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Current Issues of Regulation relative to Sustainable Corporate Governance

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Summary

Encouraging sustainable business practices with the tools of business law has recently drawn increasing focus from both legal scholars and legislators. The legal norms regulating business offer several possible levers for influencing conduct that are currently under discussion on the national and EU levels. Roughly speaking, the proposed legislation falls under the categories of measures imposing duties of sustainable practices on business managers, measures influencing compensation and dividend policies, and measures influencing the composition of management structures.

An analysis of the numerous particular issues at stake shows that evolving business law towards the anchoring of sustainable practices can and must be done on the basis of a long-standing tradition of legal discourse. Thus, for example, in developing an obligation of due diligence relative to issues of sustainability, i.e., to social (human rights) and ecological impacts, the central questions include what obligations are imposed under the law of stock corporations by the demands of the public welfare and what is meant by the term best interests of the enterprise. Further, our analysis reveals that the diverse questions under discussion are closely interconnected. This means that legislators must seek a coherent strategy for shaping future regulatory measures: The specific form and content of any law imposing a sustainability-based due diligence obligation on managers and corporations is not just crucial for the effective enforcement of that law. The issues surrounding how business managers are compensated, how profits are used, and ultimately also how management bodies are composed likewise receive orientation from the standards of conduct which the law imposes on corporations and their managers and directors.

To be sure, these fundamental questions of legal policy cannot be answered exclusively with the tools of legal scholarship. Nevertheless, scholarship can demonstrate, and evaluate in the context of fostering sustainable practices, the connections that exist among the various particular issues at stake and the relevance of traditional lines of legal discourse in the field of corporate governance. In the final analysis, developments on the national and European levels are of course linked; but national regulatory initiatives can provide a decisive impulse for future pan-European solutions.

With respect to establishing a sustainability-based due diligence obligation for business managers, it is quite possible to tie this in to the rubric of their duty to act in the best interests of the enterprise. Anchoring a manager's duty to pursue the best interests of the enterprise

in statute would be in harmony with the duty already widely recognized in the law of corporations. Without necessarily spelling out in detail the content of what is covered by the penumbra of the best interests of the enterprise, legislators could draw upon this rubric in defining a sustainability-based due-diligence obligation for business managers. Under the current state of the law, the parties directly harmed by the breach of such a due diligence obligation—who as a rule reside outside the EU—would in most cases have no effective legal recourse for enforcing the obligation or obtaining compensation of their damages. Pursuing a liability of this nature under tort law generally runs up against systemic limitations. These limitations, however, are not absolute. Depending on how the sustainability-based due-diligence obligation were to be defined, an enforcement mechanism in tort law could be created de lege ferenda, for instance by qualifying the duty as component of a law intended to protect third parties (*Schutzgesetz*) within the meaning of § 823 Para. 2 BGB (German Civil Code).

Section 87 Para. 1 sent. 2 AktG (German Stock Corporation Act) already creates a statutory obligation for corporations to orient the compensation of managers and directors towards the principle of sustainability. There are, however, some uncertainties with regard to the scope and content of this principle. Here, too, therefore, the future shaping and definition of managers' duties of conduct are crucial, since the gamut of duties thus defined has a direct impact on the calculation of management compensation. The use or distribution of corporate profits, by contrast, has until now remained largely unaffected by the discourse over sustainability issues in business law. The statutory rules governing the disposition of profits, particularly in § 58 AktG, do however address key questions of internal corporate governance with the inherent conflict of interests and responsibilities between management and shareholders. These questions also underlie the debate over definition of an enterprise's ultimate aims. Thus the role that sustainability plays in the disposition of corporate profits is closely tied to the role it plays in defining the duties of managers.

The same is true for the structural question of how management boards are composed. If we consider the historic development of Germany's two-tiered system in the context of the discourse surrounding the relevance of the public interest to stock corporation law, the supervisory board, with its primary responsibility for oversight of the company, appears crucial in connection with taking the public interest into account, as well. Imposing a comprehensive obligation to take sustainability concerns into account that applies to the supervisory board as a whole might render it unnecessary to introduce structural organs specifically designed to foster sustainability.

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A. Subject and Context of our Study

This study addresses various ways to encourage the development of sustainable business practices using the tools of business law. Tying in to the developments currently under debate on the national and European levels, we focus on three sets of issues: Of central importance is legislation imposing duties on management with regard to sustainability concerns, specifically in the form of a general due diligence obligation, and establishing legal mechanisms for the enforcement of that duty (Part B below). In addition, we consider the introduction of special rules governing management compensation and the distribution of corporate profits (Part C). Finally we investigate, as a procedural instrument, measures touching on the composition of corporate management bodies (Part D). Besides Germany's national business laws, we take the legal context on the level of the EU into consideration. Here, various approaches to regulation are at present under debate or even in the process of being enacted. Owing inter alia to the precedential effect that European legislation may exert on the varying provisions of national law,[1] it is crucial to keep ongoing developments in the EU legislature in focus. Conversely, however, legislative initiatives on the national level send out important impulses that may eventually lead to regulation in the EU, as the adoption in France of a law regulating transnational supply chains has shown.[2]

On the level of the EU, there are three projects under way that are relevant to our study: The Sustainable Finance Initiative,[3] which has primarily indirect effects on business law; the Global Supply Chain Legislation,[4] which concerns business law and several other areas of law, as well; and the Sustainable Corporate Governance Initiative,[5] which will have a direct and significant impact on business law. The three primary subjects of the present memorandum of law also form the subject of these EU Initiatives. A key feature of all is the intention to obligate the managers of corporations to take sustainability issues into account. The EU Commission speaks in this connection of introducing a due diligence obligation relative to issues of sustainability, particularly human rights and the environment.

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[1] ECJ, Case C-6/64, Costa/ENEL, ECLI:EU:C:1964:66, is fundamental here.

[2] Loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre (loi de vigilance). For a discussion, see *Nasse*, ZEuP 2019, 773.

[3] Cf. in particular the Commission's Action Plan: Financing Sustainable Growth, COM/2018/097 final, dated 18.3.2018.

[4] European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)). The Commission is expected to release a first draft in the Autumn of 2021.

[5] For more details, cf. https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance.

B. Management Duties and their Enforcement

I. Basis in Law

The EU plans to adopt a human rights and environmental due diligence obligation in European business law on the basis of a directive which, pursuant Art. 288 Para. 3 TFEU, is to be implemented into national law. The resulting national provisions would consequently be interpreted in conformity with the EU directive. The ECJ would have authority to resolve any uncertainties of interpretation.[6]

From the perspective of German business law, the key provision affected by such a guideline is § 76 AktG, which stipulates that the executive board shall have full responsibility for managing the company. This only applies to stock corporations, of course, but it is these which form the primary target of the planned legislation, on account of their economic and transnational significance. The European Sustainable Corporate Governance Initiative expressly refers, in addition, to SMEs and even micro-enterprises, so analogous legislation should not be ruled out for the future. The Commission in any event tends not so much to distinguish among the various legal forms for businesses, as to orient its policies with reference to the criterion of a company's size. From the German perspective, the other legal forms of business that could be affected include, primarily, the GmbH (limited liability company) and in exceptional cases partnerships (particularly oHGs and KGs).[7] For companies in one of these forms, there is no applicable provision comparable to § 76 AktG, because the managers of such companies are significantly less independent than those of a stock corporation (AG). They are to a much greater extent subject to the instructions of shareholders.[8] With regard to terminology, we should point out that the term "directors' duties," frequently used on both the EU and national levels, is somewhat misleading. In German and more generally in Continental-European business law, the managers responsible for a company's policy decisions are not so much "directors" as members of a collegial body such as the German *Vorstand* and *Aufsichtsrat* (there are similar management organs in other jurisdictions).

The question of the extent to which duties to act in the interest of sustainability are compatible with the ultimate aims of a manager's conduct of business must be analyzed initially with reference to the historical development of that concept. Only on this basis is it

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[6] For more detail, see *Röthel*, in: Riesenhuber (Ed.), Europäische Methodenlehre (European Methodology), 3. ed. 2015, pp. 225 et seq.

[7] The legal structure of the GbR is currently undergoing fundamental reforms. Cf. the draft bill of a law (*Gesetz zur Modernisierung des Personengesellschaftsrechts (MoPeG)*) from 20.2.2021; and the discussion by *Schollmeyer*, NZG 2021, 133.

[8] For this reason, we refer in the following primarily to the law of stock corporations.

possible to provide meaningful answers to questions involving a sustainability-based due diligence obligation.

II. Historical Evolution of How the Ultimate Aims of Management's Conduct of Business are Defined

The discussion of sustainability in business law is a recent development. This discussion ties in, however, to the significantly older discourse surrounding the ultimate aims of a manager's conduct of business and puts this latter concept into a new light. To address the question of the extent to which a company's management is authorized or obligated to take sustainability issues into account, we thus must first consider the debate over a stock corporation's duties relative to the public interest (Sub-Section 1 below). This debate stretches back over a considerable history, especially given that there is "hardly a field of law ... which has been more profoundly influenced year after year by economic policy objectives than the law of stock corporations."[9] As a result, the extent to which a stock corporation is authorized or even obligated to take the public interest or the welfare of the community into account has been debated since time immemorial. We shall sketch out this development in the following paragraphs, with a view to deducing therefrom conclusions concerning the establishment of a sustainability-based due diligence obligation (human rights and environmental due diligence). Following that, we shall turn to a discussion of the prevailing legal framework, which is largely shaped by the notion of the best interests of the enterprise (Sub-Section 2). The substance of this legal notion is in turn largely shaped by the question of a business's duties towards the public interest under stock corporation law; the scope and substance of such duties remain a subject of intense debate even today.

1. Discourse over the Public Interest in Stock Corporation Law

a) The System of Privileges or Concessions

The early phase of legislation for stock corporations, in the late 18th and early 19th centuries, was characterized by a sharp dichotomy between public and private interests. The two

[9] *Lieder*, Die 1. Aktienrechtsnovelle vom 11. Juni 1870 (The First Stock Corporation Law Reform of 11 June 1870), in: Bayer/Habersack (Eds.), Aktienrecht im Wandel, Bd. I: Entwicklung des Aktienrechts (The Law of Stock Corporations in Transformation, Vol. I: Development of the Law of Stock Corporations), 2007, Chapter 7, Para. 9.

appeared incompatible to such an extent that the system of privileges and later concessions sought to weave them together by regulation, in order to provide citizens with a degree of protection from the reckless pursuit of private interests and the concomitant dangers for the public welfare. In consequence, the stock corporation was bound by statute to the public interest, insofar as the right to found a corporation was conditioned on obtaining a concession from the state and—what is far less commonly remembered—on management's accepting the oversight of a so-called governor or commissioner, who had the ongoing responsibility of ensuring that the public interest was upheld in the course of business operations.[10] Thus, pursuant to the central provision set forth in II 6 § 25 of the Prussian *Allgemeines Landrecht* (General State Laws) of 1794, founding a lawful corporation would henceforth require a sovereign act of recognition.[11] Special advantages in the form of corporate rights and in particular limited liability for the corporation's members were reserved to such companies as pursued, on an ongoing basis, an objective lying in the public interest.[12] The provision read as follows:

> *The rights of corporations and associations shall attach only to such state-approved companies as have committed themselves to pursuing on an ongoing basis an objective that lies in the public interest.*

The basis for fulfilling the condition of an objective that lies in the public interest was orientation of the company towards a "general interest of the state's economy."[13] With the enactment of further provisions pertaining to stock corporation law in the Prussian *Eisenbahngesetz* (Railroad Act) of 1838 and the Prussian *Gesetz über Aktiengesellschaften* (Stock Corporation Law) of 1843, the system of privileges gave way to a system of concessions. The concession—like the privilege—was an expression of sovereign oversight: The state sought to protect the public from imprudent enterprises by denying approval wherever the interests of the public outweighed the alleged private benefits.[14]

b) System of Normative Provisions

With the increasing dominance of liberalism in the second half of the 19th century, the requirement that a corporation bind itself to state interests and the public welfare faded and the granting of concessions increasingly took on the character of a purely bureaucratic measure. Instead, trust was placed in the self-regulating forces of the market. Further, it was

