all of this is a comprehensive disclosure mandate that covers emissions, climate change risks, and the related processes.

This rule bears some similarities to the Directive. Even though it would be a disclosure mandate, companies would be required to conduct due diligence to ascertain and then report on their climate-related risks, emissions, and procedures. Despite the rule's focus on climate change, however, it does not go as far as the Directive as it fails to require emissions reductions.

The most controversial aspect of the new rule is the requirement to disclose GHG emissions. The most straightforward explanation is that this rule is designed to name and shame large polluters, thereby creating an incentive for them to cut emissions. This explanation is problematic, however, because its policy underpinning relates to climate change rather than the SEC's core investor protection mission. How then does the SEC defend it? The agency again traces the rule to financial considerations. It argues that "[q]uantitative greenhouse gas ("GHG") emissions data can enable investors to assess a registrant's exposure to climate-related risks, including regulatory, technological, and market risks driven by a transition to a lower-GHG intensive economy."[83] In other words, the new disclosures would allow investors to see how much greenhouse gas the company and its products produce. This would allow them to see the extent to which these companies are exposed to legal changes that would restrict such emissions. While this logic is plausible, it is also easy to argue that it is pretext for a rule that is really designed to expose companies that are major GHG emitters in the hopes that fear of public retribution will inspire them to curtail these activities.

Because these disclosures stretch the SEC's mission, they have been politically fraught. Two bills circulating in Congress are designed to obstruct the rulemaking.[84] Congressman Rounds, a cosponsor of one of the bills, has criticized the SEC's rule as using "American businesses … as a gateway to advance climate change policy."[85] The bills do not expressly prohibit the new rules, but instead would require that the SEC only adopt new disclosure

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[80] *Id.* at 21345.
[81] *Id.*
[82] *Id.*
[83] *Id.* at 21344.
[84] Brian Croce, House Republicans Float Bill to Block SEC Climate Disclosure Proposal, Pension & Investments, (Dec. 5, 2022), https://www.pionline.com/legislation/house-republicans-float-bill-block-sec-climate-disclosure-proposal.
[85] *Id.*

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obligations after concluding that the information sought is material to investors.[86] By only challenging the SEC's rule indirectly, the bills, if enacted, set up a fight about whether climate-related information meets the materiality threshold.

The SEC proposal may also be held unconstitutional. In 2022, the US Supreme Court decided *West Virginia v. EPA.*[87] The U.S. Environmental Protection Agency, which has the authority to regulate power plants, had regularly imposed regulations requiring power plants to operate more cleanly.[88] But in 2015, it proposed a regulation that "included a requirement that such facilities reduce their own production of electricity, or subsidize increased generation by natural gas, wind, or solar sources."[89] Applying the "major questions" doctrine, the Supreme Court found that the EPA lacked the statutory authority to "substantially restructure the American energy market."[90] It, therefore, struck down that aspect of the rule.[91] If the Court applied the same narrow reading of statutory authority to the SEC's actions in the climate-change proposal, there is a significant risk that the rule would be struck down. As discussed above, while the SEC works hard to frame the rule as merely an application of its investor-protection mission, there is ample room to question whether environmental policy is the true driver.

The many hurdles to the SEC's proposal illustrate the difficulty of implementing sustainability efforts in the US. The SEC is initially constrained because its authority is limited to disclosure requirements. More importantly, the need to tie the rules to the SEC's historical investor protection mission gives rise to intellectual gymnastics and legal challenges.

b. Substantive Due Diligence Related to Financial Disclosures

The securities laws also require that companies maintain internal controls in connection with their financial reporting.[92] Internal controls for financial reporting refer to the processes, policies, and procedures that a company has in place to ensure the accuracy and reliability of its financial reporting. The purpose of these controls is to prevent errors, fraud, or other irregularities that could potentially mislead investors.