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[10] This amounts to a structural instrument. See, in more detail, Part D below.
[11] See, recently, *Fleischer*, AG 2017, 509, 510.
[12] For more support, see *Weber*, Die gemeinnützige Aktiengesellschaft (the Public-Interest Corporation), 2014, pp. 28 et seq. and the sources cited therein.
[13] Ibid. (with a detailed discussion).
[14] *Lehmann*, Recht der Aktiengesellschaften (Law of Stock Corporations), Vol. 1 (1898), 2002, p. 287.

seen as scarcely compatible with the foundations of liberalism to leave the granting of concessions in the "arbitrary" discretion of state bureaucracies. More and more, therefore, hard and fast regulations defining the conditions under which concessions should be granted were adopted.[15] These so-called normative provisions[16] characterize the transition to a normative system in connection with the first reform of the German Stock Corporation Act in 1870, nine years following enactment of the ADHGB (General German Commercial Code).[17] The ADHGB had originally provided that corporations were required to obtain a concession. The 1870 reforms introduced a newly drafted Article 208 ADHGB, which omitted the requirement of obtaining state approval for the founding of a stock corporation and instead foresaw that the establishment of the company and the content of its articles of incorporation be recorded in a court or notarial deed. The new stock corporation came into existence after successfully completing a registration procedure and being recorded in the trade registry. These extensive reforms amounted to a fundamental liberalization of the German stock corporation law. A central feature of the reform was the vanishing of state oversight over the corporation; in lieu of this, the law now foresaw mandatory establishment of a supervisory board (*Aufsichtsrat*), which henceforth acted as third organ of the corporation – and as intermediary between the executive board (*Vorstand*)[18] and the General Shareholders' Meeting (today called *Hauptversammlung*).[19] Introduction of the supervisory board with the ADHGB in 1861 has its historical basis in the state's desire to retreat from the oversight of stock corporations and replace such oversight with another control mechanism.[20] The role assigned to the supervisory board was initially to ensure that the public interest was upheld, acting as an extension of the arm of the state. Thus, German law did not return to a positive-law standard mandating respect of the public interest, even though the growing acceptance of socialist values towards the end of the 19th century demanded a shift in national economic

[15] *Kießling*, in: Bayer/Habersack (Eds.), Aktienrecht im Wandel, Vol. I (Fn. 9 above): Ch. 7, Para. 47.
[16] Ibid.
[17] Gesetz betreffend die Kommanditgesellschaften auf Aktien und die Aktiengesellschaften (Law concerning Partnerships with Shares and Stock Corporations), Bundes-Gesetzblatt des Norddeutschen Bundes 1870, p. 375; see also *Lieder*, in: Bayer/Habersack (Eds.), Aktienrecht im Wandel, Vol. I (Fn. 9 above): Ch. 10 (discussing the law) and *Schubert*, ZGR 1981, 285, 292 et seq. (with an extensive discussion).
[18] *Primker*, in: Endemann, Handbuch des deutschen Handels- See- und Wechselrechts (Handbook of German Trade, Maritime, and Securities Law), Vol. 1, Part 2, p. 502, 580.
[19] The ADHGB of 1861 had left establishment of the supervisory board to the discretion of the corporation and its shareholders, cf. Art. 225 ADHGB. This organ, previously designated as the *Verwaltungsrat*, was however primarily comprised of representatives of the shareholders and therefore was not in a position to effectively oversee the business conduct of the management board. Cf. *Lieder*, Der Aufsichtsrat im Wandel der Zeit (The Supervisory Board in Transformation), 2006, p. 79.
[20] *Hopt*, Comparative corporate governance, the state of the art and international regulation, in: Fleckner/Hopt (Eds.), Comparative Corporate Governance, 2013, p. 3, 29. The justifications offered for the 1870 reform of the Stock Corporation Act spoke in this connection of a "corporation's right to supervise itself," cf. Stenografische Berichte über die Verhandlungen des Reichstages des Norddeutschen Bundes, I. Legislatur-Periode (Stenographic reports on the discussions held in the Parliament of the North-German Alliance, First Legislature Period), Session 1870, Vol. 4, Annex No. 158, p. 645, 655.

policy away from classical economic liberalism and towards more active intervention of the state.[21]

c) Rathenau and the "Corporation as Such"

In the 20th century, the discourse over the public welfare and stock corporations was shaped in part by ideologies or – from today's perspective – by a critique of ideologies. This is already evident when we look at the law and policy debate over the notion of the corporation as such, which was spawned by the writings of Walther Rathenau. This theory dissociated the stock corporation from the private interests of its individual shareholders and held that, in light of the increased economic significance of large corporations and consolidated groups, the corporation, through its governing organs, had in practice become an independent entity. Most remarkable, especially in the context of the international debate over corporate governance, is the fact that Rathenau emphasized the long-term existence of the corporation as contrasted with the private interests of individual shareholders. We find this core plea reflected in the following sentence, which is central to Rathenau's theory:

> *The large enterprise today is no longer an amalgam of private legal interests at all; rather, it is, both singly and collectively, a factor of the national economy, forming an integral part of the whole; which may well, for historical reasons – justly or unjustly – continue to bear the features of a purely profit-oriented business operating in the private economy, despite that it has long since and increasingly become an entity of service to the public interest and as such has acquired a new right to existence.*[22]

Above all, it is interesting that Rathenau demands that the corporation be maintained "for the benefit of the public as a whole" and that to this end we protect it from "being carved up into little pieces by the particularism of private interests."[23] This goal proves that Rathenau's understanding of the corporation looks beyond its origin as an aggregation of the various interests of its stakeholders and instead emphasizes the macro-economic context of the enterprise. The discussion that Rathenau incited, above all with a view to creating harmony among the public interest, employees, and the (justified) interests of shareholders, prepared the ground for the reforms to come.

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[21] *Winkel*, in: Coing/Wilhelm (Eds.), Wissenschaft und Kodifikation des Privatrechts im 19. Jahrhundert (Understanding and Codification of Private Law in the 19th century), Vol. IV, 1979, p. 3, 10; *Laux*, Die Lehre vom Unternehmen an sich (The Theory of the Corporation as Such), 1998, p. 54 f.

[22] *Rathenau*, Vom Aktienwesen. Eine geschäftliche Betrachtung (On Stock. A Business Perspective), 1917, p. 38 f.; the same passage is also quoted as "key provision" of the work in *Fleischer*, JZ 2017, 991, 992.

[23] Id., p. 41.

d) Stock Corporation Act of 1937 and 1965

The German legislature, in the well-known public-welfare clause introduced in 1937 as § 70 Para. 1 AktG, expressly obligated the executive board,

> *on its own responsibility and discretion, to manage the corporation as the well-being of its business operations and employees, and the common utility of the [German] people and empire, shall require.*[24]

According to the authors of the commentary accompanying the legislative committee's draft bill, this public-welfare clause, as "unwritten preamble to the Stock Corporation Act," also constitutes the central "guideline for interpretation of the Act as a whole."[25] Remarkably, the provision does not include the interests of shareholders among the factors defining the ultimate aims of the enterprise. Owing to association of the public-welfare clause, as so formulated, with the ideology of the Nazis, the Stock Corporation Act reforms of 1965 deleted this provision from the text of the statute. Nevertheless, the fate of the public-welfare provision in § 70 Para. 1 AktG was a subject of intense debate during the drafting stage of the reforms. The draft bill proposed by the legislative committee took a different approach from the government bill. The committee draft included the public-welfare clause with slightly revised language—in particular recognizing the interests of shareholders—but the government ultimately omitted this "statement of the obvious."[26] The committee draft was formulated as follows:

> *The executive board shall, on its own responsibility and discretion, manage the corporation as the well-being of the enterprise, of its employees and shareholders, and of society as a whole shall require.*[27]

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[24] See *Fleischer*, ZGR 2017, 411, 412 f. (which gives an instructive overview of how this clause came about); *Raiser/Veil*, Recht der Kapitalgesellschaften (The Law of Corporations), 6th Ed., 2015, p. 5; *Riechers*, Das „Unternehmen an sich" (The "Corporation as Such"), 1996, pp. 154 et seq. (with reference to the theory of the corporation as such).

[25] *Schlegelberger/Quassowski*, AktG, 3d Ed. 1939, § 70 Para. 8; the law-makers did in fact consider including this principle as written preamble at the head of the Stock Corporation Act, cf. *Fleischer*, ZGR 2017, 411, 413 (and the sources cited therein).

[26] *Kropff*, Aktiengesetz: Textausgabe des Aktiengesetzes vom 6.9.1965 und des Einführungstextes zum Aktiengesetz (Stock Corporation Act: The Act as published in 6.9.1965 and its Introductory Text), 1965, p. 97 f.; see also *Fleischer*, ZGR 2017, 411, 414; *Rühmkorf*, Shareholder Value versus Corporate Sustainability, in: Sjåfjell/Bruner (Eds.), The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, 2020, pp. 232, 234; and finally *Schubert*, Das Unternehmensinteresse – Maßstab für die Organwalter der Aktiengesellschaft (The Best Interests of the Enterprise – Standard for the Managers of a Stock Corporation), 2020, p. 27.

[27] *Bundesjustizministerium*, Referentenentwurf eines Aktiengesetzes – Gesetz über Aktiengesellschaften und Kommanditgesellschaften auf Aktien nebst erläuternden Bemerkungen (Committee's Draft of a Stock

The government bill omitted any such standard, on grounds that the objectives set forth in the committee draft for the conduct of the executive board were self-evident and therefore need not be explicitly included in the text of the statute.[28] After intense debate, the legislature thus ultimately omitted any public-welfare clause and adopted as new § 76 AktG the following language, which remains in force to this day:

The executive board shall manage the corporation on its own responsibility and discretion.

With this history in mind, it is clear—albeit controversial—that the assumption of a corporation's obligations with regard to the public welfare remains valid as an unwritten principle of stock corporation law. It is no doubt more owing to the oft-noted shortcomings of such a clause in terms of its legal substance—rather than its repeatedly emphasized self-evidence—that the practical relevance of this public-welfare obligation in the ensuing years remained minimal.

e) More Recent Developments and Reform Proposals

More recent developments have focused less on the question of the public interest and more on the rubric of the best interests of the enterprise, as well as—above all in response to calls for shared control of the corporation—the weight to be assigned to the conflicting concerns of different interest groups within the corporation. The question of a public-welfare obligation becomes prominent again only in connection with the contemporary discourse over sustainability and ties in explicitly to the rubric of Corporate Social Responsibility. This is evident in recent reform proposals, which seek to re-introduce the notion of the public welfare into the normative guidelines for the conduct of the executive board:[29] In connection with the discussion over management salaries fanned into fire by the financial crisis, the SPD Parliamentary bloc in 2017 drafted a legislative bill addressing this question. In that draft, they propose expanding § 76 Para. 1 AktG to include a provision that once again expressly invokes the public interest as a reference for the conduct of the executive board: [30]

Corporation Act – Act on Stock Corporations and Stock Partnerships together with Explanatory Notes), 1958, § 71 Para. 1.

[28] Regierungsentwurf eines Aktiengesetzes nebst Begründungen (Draft Bill of a Stock Corporation Act together with Commentary and Rationale), BT-Drucks. IV/171 of 3.2.1962, Rationale for § 73, p. 121; *Kropff*, Aktiengesetz, 1965, p. 97 f.; see also *Reuter*, AcP 179 (1979), 509, 552 (in accord with the foregoing).

[29] *SPD-Fraktion (SPD Parliamentary bloc)*, Entwurf eines Gesetzes zur Angemessenheit von Vorstandsvergütungen und zur Beschränkung der steuerlichen Absetzbarkeit (Draft Bill for an Act on the Proportionality of Executive Board Compensation and the Limitation of Tax Deductibility) of 20.2.2017.

[30] Ibid.

> *[In directing the affairs of the corporation, the executive board] has an obligation towards the well-being of the enterprise, its employees, its shareholders, and the public interest.*

As grounds for this addition, the drafters state that clarifying the existing obligations of the executive board is an appropriate measure to enable better evaluation of the executive board members' performance and shortcomings, as the case may be, which is required to evaluate in turn the appropriateness of their compensation.[31] As normative background, they refer moreover expressly to the obligation towards the public welfare set forth in Art. 14 Para. 2 GG (German Constitutional Law); and state that this obligation ought to be incorporated into the Stock Corporation Act, as well.[32] This reform proposal did not find a majority for adoption in Parliament. Nonetheless, reviewing it makes clear that debate over a public-welfare obligation has in recent years taken place on a much wider basis. The key point of reference for the contemporary corporate governance discussion is thus no longer merely the stock corporation's obligation towards the public welfare. Rather, the debate oscillates between the two poles of a standard of conduct for the executive board monistically oriented towards the maximizing of shareholder value, on the one hand, and a pluralistic understanding of the enterprise, in which the public interest is to be considered merely as one among the numerous factors defined by the interests of the corporation's several stakeholders, on the other. In order to see how the discourse arrived at the point where it is today, we thus must review the legal notion of the best interests of the enterprise. This rubric is the link between the traditional discourse surrounding the public-welfare obligation and the contemporary corporate governance discourse. The latter is today shaped increasingly by the dichotomy between shareholders and stakeholders, borrowed from the Anglo-American legal tradition.

2. The Best Interests of the Enterprise as Standard for the Conduct of Management

The best interests of the enterprise today represents the central standard for assessing the conduct of a corporation's management, although neither this term nor its precise content is explicitly defined by statute. The discourse surrounding the best interests of the enterprise stretches back over nearly a century now.[33] It ties in to the discourse concerning the public interest and stock corporations, in part overlapping with that discussion in substance and in part extending it. The question of the stock corporation's obligations vis-à-vis the public welfare looks outward and focusses on the relationship between the corporation and civil society. That of the best interests of the enterprise, by contrast, focusses more narrowly on the company's internal organization, targeting primarily the extent to which the relationship

[31] Id., p. 12.
[32] Ibid.
[33] Provided one takes into consideration its precedents, sc. the debate over the concept of the corporation as such initiated by Rathenau.

among various stakeholder interests can be shaped, while not disregarding the enterprise's significance within the broader societal context.

a) Statutory Levers and Evolution of the Discussion

Stock corporation law as currently in force refrains from defining the objectives of the executive board's conduct of operations in § 76 Para. 1 AktG. Article 93 Para. 1 sent. 2 AktG cites, as principal criterion for the obligations of management in the context of the so-called business judgement rule, the "welfare of the corporation." Interpreting this term – which likewise lacks any precise definition – ultimately involves finding an appropriate balance in a complex web of interests. Management enjoys a degree of discretion in their assessment of this balance.[34] The German Corporate Governance Code (GCGC) has expressly referred, from its initial version published in 2002, to the concept of the best interests of the enterprise. In 2009, it even furnished a definition of the term, but this definition does not have the force of law. Given the importance of the standard of the best interests of the enterprise for the orientation of management decision-making, the absence of any clear definition of its substance has ensured that its meaning remains a subject of ongoing controversy through the present day.[35]

The discourse over the best interests of the enterprise reached its zenith in the late 1970s and early 1980s and was dominated by the attempt to transform the law of corporations into a law of enterprises. All in all, a large number of theories giving shape to this idea were developed. These theories were by no means limited to serving a descriptive-analytical function. Rather, they also sought to develop binding standards of conduct for the corporation's governing bodies and to answer the questions of liability pertaining thereto. The attempt to concretely define the substance of the term best interests of the enterprise, however, never succeeded in the sense of producing a broadly accepted set of criteria for its evaluation; in the end, it remains impossible to draw anything like a clear guideline for conduct for managers from the intense and extensive debates on this subject.[36]

A little later, the patterns of thought shifted towards a diametric opposition between the concepts of shareholder and stakeholder value, largely shaped by the Anglo-American

[34] *Spindler*, in: Münchener Kommentar zum AktG (Munich Commentary on the Stock Corporation Act), 5th Ed. 2019, § 93 Para. 54.

[35] More on this point immediately following.

[36] For a comprehensive discussion, see *Brinkmann*, Unternehmensinteresse und Unternehmensrechtsstruktur (The Best Interests of the Enterprise and the Structure of Enterprise Law), 1983; *Jürgenmeyer*, Das Unternehmensinteresse (The Best Interests of the Enterprise), 1984; and for a more recent perspective with reference to sustainability concerns: *Schubert*, Das Unternehmensinteresse – Maßstab für die Organwalter der Aktiengesellschaft (The Best Interests of the Enterprise – Standard for Managers of the Stock Corporation), 2020.

corporate governance discourse. The notion of shareholder value, which prioritizes the interests of shareholders, gained great significance in the discussion of corporate governance in Germany, as well, particularly in the 1990s. It led to a number of measures reforming the law of stock corporations, by which the legislature aimed to adapt that law to the needs of modern capital markets.[37] Of especial significance in this connection are the amendments to the law of stock corporations introduced by the German Act on Oversight and Transparency in the Corporate Sector (KonTraG),[38] which oriented the standard for management of the enterprise more clearly towards augmentation of the company's share value on the stock markets.[39] Although recognition has been accorded here and there to the theory of shareholder value, an overwhelming majority of commentators in the German discourse over corporate governance hold to a pluralistic concept of the best interests of the enterprise as guideline for the conduct of a stock corporation's management.

b) Substantive Guidance from the German Corporate Governance Code (GCGC)

The guiding principle for the executive board, as set forth in the original version of the German Corporate Governance Code (GCGC) from 2002, was amended to better reflect this pluralistic view in 2009.[40] Section 4.1.1. GCGC thereafter contained, for a good ten years, the following provision:

> *The executive board shall direct the enterprise with a view towards sustainable value creation on its own responsibility and discretion and in the best interests of the enterprise, that is, with due regard to the concerns of its shareholders, employees, and other groups involved in the enterprise (stakeholders).*

The extent to which this definition, however, had in practice a tangible impact on resolving real conflicts within the corporation may be doubted. This is true in part simply as a result of the provision's non-binding formulation: Formally, the 2009 version of Section 4.1.1. GCGC, as a mere clarification of statutory wording, was not covered by the obligation set forth in § 161 AktG.[41] Thus neither the executive board nor the supervisory board of exchange-listed corporations was obligated to confirm on an annual basis, as that provision requires, the

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[37] *Birke*, Das Formalziel der Aktiengesellschaft (The Formal Aims of the Stock Corporation), 2005, p. 206 f.; *Seibert*, AG 2002, 417.

[38] Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (Act on Oversight and Transparency in the Corporate Sector, KonTraG) of 27 April 1998, BGBl. I 1998, p. 786; see also *Claussen*, DB 1998, 177; *Zimmer*, NJW 1998, 3521.

[39] BT-Drucks. 13/9712, p. 11; cf. *Birke*, op.cit. (Fn. 37), 2005, pp. 207, 209.

[40] *Fleischer*, ZGR 2017, 411, 416 f.; on the amendment process, see *Werder*, in: Kremer/Bachmann/Lutter/v. Werder (Eds.), Deutscher Corporate Governance Kodex (German Corporate Governance Code), 6th Ed. 2016, 4.1.1., Para. 802 et seq.

[41] *Fleischer*, ZGR 2017, 411, 417.

extent to which they had oriented their decision-making towards the pluralistic guiding principle of Section 4.1.1. GCGC.

The revisions to the GCGC from 16.12.2019, which went into effect on 20 March 2020, altered the picture. In substance, the Code's conception of the best interests of the enterprise was maintained, but the relevant wording was moved to a new place in the Code, from Section 4 into the Foreword, and combined with the obligation to pursue an economic model based on the social market economy, which had already appeared in the Foreword of the previous version of the GCGC.[42] The fundamental principles of the GCGC 2019 refer to this concept repeatedly. Thus, for instance, in Principles 1 (sent. 1), 10, 13 (sent.1) and 19, members of the executive board and the supervisory board are expressly obligated to uphold the best interests of the enterprise. The revised structure of the GCGC introduced the category of fundamental principles, alongside those of the comments and recommendations already present in previous versions, in order to reduce to a minimum the category of provisions which merely recite the provisions of prevailing law. As a result, those recitals concentrate on the restatement of the principal legal provisions defining responsible management of an enterprise, and this heightens the significance of the term best interests of the enterprise and the meaning assigned to it in the GCGC in comparison with earlier versions of the Code. Because, however, the new category of fundamental principles is not included among the provisions with which managers are obligated to disclose the extent of their compliance pursuant to § 161 AktG, the impact of these provisions—as with their predecessors—has remained limited.

All in all, one may conclude that the notion of shareholder value has neither replaced the concept of the best interests of the enterprise nor predominantly shaped its meaning. Instead, the past twenty years have witnessed an increasing tendency to (re-)emphasize a pluralistic view of stakeholder value, which has found expression in the case law of the BVerfG and BGH (Germany's Constitutional and Supreme Courts, respectively) on the capital market orientation of share ownership as well as in various proposals from legal scholars and political bodies.[43] The German law of stock corporations has thus refuted the theory of convergence so prominently championed at the turn of the century: Contrary to the prognosis of an "end of history for corporate law," to quote the title of an article by Henry Hansmann and Reiner

[42] Para. 1 of the Foreword to the current version of the GCGC from 2019 now reads: "The Code highlights the obligation of Management Boards and Supervisory Boards—in line with the principles of the social market economy—to take into account the interests of the shareholders, the enterprise's workforce and the other groups related to the enterprise (stakeholders) to ensure the continued existence of the enterprise and its sustainable value creation (the enterprise's best interests)."

[43] See *BVerfG* NZG 2012, 826, 828; and *Klöhn*, NZG 2012, 1041, 1044 (commenting on the foregoing); BGH NJW 2014, 146; and *Bayer*, ZfPW 2015, 163 (commenting on the foregoing).

Kraakman, there is no indication at present that the various systems of corporate governance worldwide are converging towards a consensus around the principle of shareholder value.[44]

c) Conclusions and Current Reform Proposals

In contrast to the stakeholder theory as developed in the US-American corporate governance discussion, the guiding conception of the best interests of the enterprise is not limited, according to the prevailing and most cogent view, to a merely procedural approach, which takes the various stakeholder groups directly into consideration. Rather, it is shaped to a much larger extent by normative principles of overriding importance. This understanding is the consequence of a substantive connection between the best interests of the enterprise and the discourse over stock corporations and the public welfare. The latter discourse, as a result of its incorporation into statute, constitutes a theoretical foundation for construction of the relationship of the stock corporation to the public domain and thus to society as a whole. Stakeholder interests are relevant to determination of the best interests of the enterprise in any particular case and have a decisive influence on how we understand the term. Nevertheless, members of the executive board, in their corporate decision-making, must take the broader context of the relationship between the enterprise and society as a whole into consideration. Statutory clarification of this principle, for instance in the form of an enrichment of the substance of § 76 Para. 1 AktG, would thus be useful.

Numerous commentators and political bodies have recently put forth proposals to this purpose. Peter Hommelhoff suggested, as early as 2001, in connection with implementation of the OECD Guidelines, an amendment to § 76 AktG so as to specify explicitly that the executive board, in directing the corporation's affairs, must take into account the interests of shareholders, employees, and other parties with an interest in the enterprise.[45]

Recently, Claudia Schubert put forth a similar demand: In light of the decades-old discussion concerning the best interests of the enterprise in connection with the more recent debate over sustainable and socially responsible business management, § 76 Para. 1 AktG should be revised to reflect the current state of the discussion. A pluralistic view of management obligations, which expressly recognizes the interests of shareholders and employees, should

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[44] *Hansmann/Kraakman*, Georgetown Law Journal 89 (2001), 439, 441: "as a consequence of both logic and experience, there is convergence on a consensus that the best means to … the pursuit of aggregate social welfare is to make corporate managers strongly accountable to shareholders interests and, at least in direct terms, only to those interests." For a critique of this view, cf. *Sjåfjell/Johnston/Anker-Sørensen/Millon*, Shareholder Primacy: the main barrier to sustainable companies, in: Sjåfjell/Richardson (Eds.), Company Law and Sustainability, 2015, p. 79; *Welsh/Spender/Lynch Fannon/Hall*, Australian Journal of Corporate Law 29 (2014), 147.