There are five key components of internal controls for financial reporting, many of which overlap with the principles in the Directive:

1. Control environment: This refers to the overall culture, values, and ethical standards of the organization. It includes factors such as the tone at the top, the organization's commitment to integrity, and the accountability of management.
2. Risk assessment: This involves identifying and analyzing the risks that could impact the accuracy and reliability of financial reporting. Risks could include errors, fraud, or noncompliance with regulations.

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[86] *Id.*
[87] West Virginia, et al. v. EPA, et al., No. 20-1530 (2022).
[88] *Id.* at 2.
[89] *Id*.
[90] *Id.* at 20.
[91] *Id.* at 31.
[92] Technically, the rules are framed as reporting obligations. *See* 17 CFR § 229.308.

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3. Control activities: These are the policies and procedures that are put in place to mitigate the risks identified in the risk assessment. Examples of control activities include segregation of duties, physical controls over assets, and reconciliations.
4. Information and communication: This refers to the systems and processes used to capture, record, and report financial information. Effective communication of financial information to stakeholders is also important to ensure transparency and accountability.
5. Monitoring: This involves ongoing monitoring of the effectiveness of internal controls for financial reporting. It includes regular testing of controls, analyzing results, and taking corrective action when necessary.

Overall, the goal of internal controls for financial reporting is to ensure that financial information is accurate, reliable, and consistent with generally accepted accounting principles or international financial reporting standards. Effective internal controls can help prevent financial misstatements, reduce the risk of fraud, and increase investor confidence in the organization's financial reporting.

While this structure is limited to financial matters, it is essentially the same one that a thorough company would use to comply with the Directive. The purpose of financial internal controls is to mitigate the risk of financial irregularities; but the internal controls structure is equally well-equipped to mitigate the risk of adverse human rights and environmental impacts.

It would be technically possible for the SEC to extend the internal controls requirements to sustainability matters. In fact, the rationale would be the same as for the proposed environmental rules—that internal controls over sustainability issues is important to investors because they ensure that a company is informed about and transparent with respect to such risks. Any such effort, however, would encounter the same legal and political obstacles discussed above.

c. The Conflict Minerals Rule

In an aberration from the typical skepticism US lawmakers harbor toward sustainability efforts, Congress enacted the conflict minerals rule in the Dodd-Frank Act of 2010. Ironically, this is likely one of the intellectual progenitor of the Directive. The Act called for the SEC to implement rules requiring that public companies conduct due diligence into their supply chains and report on the extent to which their products contain conflict minerals (tin, tungsten, tantalum, and gold) from the Congo region of Africa.[93]

The SEC was never truly supportive of the legislation,[94] but it responded with a good faith effort to effectuate this intent in 2012.[95] The rule was complex, extraordinarily

[93] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, § 1502 (2010).
[94] *See, e.g.,* Mary Jo White, Chairwoman, U.S. Sec. & Exch. Comm'n, 14th Annual A.A. Sommer, Jr. Corporate Securities and Financial Law Lecture at Fordham Law School: The Importance of Independence (Oct. 3, 2013) (criticizing the conflict minerals rule).
[95] Conflict Minerals, 77 Fed. Reg. 56,274, 56,276 (Sept. 12, 2012).

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controversial, and short-lived.[96] The chief concerns were the cost of compliance and the use of the securities laws to pursue human rights goals.[97] The strong opposition turned to litigation almost immediately.[98] Though the rule survived largely intact, the SEC ceased enforcing it only 5 years after it was enacted.[99] The SEC cited the court holding for its actions, but the decision to turn away from the rule was largely viewed as political.

During its brief run, the conflicts mineral rule had little success. Unlike other US sustainability efforts, which tie sustainability to finance, this rule was unabashedly about human rights. Congress was concerned about human-rights abuses at mining operations run by militia groups in the Congo. The goal was to "name and shame" companies that were procuring such minerals from the region and thus indirectly complicit in the workers' mistreatment.[100] The problem was that the reports that the companies submitted in response were too vague for anyone to decide who should be named and shamed.[101] The most common answer to the question of whether there were conflict minerals in corporate supply chains was that the company could not figure it out—an answer acceptable under the rule.[102] There are many reasons the rule failed, but the main one is that the SEC lacked an understanding of the conflict mineral supply chain it was regulating and therefore crafted due diligence and disclosure requirements that were easily evaded.[103]

4. Sustainability Through Private Ordering

With sustainability legislation and regulation lagging in the US, shareholders have increasingly pushed public companies to act in this manner. Shareholders have exerted their influence through their power to elect directors and through the shareholder proposal process.

Probably the best example of how shareholders have used their leverage to shape corporate policy is the recent proxy contest at Exxon. A little-known hedge fund nominated a slate of directors to Exxon's boards who were committed to shifting Exxon's focus from fossil fuels to renewable energy. Thanks to the support of large institutional shareholders, the hedge fund succeeded in nominating three members to Exxon's board.[104]

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[96] For a detailed description of the conflict minerals rule and its aftermath, see Jeff Schwartz, *The Conflicts Mineral Experiment*, 6 Harv. B. L. Rev. 129, 134-44 (2016).
[97] *See id.* at 141-44; *see generally* Jeff Schwartz & Alexandrea Nelson, *Cost Benefits Analysis and the Conflicts Mineral Rule*, 68 Admin. L. Rev. 287 (2016) (analyzing and discrediting concerns about the costs of the conflict minerals rule).
[98] *See* Schwartz, *supra* note 96, at 140-41 (discussing litigation surrounding the rule).
[99] Sarah N. Lynch, *SEC Halts Some Enforcement of Conflict Minerals Rule Amid Review*, Reuters (April 7, 2017), https://www.reuters.com/article/us-usa-sec-conflictminerals/sec-halts-some-enforcement-of-conflict-minerals-rule-amid-review-idUSKBN1792WX.
[100] Senator Richard Durbin argued that the "transparency" elicited through the rules "will allow consumers and investors to know which companies source materials more responsibly in DRC and will hopefully persuade the industry to finally create clean supply chains out of Congo." Press Release, Senator Richard Durbin, Statement on U.S. District Court Decision Regarding Conflict Minerals (July 7, 2013), http://www.durbin.senate.gov/newsroom/press-releases/durbin-statement-on-us-district-court-decision-regarding-conflict-minerals.
[101] *See* Schwartz, *supra* note 96, at 157, tbl 4., 159.
[102] *See id.* at 139, 168-69.
[103] *See id.* at 161-67.
[104] *See* Jeff Schwartz, *Stewardship Theater*, 100 Wash. U. L. Rev. 393, 395 (2022).

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Although less dramatic, there has also been a groundswell of shareholder proposals related to sustainability. Under state corporate law, shareholders have the right to make precatory proposals to the board of directors of corporations in which they own shares. Securities laws require that, if certain conditions are met, public corporations must include shareholder proposals and supporting statements in their annual meeting materials. These proposals increasingly focus on environmental and social issues.

These proposals tend to focus on transparency. For example, a 2022 proposal at Google's parent company, Alphabet, requested that it "publish a regular periodic assessment of resilience to the physical risks of climate change, including description of short-, medium-, and long-term measures that the Company is taking to mitigate physical risks, including threats to its headquarters and other key assets from sea level rise and flooding." Social proposals tend to focus on what has come to be known as diversity, equity, and inclusion ("DEI"). For example, Amazon's 2022 annual meeting featured a proposal that it "report on median pay gaps across race and gender, including associated policy, reputational, competitive, and operational risks, and risks related to recruiting and retaining diverse talent." There is also a nascent trend proposing that companies reincorporate from traditional for-profit companies into benefit corporations.[105]

Large asset manages like Vanguard and BlackRock, have waivered in their support for such initiatives. They embraced them in 2021 after a period of skepticism, but now appear to be cooling again in the face of strong political opposition.[106] But shareholders are not the only ones pushing companies to act more sustainably. Consumers increasingly identify with the products they own. They want to buy products manufactured sustainably. And employees increasingly demand to work for sustainable companies. The combined pressure has led many companies to pivot toward more sustainable operations.[107]