[45] *Hommelhoff*, ZGR 2001, 238, 250 (who however, in light of a "unanimously accepted interpretation" of the current state of the law, holds back from endorsing a pluralistic view).

be codified.[46] With a view to other interest groups, Schubert took the position that § 76 Para. 1 AktG should incorporate the concept of social responsibility, and this should function as an overarching term that comprehends other groups of stakeholders as well as the public interest.[47] Finally, her proposal suggests pointing out that the interests of such other groups form a part of the corporation's own best interests and that more comprehensive obligations relative to the public welfare or third parties are defined in express statutory provisions or a state-imposed mandate of self-regulation.[48] Codification of a pluralistic understanding of the enterprise's interests is also recommended in the proposal put forth by the Parliamentary bloc Bündnis 90/Die Grünen in 2012, which however targets § 93 Para. 1 sent. 2 AktG and suggests the following language:

> *Moreover, it does not constitute a breach of duty when the executive board member bases his or her decision on standards of human rights, social responsibility, or environmental protection to which the Federal Republic of Germany has obligated itself to adhere under international law.*[49]

III. Conclusions relevant to the Anchoring of a Sustainability-based Due Diligence Obligation in Statute

From the developments traced out above, we can draw several conclusions relevant to the anchoring of a sustainability-based due diligence obligation in statute.

1. Anchoring in Statute

First of all, creating a statutory duty for business managers to take sustainability issues into account would be no novelty in the law of stock corporations from a historical point of view. The corporation's obligations vis-à-vis the public welfare, which find expression in various statutory provisions, as well as the legal concept of the best interests of the enterprise, make clear that concern for the public interest by the management of a corporation has always played an important role in the law of enterprises. The developments show that legal duties of this nature have played a role not only in the area of public law, where – as for instance

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[46] *Schubert*, Das Unternehmensinteresse – Maßstab für die Organwalter der Aktiengesellschaft (The Best Interests of the Enterprise – Standard for the Management of a Stock Corporation), 2020, pp. 210 et seq., 220 (Thesis 24).
[47] Ibid.
[48] Ibid.
[49] BT-Drucks. 17/11686, Entwurf eines Gesetzes zur Änderung des Aktiengesetzes (Draft Bill for an Amendment to the Stock Corporation Law) of 18.11.2012.

with environmental provisions – the obligations are imposed on corporations "from the outside;" but also that the law of stock corporations itself has served and in principle continues to serve as a vehicle for defining such duties. Owing to the historical circumstances, environmental issues, in contrast to social issues, have only fairly recently captured the attention of legislators and business actors. From the point of view of the tools used for regulation, however, what applies to the one field in essence applies to the other.

The statutes in Germany as currently in force make practically no explicit reference to the obligation of business managers to take sustainability concerns into account. Under the current state of the law, the standards governing the conduct of business managers are largely of an unwritten nature. For this reason alone, as also in light of the most recent developments, clarifying this duty in § 76 AktG is not only possible, but appropriate to meet the demands repeatedly made by legal scholars and political actors and establish a statutory norm that reflects the overwhelming consensus on the relevance of the best interests of the enterprise as key standard. Another possible target for an amendment of this kind, besides § 76 AktG, might be § 93 AktG.

2. Substance of the Proposed Amendment

Creating a due diligence obligation of this nature is thus not just possible from a legal point of view, but even overdue. What remains in question is the precise formulation of such a duty: Several versions of it are currently under debate on both the national and the European levels.

An important first step is understanding that, in light of the discussions concerning the law of stock corporations in Germany, any simple dichotomy between a monistic view of the shareholder value theory and the contrasting pluralist stakeholder approach is too narrow a straightjacket for any comprehensive portrayal of the problems at stake. The developments sketched out above make clear that due regard for environmental and social issues from the managers of stock corporations involves more than just internal corporate governance. It touches fundamentally on the relationship between public and private interests. It thus raises the question of the relationship of the stock corporation to society as a whole, which is subject to a dynamic process of evolution tied to the given historical context. Narrowing the business-law discussion to a stand-off between the shareholder approach and the stakeholder approach thus over-emphasizes a debate that has played a more modest role in the overall historical context. In consequence, a legislative solution that does no more than resolve this conflict in favor of the stakeholder model, and then integrate social and environmental concerns into it, would not appear to be very useful. Moreover, the diversity of the various stakeholder groups and their often disparate motives would speak against prioritizing any particular interest group – for this would inevitably entail disadvantaging others.

A more adequate approach would, by contrast, take the legal concept of the best interests of the corporation as hook for establishing a sustainability-based due diligence obligation. Such an approach is, particularly from the perspective of the German law of stock corporations, better suited to integrating sustainability issues into the business law. The rubric best interests of the corporation can readily incorporate the ideas of the pluralistic stakeholder model, but goes beyond that by tying in the discourse over stock corporations and the public welfare in the law of stock corporations and producing a link between the enterprise and society as a whole. The legislature could thus explicitly obligate business managers in statute to have due regard for the best interests of the corporation, even if the specific content of that duty would continue to depend on the circumstances of the particular case. In this way, the legislature ultimately would be merely codifying an obligation which the broader German law of stock corporations already imposes on managers.[50] To obtain the requisite clarity, however, this provision would need to be combined with a new, general due diligence obligation in business law.

A measure which went no further than to clarify the term best interests of the corporation and stipulate that it extends to taking sustainability issues or environmental and social factors into due account would already be very helpful and quite doable from a legal point of view. This need not mean, however, that the concept of the best interests of the corporation would be prescribed in detail by statute. The long history of discussions over this notion has shown that defining it abstractly in a legally binding fashion is neither possible nor desirable. This observation is worth making outside the national context, as well: On the level of the EU, there is currently a debate over whether the concept of the best interests of the corporation should be harmonized in European law.[51] This is a highly controversial question, which should be answered in the negative on the basis of the rationale set forth in the present study. Nevertheless, the best interests of the corporation should, on the level of EU law, too, be used as a key standard in establishing a duty of sustainable business management with regard to environmental and social concerns. More concretely, the legislature (the national and the European both) could in this context refrain from anchoring the principle of stakeholder value in statute and instead stipulate that the goal of business management and consequently the best interests of the corporation should be oriented towards "*sustainable value creation within the confines of the Planet Earth*."

How any given enterprise may best reach this goal in practice should be left for the corporation's governing bodies (executive board and supervisory board in a stock corporation)

[50] See Schubert, Das Unternehmensinteresse (Fn. 46 above), 2020, pp. 210 et seq., 220 (Thesis 24) (drawing a similar conclusion).

[51] This question formed the subject of the Commission's public consultation on the Sustainable Corporate Governance Initiative between October 2020 and February 2021.

to determine on a case by case basis, depending on the circumstances, as appears from the developments traced out in the present study. In order to provide management with the necessary basis for their deliberations, however, it is crucial to establish a sustainability-based due diligence obligation. For reasons of consistency, this obligation should also be based on the understanding of sustainability recognized in European and international law, i.e., it should extend to environmental, social, and corporate governance concerns and demand sustainable value creation within the confines of the Planet Earth. It would be fitting to anchor this obligation in various fields of regulation, as for instance has been done in the currently circulating draft of an Act on Corporate Due Diligence in Supply Chains.

IV. Enforcement of such an Obligation

Enforcement of a sustainability-based due diligence obligation is closely tied to the question of precisely how it is formulated. Several areas of law are potentially affected by an imposition of liability on corporations and/or the members of its governing bodies—especially in light of the transnational implications. Such liability could impact the norms of (international) procedural law, as well as those of international private law. The EU legislature has already unified large areas of the international private law and civil procedure law, so these acts of law would need to be taken into consideration, as well. From the point of view of substantive law, various provisions of the law of contracts, the law of torts, and the penal law would potentially be impacted. Given the differences present among the various national systems of liability, and the concomitant legal uncertainties, one could argue, on the one hand, that a European solution for questions of enforcement would be desirable. Experience, however, shows that the EU legislature – precisely on account of these structural differences – has acted with remarkable restraint with regard to harmonizing the mechanisms for imposing sanctions in core areas of civil law.[52] For this reason, it is necessary to develop enforcement solutions on the national level.

[52] This is readily apparent, e.g., in the field of contractual and consumer law, see *Schwintowski*, in: Schulze/Ebers/Grigoleit (Eds.), Informationspflichten und Vertragsschluss im Acquis communautaire (Informational duties and Contracting in the *Acquis communautaire*), 2003, pp. 267, 289 ("Chronic deficit of legal consequences in European Directives"); but also in the law of capital markets, see, e.g., the Market Abuse Regulation (Reg. (EU) No. 596/2014 of 16 April 2014).

1. Model of Liability under the Current State of the Law

On the national level, various models of liability are being deliberated in connection with the discussion over the regulation of transnational supply chains:[53] Contractual liability only arises where there was a contractual relationship between the damaged party and the responsible party. As a result, it is generally of little significance for remedying damages that arise along transnational supply chains. For those who suffer when European companies violate human rights or environmental standards are only in rare cases the company's contractual partners.

The focus of reform proposals lies therefore instead with liability in tort law for the conduct of corporations. But here, too, numerous problems arise. In the first place, the violation of human rights or environmental standards as such does not constitute the breach of any legally recognized right under § 823 Para. 1 BGB.[54] Even when in a given case the conduct of the corporation does breach one or more of the legally recognized rights thereunder, § 823 Para. 1 BGB in general only imposes sanctions for conduct committed by the responsible party itself (the so-called *Vertrauensgrundsatz*, or principle of legitimate expectations).[55] Strong grounds must therefore be supplied for imposing comprehensive liability all along the supply chain. Those in favor of doing so draw upon the case law of the BGH relative to the due diligence obligation in tort law or the duty to ensure the safety of passers-by, applicable to anyone whois the owner of a source of danger.[56] The criteria developed for liability in that context can in principle be applied to the context of the supply chain, as well.[57] There are, however, hurdles to overcome in the law of stock corporations: The issue of how far the chain of responsibility stemming from organizational fault should extend is highly controversial. The same is true with regard to the liability of a parent company for its subsidiaries, since the principle recognizing the independence of a legal entity under German stock corporation law (*Rechtsträgerprinzip*), or the principle of limited liability or separability within a group of

[53] *Habersack/Ehrl,* AcP 219 (2019), 155, 190 et seq.; *Mansel,* ZGR 2018, 439 (from the perspective of international private law); *Saage-Maaß/Leifker,* BB 2015, 2499, 2501; *Wagner,* RabelsZ 80 (2016), 717, 750 et seq. *Weller/Kaller/Schulz*, AcP 216 (2016), 387, 398 et seq.; *Weller/Thomale,* ZGR 2017, 509, 517 et seq.; *Wendelstein,* RabelsZ 83 (2019), 111, 124 et seq.

[54] See *Weller/Kaller/Schulz*, AcP 216 (2016), 387, 400 and the sources cited therein (with regard to violations of human rights).

[55] *Wagner,* RabelsZ 80 (2016), 717, 758.

[56] See the Memorandum of Law from the Initiative Lieferkettengesetz, available for download at: https://lieferkettengesetz.de/wp-content/uploads/2020/02/200527_lk_rechtsgutachten_webversion_ds.pdf (citing further sources, including BGH, Urteil (Ruling) of 14.10.1964 – IbZR7/63, NJW 1965, 197; BGH, Urteil (Ruling) of 30.11.1965 – V/ZR 145/64; and—in agreement with the foregoing—the Fifth Civil Chamber of the BGH, Urteil (Ruling) of 23.2.2000 – VZR 389/99.

[57] *Grabosch/Scheper,* Die menschenrechtliche Sorgfaltspflicht von Unternehmen, Studie im Auftrag der Friedrich-Ebert-Stiftung (The Human Rights Due Dilgence Obligation for Companies, Study Commissioned by the Friedrich-Ebert-Stiftung), 2015.

affiliated companies (*Trennungsprinzip*), generally stands in the way.[58] These principles represent an expression of the tort-law principle of legitimate expectations in the context of stock corporation law and hold that the conduct of one independent legal entity within a group of affiliated companies is in general not to be ascribed to the others (no "piercing of the corporate veil"). This applies both to the relationship among affiliated companies in a consolidated concern and to the relationship between a corporation and its stockholders.[59] But here, too, a trend towards qualifying the principle that prohibits piercing the corporate veil is evident—both in the literature and particularly in recent case law from various jurisdictions. As a result, it is no longer inconceivable that plaintiffs will be able to rely on § 823 Para. 1 BGB as basis for holding a parent company liable for the breach of human rights or environmental standards by its subsidiaries.[60]

The liability set forth in § 823 Para. 1 BGB applies equally, pursuant to § 823 Para. 2 BGB, to anyone who violates a so-called law for the protection of third parties (*Schutzgesetz*), i.e., a law which, at least in part, serves to protect the private interests of individuals.[61] This is generally the case with respect to individual liberties and human rights. Such rights, however, are traditionally formulated under national law as also under international treaties as rights of the citizen vis-à-vis the state.[62] Private companies, under the clearly prevailing opinion, do not qualify as parties bound by international treaties and thus as parties bound to uphold individual liberties and human rights.[63] Likewise controversial is the question of whether the UN Guiding Principles on Business and Human Rights, which were introduced by the Human Rights Council as soft law standards in 2011 and which prescribe an obligation of human rights due diligence for corporations, qualify as a *Schutzgesetz* for the benefit of third parties within the meaning of the BGB. From an international perspective, the recent seminal ruling of The Hague District Court in the Netherlands in re: Royal Dutch Shell (RDS)[64] speaks in favor of such

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[58] See, e.g., *Wagner,* RabelsZ 80 (2016), 717, 759 et seq. (also discussing recent developments tending to relax this principle).

[59] Ibid.

[60] See especially the seminal ruling of the UK Supreme Court in Okpabi v Royal Dutch Shell (12.2.2021) and, three months later, the ruling of The Hague District Court in the Netherlands in re: Royal Dutch Shell (RDS) from 26.5.2021 (which goes much further); we discuss this development in more detail in Section B III 2 below. See also *Schall*, ZGR 2018, 479 – 512.

[61] *Wagner*, in: Münchener Kommentar zum BGB (Commentary to the BGB), 8th Ed. 2020, § 823 Para. 562.

[62] BVerfGE 61, 82, 101; *Bethge*, VVDstRL 57 (1998), 7, 14; *Gärditz*, in Landmann/Rohmer, Umweltrecht (Environmental Law), 93d EL August 2020, Art. 20a GG (German Constitutional Law) Para. 73.

[63] For a more detailed discussion, see *Dörr*, Unternehmensverantwortlichkeit im Völkerrecht (Corporate Responsibility in International Law), in: Reinisch/Hobe/Kieninger/Peters (Eds.), Unternehmensverantwortung und Internationales Recht (Corporate Responsibility and International Law), 2020, pp. 133, 136 et seq.; *Weller/Kaller/Schulz*, AcP 216 (2016), 387, 406.

[64] The ruling can be downloaded in English at: https://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:RBDHA:2021:5339; for a detailed discussion of it, see the article of Burgers from 2.6.2021 on the blog "Blogging for Sustainability," sponsored by the University of Oslo, which can be downloaded at https://www.jus.uio.no/english/research/areas/companies/blog/companies-markets-and-sustainability/2021/2021-06-02.

a view: The Court here referred explicitly to the UN Guiding Principles in interpreting a tort-law provision from the Dutch Civil Code so as to obligate corporations to comply with the human rights referred to in the Guiding Principles. On this basis, the Court granted the temporary injunction sought by the plaintiffs, which obligated RDS to reduce, between now and 2030, the overall emissions of the consolidated Shell concern by 45 % relative to 2019. The argumentation used by the Court in RDS could just as well be applied to the German tort law.

The argument for basing the liability of a parent company or dominant customer under § 831 BGB on the model of a principal's liability for his agent is generally rejected.[65] Such liability for "vicarious agents" only attaches where the company causing the damages is bound to follow the instructions of the principal that is to be held liable. As subsidiaries and suppliers are generally independent enterprises, they do not qualify as "vicarious agents" within the meaning of the applicable standard.[66] In any event, the principal can exonerate itself pursuant to § 831 Para. 1 sent. 2 BGB, provided it can prove that it exercised the degree of care required in the industry or that the damages would have arisen anyway, even if it had exercised this degree of care. As the principal in the case of large corporations is in no position to select and supervise each and every one of its employees personally, the case law here permits a so-called de-centralized proof of exoneration: i.e., the principal must only prove that it exercised the required degree of care in connection with selecting and supervising the relevant executive employee.[67]

The last relevant category of claim in tort law, namely a claim for damages resulting from intentional, immoral conduct pursuant to § 826 BGB, sets a high standard for the plaintiff's showing and proof of defendant's fault and therefore cannot be regarded as an effectual enforcement mechanism, either. In sum, de lege lata, there is no reliable basis for enforcing a sustainability-based due diligence obligation using civil liability.

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[65] See, e.g., Nordhues, Die Haftung der Muttergesellschaft und ihres Vorstands für Menschenrechtsverletzungen im Konzern (The Liability of a Parent Corporation and its Executive Board for Human Rights Violations in the Consolidated Concern), 2019, p. 136; but cf. Hein Kötz, Deliktshaftung für selbständige Unternehmer (Tort Liability for Independent Contractors), ZEUP 2017, pp. 283 – 309.

[66] This is a consistent holding in the case law. See BGH NJW 2006, 3628, 3629; BGH NJW 1994, 2756, 2757; BGH NJW 1981, 1516; *Rühl*, Unternehmensverantwortung und (Internationales) Privatrecht (Corporate Responsibility and (International) Private Law), in: Reinisch/Hobe/Kieninger/Peters (Eds.), Unternehmensverantwortung und Internationales Recht (Corporate Responsibility and International Law), 2020, pp. 89, 108 (and the sources cited therein).

[67] *Rühl*, op.cit. (Fn. 66), 2020, pp. 89, 109 f.; *Wagner,* RabelsZ 80 (2016), 717, 767.

2. Possible Hooks for Liability de Lege Ferenda

With regard to future legislation for enforcement of a sustainability-based due diligence obligation, the following factors should be taken into consideration. The principal arguments against liability in civil law are, on the one hand, that holding downstream clients liable for violations of due diligence in their supply chains would flout the principle recognizing the independence of a legal entity under stock corporation law (*Rechtsträgerprinzip*), or the principle of limited liability within a group of affiliated companies (*Trennungsprinzip*); and, on the other, thatsuch a theory of liability would be incompatible with the prevalent principles of tort law.[68] With regard to the first objection, we point out that the *Trennungsprinzip* has recently been increasingly vulnerable to challenge by theories which justify the piercing of the corporate veil and that considerable doubts now exist concerning the broad extent of that principle's validity.[69] Consequently, one can no longer rule out the possibility that a parent corporation will be held liable for the violation of environmental or human rights standards by its subsidiary on the basis of the *Trennungsprinzip* per se. This is evident from the comparative-law standpoint first of all with reference to France, where the national legislature in 2017, with the *loi de vigilance*, significantly expanded the potential liability of large concerns.[70] Moreover, the UK Supreme Court in the watershed case *Okpabi v. Royal Dutch Shell* recently upheld a ruling to the effect that a parent company was liable for environmental damages caused by its subsidiary on the basis of tort law, without so much as mentioning the bedrock principle of the limited liability of separate entities.[71] The seminal ruling of The Hague District Court in the Netherlands a few months later in re: Royal Dutch Shell (RDS) also holds that RDS is in a perfectly adequate position to exercise control over subsidiaries in the Shell Group and indeed to influence the emissions of its business partners.[72] These developments make clear that it is appropriate to re-assess the theoretical basis of the principle of limited liability or separability in the context of a parent company's liability for subsidiaries and to adapt that principle more flexibly in the tort-law context.[73]

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[68] *Wagner*, RabelsZ 80 (2016), 717, 750 et seq.; *Schneider*, NZG 2019, 1369, 1371 et seq.; *Fleischer/Korch*, ZIP 2019, 2181, 2188 et seq.; *Hübner*, in: Krajewski/Saage-Maaß/Oehm (Eds.), Zivil- und strafrechtliche Haftung von Unternehmen für Menschenrechtsverletzungen (Civil and Penal Liability of Corporations for Human Rights Violations), pp. 13, 18 et seq.; *Weller/Kaller/Schulz*, AcP (2016), 387, 398 et seq.; *Habersack/Ehrl,* AcP 219 (2019), 155, 190 et seq.; *Mittwoch*, RIW 2020, 397, 403.

[69] Under the currently prevailing opinion, the parent corporation is liable for its subsidiary only where extraordinary circumstances are present. See, e.g., *König*, AcP 217 (2017), 611, 667 et seq.; *Wagner*, RabelsZ 80 (2016), 717, 750 et seq., 762 et seq.

[70] Loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre, Fn. 2 above.

[71] For more detail, see *Fleischer/Korch*, ZIP 2021, 709.

[72] See Fn. 64 above.

[73] See *Fleischer/Korch*, ZIP 2021, 709, 712 et seq., „Vom Konzerndeliktsrecht zum Deliktsrecht in Konzernlagen" ("From a Law of Corporate Torts to a Tort Law in the Corporate Context").

With regard to the alleged incompatibility of tort-law principles, the factors include primarily the fear of a wide-open field of potential sources of liability, leading to a sharp increase in actual liabilities, which would vitiate the structure of tort law and generate prodigious legal uncertainties.[74] Many commentators therefore criticize this approach and propose instead a solution in stock corporation law involving a stricter regime of duties for business managers.[75] This would indeed be in keeping with the German legal system, but it would not help directly damaged parties to prosecute claims for compensation of their damages: If law-makers were to anchor a due diligence obligation in, for instance, § 76 AktG, the corporation would be entitled to claim compensation of damages under § 93 Para. 2 AktG from an executive employee who violated this duty; in the law governing LLCs (GmbHs), the claim against the executive would arise under § 43 Para. 2 GmbHG. But in both cases, the liability claim is in essence purely internal.[76]

The case would be different if such a duty were to be formulated as a *Schutzgesetz* (law for the protection of third parties) within the meaning of § 823 Para. 2 BGB – and thus provided with implications beyond the corporate entity.[77] In this case, the executive employee's breach of duty could be ascribed to the corporation pursuant to § 31 BGB and, as a result, the corporation itself could be held liable for the resulting damages.[78] Formulating the sustainability-based due diligence obligation as a law for the protection of third parties is possible in principle. But the precise formulation of such a duty is of great importance, as we suggested above. For reasons of legal certainty, and in order to avoid saddling German companies with a competitive disadvantage, the scope and substance of this duty must be defined in adequate detail. Further, it would appear helpful to foresee a defense for the corporation where it shall have complied with all requirements of the sustainability-based due diligence obligation. In contrast, the law should provide for a presumption of liability in the event that a breach of the due diligence obligation has occurred.

Finally, besides civil law liability, the law can impose administrative sanctions on those who breach the due diligence obligation. An approach like this is reflected in the recently adopted German Act on Corporate Due Diligence in Supply Chains.[79] Pursuant to § 19 Para. 1 of the legislative bill, the Federal Office for Economic Affairs and Export Control (Bundesamt für

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[74] *Habersack/Ehrl,* AcP 219 (2019), 155, 205, 210 (arguing that a tort-law solution should be of remedy of last resort); *Wagner*, RabelsZ 80 (2016), 717, 780 f.; *Schneider*, NZG 2019, 1369, 1377.