Perhaps the best evidence of this shift comes from a statement from the Business Roundtable. The Business Roundtable is a traditionally conservative business advocacy organization (it was one of the organizations that sued over the conflict minerals rule). Since the 1980s, it had espoused a shareholder primacy view of the firm. In 2019, however, it pivoted to stakeholder theory. In a statement signed by over 200 CEOs of public companies, it embraced the proposition that corporate leadership's duty was to serve all of the corporation's constituents.[108] While this statement may be as much (or more) about marketing than substance, it still signals the pressure corporations are under to at least appear more sustainable.

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[105] *See* Jill E. Fisch, *Purpose Proposals*,1 U. Chi. Bus. L. Rev. 113, 122-126 (2022) (describing evolution and impact of shareholder proposals).
[106] *See* Schwartz, *supra* note 104, at 441, 421-24 (describing different "eras" of asset manager stewardship); Collin Eaton, *ESG Blowback: Exxon, Chevron Investors Reject Climate Measures*, Wall St. J. (June 1, 2023), https://www.wsj.com/articles/esg-blowback-exxon-chevron-investors-reject-climate-measures-4532da99?mod=article_inline (describing asset manager pullback from ESG); *see also* Jeff Schwartz, *"Public" Mutual Funds*, *in* The Cambridge Handbook on Investor Protection (Arthur Laby ed., 2021) (arguing that asset-manager voting is driven by fear of regulation).
[107] Another form of private ordering is through contractual social responsibility, "KSR." *See generally* Jonathan C. Lipson, *Promising Justice: Contract as Social Responsibility*, 2019 Wis. L. Rev. 1109 (2019).
[108] Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans,' Bus. Roundtable (Aug. 19, 2019). Commentators have pointed out that this statement is seemingly in

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III. Conclusions

A. Comparative Observations about US Law

The Directive is not only ambitious, but fits into a comprehensive sustainability structure in the EU that the US completely lacks. This divergence likely owes, at least in part, to differences in public and related political attitudes toward sustainability and to differences in the legal structure. The EU has embraced sustainability as a stand-alone goal, while in the US, the concept has been bound up with and weighed down by its relationship to financial materiality and shareholder value. A regulatory structure designed to specifically target sustainability is not on the table in the US. Similarly, as noted above, while the structures of corporate and securities law could rather easily be extended to directly embrace sustainability, the US currently lacks the political will and public consensus[109] about these topics to make the necessary adjustments.

Another significant impediment to US sustainability efforts is its disjointed structure. As noted above, the periodic disclosure requirements of the securities laws only apply to public companies. Thus, even if the laws did include sustainability obligations, they would only apply to the small subset of companies that have chosen to sell shares to the public. Also problematic is that public companies could go private to avoid such rules. Further still, public companies could easily sell problematic assets to private companies, giving them the public companies the appearance of sustainability without making any real progress toward sustainability goals.[110]

A better option than the federal securities laws might be to regulate sustainability through state law fiduciary duties. As noted above, the *Caremark* doctrine, which imposes liability on directors for failure to oversee their companies, offers a plausible structure. But the problem here is similar. Laws vary by state and, while unusual, corporations could change their state of incorporation to avoid laws they deem too costly. Probably of larger concern, fiduciary duties are typically defined through judge-developed case law. Judges hesitate to make big moves, like extending fiduciary duties to sustainability.

B. Comparative Observations about the Directive

Even though the US lags far behind, its experience with the conflict minerals rule offers some takeaways. The conflict minerals rule was one of the first attempts to incorporate sustainability due diligence and disclosure obligations into corporate operations. The Directive, however, adds a key third component—substantive change. Under the conflict minerals rule, US companies were under no obligation to actually remove conflict minerals from their value chains.

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tension with their fiduciary duties to maximize shareholder value. As noted above, any actions must be plausibly defensible in value terms.