[75] *Habersack/Ehrl,* AcP 219 (2019), 155, 205, 209; *Weller/Kaller/Schulz*, AcP (2016), 387, 417.

[76] *Spindler*, in: Münchener Kommentar zum AktG (Munich Commentary on the Stock Corporation Act), 5th Ed. 2019, § 93 Para. 1, 87; *Fleischer*, in: Münchener Kommentar zum GmbHG (Commentary on the LLC Act), 3d Ed. 2019, § 43 Para. 339 f.

[77] The proposal made by *Weller/Kaller/Schulz*, AcP (2016), 387, 417 does just this.

[78] *Weller/Kaller/Schulz*, AcP (2016), 387, 417.

[79] Gesetzesentwurf der Bundesregierung für ein Gesetz über die unternehmerischen Sorgfaltspflichten in Lieferketten (Legislative Bill for an Act on Corporate Due Diligence in Supply Chains), Draft of 3.3.2021.

Wirtschaft und Ausfuhrkontrolle, BAFA) will be responsible for the administrative enforcement and oversight of the duties arising under the Act. Administrative sanctions, such as fines or exclusion from tender procedures for public procurements, may in appropriate cases represent effective enforcement mechanisms. They do not, however, provide the parties directly harmed with a claim for compensation of their damages.

With regard to any enforcement mechanisms adopted under national law, one must keep in mind that, in cases involving transnational facts and circumstances, international private law determines what law is applicable and thus which jurisdiction's standards of liability shall apply. For this reason, a solution on the European level would be desirable. For the arguments brought forth repeatedly on the part of various trade associations concerning the danger of competitive disadvantages arising, where a national government acting independently of the others expands corporate liability along the supply chain, cannot be dismissed: The presence of disparate regulations in the different member states of the EU does lead to significant distortions of competition, since an expansion of potential liabilities significantly increases transaction costs and exacerbates the risk of losing market share for the companies affected.[80] In order to ensure that national provisions on liability are applicable to cases involving transnational facts and circumstances, such provisions must, at least with respect to the conflict of laws, be formulated as an overriding mandatory provision (*Eingriffsnorm*).[81]

C. Questions of Executive Compensation and Dividend Policy

In the following section, we address the question of legal regulation touching the impact of sustainability issues on the compensation of executive board members and on the policy of distributions to a corporation's shareholders. While statutory provisions governing the compensation of executive board members were recently amended to take better account of sustainability issues, those governing dividends in stock corporation law have thus far remained unaffected by the discussions surrounding sustainability.[82]

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[80] *Wagner*, RabelsZ 80 (2016), 717, 780 f.; *Schneider*, NZG 2019, 1369, 1379; *Mittwoch*, RIW 2020, 397, 404.

[81] *Rühl*, op.cit. (Fn.66), 2020, pp. 89, 127; *Mittwoch*, RIW 2020, 397, 403.

[82] Provisions restricting dividend distributions have recently been proposed in the law of GmbHs (LLCs). Specifically, in 2020, a team of legal scholars demanded the introduction of a *Gesellschaft in Verantwortungseigentum* (Company in Responsible Ownership) as an independent alternative to the GmbH for so-called social enterprises and, to this end, presented an (academic) draft law: *Sanders/Dauner-Lieb/Kempny/Möslein/Veil,* Entwurf eines Gesetzes für die Gesellschaft mit beschränkter Haftung in Verantwortungseigentum (Draft of an Act for the Limited Liability Company in Responsible Ownership) from 12.6.2020, which can be downloaded (in German) at https://www.gesellschaft-in-verantwortungseigentum.de/der-gesetzesentwurf/ (27.03.2021); for an overview of the proposal, see *Sanders*,

I. Executive Compensation

The compensation of members of the executive board and the supervisory board is subject—at least since the financial markets crisis of 2007/08—to increasing regulation from national and European law-makers. In Germany, as is well known, the Mannesmann proceedings in particular represent a milestone in the contemporary debate.[83] This discussion has had a powerful socio-political resonance, as the widening gap in incomes, with special reference to the compensation of executive board members in comparison with the general level of wages, has led to intense debates—both in society at large and in political fora, and not only in Germany.[84] The adoption of statutory criteria stipulating that the structure and policy of executive compensation in stock corporations be oriented on a mandatory basis towards the objectives of long-term growth and sustainability should be seen in the light of these developments.

1. § 87 Para. 1 Sent. 2 AktG since the VorstAG (Act on the Appropriateness of Executive Board Compensation)

The term sustainability was introduced into Germany's Stock Corporation Act for the first time in 2009.[85] The provision § 87 Para. 1 sent. 2, added at that time, required that the executive compensation of exchange-listed companies be oriented towards sustainable development of the enterprise. Sentence 3 of the provision, even at the time of its initial introduction, stipulated more specifically that variable elements of compensation should be based on an assessment period of several years. This provision supplemented the general requirements of § 87 Para. 1 Sent. 1 AktG, applicable to all stock corporations, which stipulates that the total compensation awarded to individual members of the executive board must stand in an appropriate relationship to their responsibilities and performance, and also to the overall condition of the corporation. Further, such compensation should not exceed what is customary without special justifying circumstances.[86] Similarly, Section 4.2.3 of the GCGC in

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ZRP 2020, 140. This legal form, however, would be chosen on a voluntary basis; such an approach is therefore of limited significance for purposes of the present study.

[83] BGH NJW 2006, pp. 552 et seq.; and for a discussion thereof, see *Fleischer*, DB 2006, 542; *Lutter*, ZIP 2006, 733; *Spindler*, ZIP 2006, 349.

[84] See, e.g., *Lutter*, ZIP 2009, 197; and *Lutter*, BB 2009, 786 (Executive Board Members as Motor for the Abuses which led to the Financial Crisis).

[85] Introduced as part of the *Gesetz zur Angemessenheit der Vorstandsvergütung* (Act on the Appropriateness of Executive Board Compensation, VorstAG), BGBl. 2009 I, 2509.

[86] For a recent discussion on the standard of appropriateness from the perspective of a student of real behavior patterns, see *Redenius-Hövermann*, Verhalten im Unternehmensrecht (Conduct in the Law of Enterprises), 2019, pp. 38 et seq.

the 2009 version[87] recommended that the structure of executive board compensation be oriented towards sustainable development of the company, and Section 5.4.6 GCGC 2009 proposed the same with regard to any success-oriented remuneration of supervisory board members.[88] Both provisions, however, were and remain non-binding on account of their character as mere recommendations of the GCGC. Finally, financial services and insurance companies are subject to the special rules on executive compensation set forth in § 25a Para. 1 No. 6 KWG (German Federal Banking Act) and § 25 Para. 1 VAG (Insurance Supervision Act), both of which provisions form the subject of legal regulations clarifying their implications.[89] Pursuant to § 25a Para. 1 No. 6 KWG, the risk management of a financial institution must include, inter alia, systems of compensation for managers and employees which are appropriate, transparent and geared towards sustainable development. § 25 Para. 1 VAG likewise requires that insurance companies shape their compensation systems relative to managers, employees, and supervisory board members appropriately, transparently, and with a view to the sustainable development of the enterprise.

The sustainable development of the enterprise, as new criterion for defining an appropriate compensation structure, caused great difficulty from the start in legal scholarship and legal practice. Before the Act on the Appropriateness of Executive Board Compensation (VorstAG) went into effect, the supervisory board needed to ensure only that "total compensation [of the executive board member] stand in an appropriate relationship to [his or her] responsibilities and to the overall condition of the corporation." The VorstAG introduced a more detailed standard and a higher level of legal regulation into the determination of executive board compensation. Not only must the structure of executive compensation now be oriented towards sustainable development of the enterprise, the performance of each individual executive board member has become a criterion for assessing the appropriateness of his or her compensation. In addition, the assessment must include a review of what is customary: Total compensation must not exceed what counts as customary earnings without special justifying circumstances. The term compensation structure is to be interpreted as the specific combination of various forms of remuneration and their relationship to one another, with reference to each individual beneficiary of the compensation.[90]

[87] Cf. Grundsatz (Principle) 23 of the current version of the GCGC (2019).
[88] The current version of the GCGC (2019) in this context limits itself, however, in Recommendation G.18, to orientation towards the long-term development of the company.
[89] For a discussion focusing on insurance companies, see *Annuß/Sammet*, BB 2011, 115; for a discussion focusing on the financial services sector, see *Glasow*, Nachhaltige Vergütungspolitik (Sustainable Compensation Policies), in: Bauer/Schuster (Eds.), Nachhaltigkeit im Bankensektor (Sustainability in the Banking Sector), 2016, pp. 106 et seq.
[90] *Koch*, in: Hüffer/Koch, Aktiengesetz (Stock Corporation Act), 13th Ed. 2018, § 87 Para. 10.

The meaning of the criterion of sustainable development of the enterprise was a highly controversial subject in the period ensuing introduction of the revised § 78 AktG in 2009. Numerous publications appeared, which took very different approaches:[91] The overwhelming majority understood the condition of sustainability only in a temporal framework and concluded it was equivalent to the criterion of long-term orientation.[92] The contrary view, which was only championed by a few commentators here and there, argued in contrast for synchronizinginterpretation of the concept of sustainability under German law with the broader understanding of the term as developed in the international discourse.[93]

2. The New Rule based on ARUG II (Act on Implementation of the Second Directive on Shareholders' Rights)

Since the beginning of 2020, § 87 Para. 1 sent. 2 AktG now couples the criteria of long-term orientation and sustainability, thus deciding the controversy in favor of the latter view: The new formulation of § 87 Para. 1 sent. 2 AktG adopted in connection with ARUG II[94] obligates the supervisory board of exchange-listed stock corporations to orient the structure of executive compensation towards a sustainable *and* long-term development of the corporation. As a result, there is no longer any basis for interpreting the term sustainability restrictively, in the sense of a merely temporal stipulation. From the start of the legislative process, the Committee for Law and Consumer Protection emphasized that the new wording of the provision should give clear expression to the requirement that companies, in determining compensation levels and in particular in setting incentives for management, must take social and environmental factors into consideration.[95] This step was also required from the point of view of EU law, given that the amended Directive on Shareholders' Rights

[91] More on this immediately following; there is an overview of the debate in *Marsch-Barner*, ZHR 175 (2011), 737, 738; *Velte*, NZG 2016, 298.

[92] *Dauner-Lieb/von Preen/Simon*, DB 2010, 377; *Behme*, BB 2019, 451, 454 (even in light of the amended version of the provision based on the revised Directive on Shareholder Rights); *Fleischer*, NZG 2009, 801; *Kling*, DZWIR 2010, 221; *Faber/v. Werder*, AG 2014, 608, 610 et seq.; *Friedrich*, Die Verrechtlichung von Organbezügen als europäisches Problem (The Legal Regulation of Board Member Compensation as a European Problem), 2011, p. 172; *Harbarth*, ZGR 2018, 379, 383 et seq.; for the conclusion, see also *Marsch-Barner*, ZHR 175 (2011), 737, 745; and *Meyer*, Vorstandsvergütung (Executive Board Compensation), 2013, pp. 214 et seq., 217, which goes somewhat farther and at least addresses the development of the modern concept of sustainability by the United Nations, assessing implementation of the term sustainability in § 87 Para. 1 sent. 2 AktG as an expression of the pluralistic stakeholder value approach; see also *Kocher/Bednarz*, Der Konzern (The Consolidated Corporation) 2011, 77, 78 (similarly).

[93] *Röttgen/Kluge*, NJW 2013, 900; see also *Ihrig/Schäfer*, Rechte und Pflichten des Vorstands (Rights and Duties of the Management Board), 2. Ed. 2020, p. 91; *v. Werder*, in: Kremer et al. (Eds.), GCGC, 8th Ed. 2021, Foreword Para. 23 f.; *Dauner-Lieb/v. Preen/Simon*, DB 2010, 379; *Velte*, NZG 2016, 294.

[94] Gesetz zur Umsetzung der zweiten Aktionärsrechterichtlinie (Act on Implementation of the Second Directive on Shareholders' Rights, ARUG II), of 12 December 2019, BGBl. I p. 26/37.

[95] Beschlussempfehlung und Bericht des Ausschusses für Recht und Verbraucherschutz (Final Recommendations and Report of the Committee on Law and Consumer Protection), BT-Drucks. 19/15153, 62; *Velte*, NZG 2020, 12, 14.

expressly aimed to ensure that "directors' performance ... be assessed using both financial and non-financial performance criteria, including, where appropriate, environmental, social and governance factors."[96]

Then as now, commentators often argue that defining in detail the substance of the principle of sustainability, as used in § 87 Para. 1 sent. 2 AktG, would be problematic, since corporate decision-making is based on prognoses.[97] But just that—orienting corporate decision-making towards the future—is at the heart of the basic definition for modern sustainability, as early as the Brundtland-Report.[98] The future orientation of this term and the three-dimensionality of its economic, environmental, and social components are easily reconciled with the context of this provision. In setting the parameters for compensation of executive board members, it is the supervisory board that determines to what extent the various individual elements of the principle of sustainability are to be taken into account in the process of individual decision-making on behalf of the company. In making this determination, however, they have the liability-limiting benefit of the business judgement rule pursuant to § 93 Para. 1 sent. 2 AktG.[99] Moreover, the wording of the amended provision introduces a heavily formalized system for the procedure and documentation of the compensation policies of exchange-listed companies.

3. The New Rule Regulating Compensation Policies

Complementarily, the provisions of § 87a AktG, adopted at the same time as the revisions to § 87, obligate the supervisory board of exchange-listed companies to develop a system for the compensation of executive board members and, in so doing, to take the mandate of sustainability into account. While the condition of sustainable development of the enterprise pursuant to § 87 Para. 1 sent. 2 AktG relates to the compensation of individual members of the executive board, § 87a AktG addresses the more general compensation policy of an enterprise as framework for the total compensation of the executive board.[100] Pursuant to § 87a Para. 2 in connection with § 120a AktG, the General Meeting of Shareholders is required

[96] Recital 29 of the Directive on Shareholders' Rights, Directive (EU) 2017/828.
[97] *Marsch-Barner*, ZHR 175 (2011), 737, 738.
[98] UN-General Assembly, Report of the World Commission on Environment and Development, 11 December 1987, UN-Doc. A/RES/42/187 or WCED, our Common future, p. 43, Recital 2. We find there the oft-cited passage "sustainable development … implies meeting the needs of the present without compromising the ability of future generations to meet their own needs."
[99] This sentence, while directly addressing the executive board, also applies to the supervisory board. See, e.g., BGHZ NZG 2013, 339; *Saenger*, Gesellschaftsrecht (The Law of Corporations), 14. Ed. 2018, Para. 604.
[100] *Bachmann/Pauschinger*, ZIP 2019, 1; *Spindler*, in: Münchener Kommentar zum AktG (Munich Commentary on the Stock Corporation Act) – Nachtrag zum ARUG II (Supplement on ARUG II), 5th Ed. 2021, § 87a Rn. 5 f.; *Koch*, in: Hüffer/Koch, Aktiengesetz (Stock Corporation Act), 15th Ed. 2021, § 87a Rn. 3 f.

to deliberate on and approve the compensation policy thus developed.[101] Finally, the compensation system is also relevant to accounting practice: Exchange-listed companies are required under § 289a Para. 2 HGB (German Commercial Code) to include a report on executive compensation in their financial reports. § 315a Para. 2 HGB imposes the same requirement for the consolidated financial reports.[102]

Neither these provisions nor the amended EU Directive on Shareholder Rights[103] furnish mandatory requirements as to what sustainable development of the company entails in substance. § 87a Para. 1 AktG does, however, set forth in nine clauses certain minimum features, which the supervisory board is required to incorporate into the compensation policy it adopts for the company. Building upon the requirement applicable to the specific compensation of individual executive board members, § 87a Para. 1 No. 2 AktG extends the appeal for long-term policies to the entire system of compensation for the enterprise and thus to its overall compensation policy.[104] Under that provision, the supervisory board must state to what extent the compensation system it has worked out contributes to achievement of the company's business strategy and to the long-term development of the enterprise. § 87a Para. 1 No. 4 AktG moreover requires statements on the inclusion of financial and non-financial performance criteria in decisions on the award of variable elements of compensation; and explanations of the extent to which these criteria have contributed to promoting the long-term development of the enterprise.

4. Evaluation

An evaluation of the consolidated financial statements of all 30 companies in the German blue-chip DAX index for the fiscal year 2017 revealed that the indicia of performance relied upon in determining the levels of variable compensation for executive board members were still overwhelmingly of a financial nature: Despite the increasing significance of non-financial reporting, only 44 % of the companies evaluated relied upon non-financial performance criteria in awarding variable compensation in 2017.[105] And within the category of non-financial performance criteria, criteria stemming from labor concerns were predominant in relation to those stemming from environmental or other social factors.[106] Our study of the new rules regulating compensation policies shows that stock corporation law now includes a well-structured legal framework for putting in place executive board compensation policies that

[101] This requirement is now also set forth in the German Corporate Governance Code. Cf. Principles 23-28 GCGC; and *Hohenstatt/Seibt*, ZIP 2019, 11, 12 f. (in more detail).
[102] For more detail, see *Müller/Needham/Mack*, BB 2019, 939, 940.
[103] Cf. Recital 28 of the Directive on Shareholder Rights, Directive (EU) 2017/828.
[104] *Bachmann/Pauschinger*, ZIP 2019, 1, 3.
[105] *Müller/Needham/Mack*, BB 2019, 939, 941.
[106] Id., 942 f.

are oriented towards the sustainable development of the enterprise. The extent to which companies are obligated to do so, however, is not expressed clearly enough, for there is not as yet any agreement on how to interpret the term sustainability.

The law-makers have waited too long to provide guidance on this plane. With the new rules adopted in connection with ARUG II, they focused more on the procedural framework than on the explicit definition of legal duties. For the future interpretation and development of the rules governing executive compensation, therefore, law-makers must furnish more guidance on the substance. Necessary and desirable is also, in this connection, an evolution in the law of executive compensation which dovetails coherently with the statutory measures adopted to encourage sustainability in other fields of business law.[107] More concretely, the legislature should clarify how the provisions governing executive compensation interact with those defining a sustainability-based due diligence obligation as discussed in Part B above. It should establish a direct connection between management's duties of conduct and their compensation, as is already implied by the wording of the relevant provisions. Defining the concept of sustainability coherently with regard to the various standards in which it is incorporated is therefore of especial importance both from a systemic and from a substantive point of view.

II. Distributions Benefitting Shareholders

The rules on distributions of profit to shareholders have, up to now, scarcely been studied in connection with business law measures aiming to encourage sustainability.[108] We should clarify straightaway that shareholders are not per se owners of "their" enterprise: From a legal point of view, shareholders are owners of the shares of stock they purchase. Their legal position as members, based on their share ownership, of course comprehends a bundle of rights relative to the company's assets and a say in its management, which can be roughly divided into membership rights relating to an association and rights of disposition relating to the market.[109] This bundle of rights, however, should not be viewed as equivalent to ownership of the enterprise financed by the shareholders. This fact has been pointed out early

[107] See also *Beckers/Micklitz*, EWS 2020, 324 (on the demand for coherence with regard to the various regulatory initiatives).

[108] So far as we can see, the only attempt of this nature is the current proposal for a law introducing the so-called Company in Responsible Ownership as an independent alternative to the GmbH (LLC). See Fn. 82 above. This proposal provides for a comprehensive prohibition on distributions of profit on the basis of a model where the company's assets are irrevocably allocated to a defined mission. But this prohibition of course only applies to companies that have actively chosen the new legal form.

[109] *Schoppe*, Aktieneigentum (Stock Ownership), 2001, pp. 212 et seq. and 352 et seq. (with an extensive discussion).

and repeatedly over the long course of the international discussion surrounding stock corporations.[110]

The German Stock Corporation Act addresses the use of annual profits in § 58, and specifically shareholders' claims to dividends in § 58 Para. 4 AktG. It is possible for this claim to be ruled out in any particular case on the basis of law, the company's articles of incorporation, a shareholder resolution, or if qualified as an additional expense in a resolution on the use of profits. § 58 AktG represents a compromise solution: It aims to settle the conflict between the shareholders' interest in as high as possible a distribution of profits and management's interest in keeping as much as possible of the company's profits on the balance sheet to expand its equity reserves.[111] This provision thus ultimately resolves a conflict of who is in charge of what,[112] which has been answered in many very different ways over the course of its historical development. One can see reflected in this conflict the whole discussion over the ultimate objectives of the stock corporation, which we addressed in Section B above with regard to management's duties in the conduct of business. Both strains of discourse should be viewed holistically, so the following discussion of the rules applicable to the use of profits is limited to a few key points. Both the obligation of management to further the best interests of the enterprise and the general sustainability-based due diligence obligation have their influence at the level of the use of profits, as well.

1. Historical Development of the Fundamental Corporate Governance Questions

The 1897 version of the HGB assigned broad powers to shareholders in connection with the use of company profits: The general meeting of shareholders (today called *Hauptversammlung* in German), and not the executive board, was responsible for approving the year-end financial statements and resolving how profits were to be used.[113] The beginning of the 20th century witnessed a shift in consequence of the sway exerted by Walther Rathenau's demand (discussed in more detail above) that the stock corporation be maintained

[110] For an early critique, see the so-called Option Theory of *Black/Scholes*, J. Pol. Econ. 81 (1973), 637. More recently, see, e.g., *Stout*, S. Cal. L. Rev. 75 (2002), p. 1189, 1191 f.; *Sjåfjell,* Towards a Sustainable European Company Law, 2008, p. 80; *Ireland*, The Modern Law Review 62 (1999), 32; *Emberland*, The Human Rights of Companies, 2006, p. 70 (and the sources cited therein); *Keay*, Eur. Company & Fin. L. Rev. (2010), 369, 393 et seq.; *Martínez-Echevarría*, The Nature of Shareholding and Regulating Shareholders' Duties, in: Birkmose (Eds.), Shareholders' Duties, 2017, pp. 29, 34 et seq.

[111] *Bayer*, in Münchener Kommentar zum AktG (Munich Commentary on the Stock Corporation Act), 5th Ed. 2019, § 58 Para. 2; *Cahn/v. Spannenberg*, in: Spindler/Stilz (Eds.), beck-online Großkommentar zum AktG (Beck-Online Commentary on the Stock Corporation Act), 2021, Para. 3.

[112] *Cahn/v. Spannenberg*, op.cit. (Fn.111), 2021, Para. 8; *Koch*, in Hüffer/Koch (Eds.), Aktiengesetz, 15th Ed. 2021, § 58 Para. 2.

[113] For a more detailed discussion of this question and more generally of the historical development, see *Strothotte*, Die Gewinnverwendung in Aktiengesellschaften (The Use of Profits in Stock Corporations), 2014, pp. 294 et seq.