[109] The Wall Street Journal runs an editorial critiquing ESG almost daily. *See, e.g.,* James Freeman, *ESG Movement Fails at the Scene of Its Greatest Triumph*, Wall St. J. (June 2, 2023), https://www.wsj.com/articles/esg-movement-fails-at-the-scene-of-its-greatest-triumph-8b75861c?mod=hp_opin_pos_4#cxrecs_s ("Environmental, social and governance" activists try to shame companies into adopting destructive political agendas that voters reject.").

[110] Jeff Schwartz & Jill Fisch, *Corporate Democracy and the Intermediary Voting Dilemma*, European Corporate Governance Institute - Law Working Paper No. 685/2023, at 26, 102 Texas Law Review (forthcoming 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4360428.

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The theory was that market forces would punish companies that failed to do so. Rather than rely on the market, the Directive directly requires companies to change their practices to eliminate human rights abuses. This is a significant improvement.

Nevertheless, there are questions about whether the Directive will live up to its ambitions. Human-rights abuses, like those targeted by the conflict minerals rule and the Directive, tend to happen at the far-reaches of a corporation's supply chain. It is the laborers at mines, factories, and fields that are the most at risk of abuse. Yet conditions at these places are the most difficult and costliest to understand. Due diligence into complex and sometimes opaque international value chains is well-known to be a fraught exercise. Complexity, opacity, and a corporate incentive to not look too hard, pose a significant risk that corporations may report an absence of human rights risks based on a level of diligence that is not sufficient to support such a claim. Whether companies subject to the Directive garner insight into the treatment of their workers in what may be rural areas in developing countries will depend on their commitment to the rule and on the robustness and reliability of institutional efforts to monitor and audit working conditions at these locations.[111] Moreover, since the Directive targets a wide range of human-rights risks, compliance may be uneven.

The success of the Directive will also depend on the usefulness of its enforcement mechanisms. It will be up to member states to enable muscular regulators and states may vary in their commitment to doing so. Further, while the Directive envisions private enforcement, it may be difficult to prove inadequate due diligence and demonstrate damages. Including the compliance obligations of the Directive as part of directors' fiduciary duties may expose them to additional liability risk, but challenges around proof and damages likely mean that the risk is small.

This explicitly stakeholderist view of fiduciary duties has proven controversial, with a group of Nordic and Baltic scholars expressing strongly opposed views.[112] As noted above, the Directive's approach is at odds with US law, which remains committed to the shareholder primacy norm. Nevertheless, I do not view the move as overly significant. While there are no doubt situations where a commitment to sustainability dictates a different decision than a focus on shareholder profits, these cases are likely rare. The US view is that shareholder value incorporates sustainability if there is a plausible link to long-term profits. Since this is almost always the case, the debate is more about semantics and symbolism than about actual boardroom practices.

Finally, a key innovation of the rule is to transform soft-law international obligations to hard law matters of corporate social responsibility. The problem is that these treaties are worded ambiguously and aspirationally, which means it will be up to corporations to decide exactly what compliance entails. Corporations looking to minimize costs and disruption to parts of their

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[111] *See* Galit A. Sarfaty and Raphaël Deberdt, *Supply Chain Governance at a Distance*, Law & Social Inquiry (forthcoming) (studying at critiquing institutional efforts to validity conflict mineral supply chains).
[112] *See* Andersen et al., *supra* note 32.

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business that incorporate questionable value chain practices have an incentive to read their obligations narrowly.[113]

Eradicating global adverse human rights risks and environmental risks is an enormously difficult regulatory challenge. It is thus no surprise that there is reason for caution about the impacts of the Directive. Nevertheless, the thoughtful structure provides reason for optimism that the risks of greenwashing and the costs involved with compliance are outweighed by the potential for positive change.

[113] Andersen et al*.,* make a similar point. *See id.* at 16 ("If obligations are going to be transplanted from the very different world of international law into the realm of national law with all the serious implications of liability for companies and individual directors that entails, it is crucial that these obligations are specified and made exact, which is not by far accomplished in the present Annex.").

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