"for the benefit of the public as a whole" and that to this end we protect it from "being carved up into little pieces by the particularism of private interests."[114] To ensure the corporation's preservation in this sense, Rathenau proposed, among other things, a restrictive dividend policy and larger equity reserves. This policy was only enacted into law, however, with introduction of the Stock Corporation Act of 1937, which assigned responsibility for preparing and approving the year-end financial statements to management.[115] Management was thus put in a position to create undisclosed reserves and unrestricted reserves and given considerable influence over the amount of profits distributed each year to shareholders.[116]

The reform of the Stock Corporation Act in 1965, however, again strengthened the position of shareholders and decided, after long discussion, in favor of what was in principle a half-and-half allocation of the rights to determining the use of year-end profits between management and the general meeting of shareholders.[117] This provision in essence remains in effect today. As a general rule, therefore, management has the right to dispose of one half of the profits, as determined in the year-end financial statements, and the general meeting of shareholders has the right to dispose of the other half.[118] The provision always was and remains controversial. In the first place, many commentators argue that thus restricting management's authority vitiates their ability to employ their expertise in conducting the corporation's affairs and can endanger its long-term financial security.[119] In contrast, others even today continue to demand that the position of shareholders be strengthened yet further.[120] The latter justify their view on grounds that management, through their power to create disclosed and even undisclosed reserves, in fact have the upper hand in determining how profits are used, and that this disproportionate power ultimately vitiates the functioning of the market by distorting the efficient allocation of capital.[121] In consequence of the financial crisis and the growing momentum of critiques of the shareholder value theory which ensued,

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[114] *Rathenau*, Vom Aktienwesen. Eine geschäftliche Betrachtung (On Stock. An business perspective), 1917, p. 41.

[115] For a detailed discussion, see *Strothotte*, op.cit. (Fn.113), 2014, pp. 300 et seq.; *Cahn/v. Spannenberg*, in: Spindler/Stilz (Eds.), op.cit. (Fn.111), 2021, Para. 12.

[116] Cf. once again the sources cited in the previous footnote, as well as *Kronstein/Claussen*, Publizität und Gewinnverwendung im neuen Aktienrecht (Publicity and Use of Profits in the new Law of Stock Corporations), 1960, p. 136.

[117] *Bayer*, in: Münchener Kommentar zum AktG (Fn.111 above), 5th Ed. 2019, § 58 Para. 18; *Cahn/v. Spannenberg*, in: Spindler/Stilz (Eds.), beck-online Großkommentar zum AktG (Fn.111 above), 2021, Para. 13; *Kronstein/Claussen*, Publizität und Gewinnverwendung im neuen Aktienrecht (Fn.116 above), 1960, p. 129.

[118] *Strothotte*, op.cit. (Fn.113), 2014, p. 327.

[119] *Jagenburg*, AG 1965, 156, 158; *Jagenburg*, DB 1967, 1399, 1402 et seq.; *Wohlgemuth*, AG 1975, 296.

[120] For an overview, see *Strothotte*, op.cit. (Fn.113 above), 2014, p. 433 f. (and the sources cited therein); *Bayer*, in: op.cit. (Fn.111 above) 2019, § 58 Para. 21; *Cahn/v. Spannenberg*, in: op.cit. (Fn.111 above), 2021, Paras. 5-9.

[121] *Cahn/v. Spannenberg*, in: op.cit. (Fn.111 above), 2021, Para. 9.

the picture has shifted again, with the majority of commentators in recent years favoring a model in which management shares in the power to decide over the use of profits.[122]

2. Evaluation

The historical developments sketched out above demonstrate the great importance of the conflict over relative authorities between shareholders and corporate management underlying the rules on the use of profits. These fundamental questions must be taken into account by the modern sustainability discussion, as well. With a view to promoting the long-term and sustainable development of the enterprise and reinforcing a sustainability-based due diligence obligation for the executive board, it would make sense not to allocate the authority for deciding how corporate profits are used exclusively or even predominantly to shareholders, but to ensure that the management body, i.e., the executive board, has a strong position here.

In the context of the authority of the management body, its statutory obligations, as discussed in Section B of this study, come into play again: Once it is clear that the management body of every corporation is subject to a sustainability-based due diligence obligation and this obligation has been adequately defined, all decisions made by the management body should ultimately stand in harmony with this obligation—including such as pertain to the use of profits. Specific duties relative to the distribution of profits, such as a statutory obligation to create reserves allocated to sustainability purposes or a statutory conditioning of dividend payments and share repurchases on the achievement of specified values for CO2-emissions, ought then to be superfluous. Share repurchase programs, in particular, may well be justified in certain situations;[123] the usefulness of such actions is in any event highly dependent on the particular circumstances of the case and can scarcely be defined abstractly by statute. It is therefore important to discuss the introduction of special rules governing the use of profits with due consideration for the underlying questions of corporate governance. In the context of promoting sustainability through rules on the use of profits, this fundamental principle highlights the importance of generally strengthening the role of the executive board as management body.

[122] *Drygala*, in: Zöllner/Noack (Eds.), Kölner Kommentar zum AktG (Cologne Commentary on the Stock Corporation Act), 3rd Ed. 2011, § 58 Para. 14.
[123] For a more detailed discussion of this issue, see *Strothotte*, op.cit. (Fn.113 above), 2014, pp. 215 et seq.

D. The Composition of Management Bodies

Besides the positive shaping of a sustainability-based due diligence obligation, structural instruments of regulation should also be taken into consideration, in order to reinforce such an obligation in the broader context of the duties incumbent on corporate executives. In this spirit, it would make sense to create a precise statutory standard for the composition of management bodies. The German legislature, in particular, appears to be open to adopting such stipulations on the structure of corporate management bodies, when the objective is to reinforce certain stakeholder interests in the law governing the incorporation of enterprises: The right of employees to have a say and play a formal role in corporate governance, for instance, has always been cited as a prime example for incorporation of the stakeholder value model into corporate law, even though this system has been subject to erosion over the past several years.[124]

Besides fostering the general diversity of the personnel composing the management body, the law could foster the participation in particular of the stakeholder groups whose lives are affected by the company's business operations. Through their participation in decision-making processes, the general awareness of pertinent social and human rights or environmental issues might be heightened and the balance between conflicting objectives could be improved. Nonetheless, it can be very difficult to identify the affected stakeholders in any particular case, especially given that—depending on the sector in which the business operates—there may be several qualifying stakeholder groups and their identity may change over time.[125] In lieu of direct stakeholder participation in corporate governance, therefore, law-makers might also consider requiring the permanent inclusion in management boards of independent members, whose special duty it would be to pursue objectives relating to sustainability.

I. The Significance of Independent Representatives in Governing Bodies from a Historical Perspective

Such ideas are not unknown, at least in German business law, and even in other jurisdictions comparable instruments of regulation have been used. We pointed out above that the question of whether and how to take the public interest into account played an important role

[124] On the first issue, see *Salacuse*, L. & Bus. Rev. Am. 9 (2003), 33, 47; on the second, *Bayer*, NJW 2016, 1930.
[125] With regard to the parallel set of problems surrounding the legal regulation of social enterprises, see *Sørensen/Neville*, EBOR 15 (2014), 267, 293.

in the discussion surrounding the reform of business law—especially in the 1960s and 1970s and in particular in connection with the concept of the best interests of the enterprise.[126] This discussion was shaped to a large extent by the call for a share in the management of the enterprise.[127]

One effort to implement an obligation to take the public interest into account which is impressive from the perspective of the modern sustainability discussion, even though it was never enacted into statute, is the proposal put forth in the so-called "Sechserbericht" (Report of the Six), which in 1968 attempted to work out a corporate charter on a pluralistic basis for large stock corporations with at least 20 000 employees.[128] This Report proposes a structural solution, independent of the company's legal form, to ensure that governing bodies take public interest concerns into account: Representatives of the various interest groups should be included in the personnel of each of two management bodies called "General Meeting of the Enterprise" and "Board of the Enterprise."[129] Interestingly, they refer explicitly not only to representatives of the owners and employees, but also to so-called "representatives of the public." The *Sechserbericht* suggests allocating to these latter representatives a voting power of 15 from a total 75 votes in the General Meeting of the Enterprise and five from a total 19 votes in the Board of the Enterprise.[130] The remaining votes are to be allocated half-and-half to the owners and the employees. With regard to the General Meeting of the Enterprise, the Report stipulates further: While six of the representatives of the public may be members who are allied with either the company's owners or its employees, the remaining three should "be as independent as possible," a term which the proposal defines by reference to the so-called "Eleven Men in the Coal-and-Steel Industry."[131]

This proposal represents a second historical example—besides the introduction of a governor or commissioner responsible for supervising the management of a stock corporation in the period of the privileges system—of a structural instrument of regulation aiming to ensure that

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[126] More on this issue in Part B above.

[127] Cf. in particular *Bundesministerium der Justiz* (German Federal Ministry of Justice) (Eds.), Bericht über die Verhandlungen der Unternehmensrechtskommission (Report on the Negotiations of the Business Law Commission), 1980.

[128] *Boettcher/Hax/Kunze/Nell-Breuning/Ortlieb/Preller*, Unternehmensverfassung als gesellschaftspolitische Forderung (Corporate Charter as Socio-Political Mandate), 1968, Chapter 7, pp. 114 et seq.

[129] The starting point for the *Sechserbericht* is the enterprise association as an enterprise in the sociological sense. As a result, it refers to the enterprise's management body using terms not specific to any particular legal form. See *Boettcher/Hax/Kunze/Nell-Breuning/Ortlieb/Preller*, op.cit. (Fn.128), 1968, p. 19. The enterprise's management is freed from any obligation towards particular interests; its only obligation is to the best interests of the enterprise. See p. 133 of the Report.

[130] *Boettcher/Hax/Kunze/Nell-Breuning/Ortlieb/Preller*, op.cit. (Fn.128), 1968, Chapter 7, pp. 114 et seq.

[131] *Boettcher/Hax/Kunze/Nell-Breuning/Ortlieb/Preller*, op.cit. (Fn.128), 1968, Chapter 7, p. 130; the supervisory board of corporations subject to the Coal-and-Steel-Shared Governance Act (MontanMitbestG) consists of eleven members. See § 4 MontanMitbestG; these members may of course be members of the other sex.

the public interest is taken into account.[132] Comparable approaches are customary in the business law of the USA, where—ever since the 1940s—initially "outside directors" and later so-called "independent directors" exercised the function of supervising management.[133] The legal form of the benefit corporation, first introduced in the USA in 2010, likewise uses such instruments, putting in place a benefit director and a benefit officer as executive employees specially responsible for supervising the company's compliance with environmental or social objectives.[134]

II. Evaluation from Today's Perspective

In the German law of stock corporations, structural instruments that provide for the inclusion of permanent, independent members in governing bodies have not been customary for a long time. The primary reason for this is the obligatory establishment of the supervisory board as a governing body responsible for overseeing management: As described above, the original role of the supervisory board was to act as an extension of the arm of the state and ensure the public interest was taken into account in the conduct of business operations.[135] The mandatory separation between two boards responsible for management on the one hand and supervision on the other characterizes the dualistic system customary in Germany and contrasts with the monistic system predominantly in place in Anglo-American jurisdictions—even if it is true that the two systems have tended to converge in practice.[136] Consequently, the appointment of special, independent board member with their own spheres of authority and their own responsibilities and objectives was held unnecessary.

From a legal point of view, it would be conceivable to introduce a structural measure that provided for the inclusion of a permanent, independent member in the executive board, in order to ensure compliance with a due diligence obligation relating to social and human rights or environmental concerns. In light of the current system of stock corporation law in Germany, however, it would appear more fitting to explicitly subject the entire board of management to compliance with a sustainability-based due diligence obligation. This would make it clear that a company's principal management body must as such be endowed with the requisite

[132] We discuss this issue above in Section B. II. 1. a).
[133] A fundamental precedent here was thus the Investment Company Act, 15 U.S.C. §§ 80a-1-80a-64 of 22 August 1940; for an in-depth discussion of this development, see *Gordon*, Stanford Law Rev. 59 (2007), 1465.
[134] An overview of the earlier period in various states appears in *Brakman Reiser*, Wake Forest Law Review 46 (2011), 591, 605; and for other pertinent details, see *Möslein/Mittwoch*, RabelsZ 80 (2016), 399, 417 et seq. (and the sources cited therein).
[135] We discuss this issue above in Section B. II. 1. b).
[136] On this point, see *Hopt*, ZGR 2000, 779, 783 et seq.; *Lieder*, Der Aufsichtsrat im Wandel der Zeit (Fn.19), 2006, pp. 633 et seq.

expertize and that the obligation to operate sustainably does not apply exclusively to one or a minority of the executive board members.

Such an approach would also appear preferable from the point of view of effectively fostering sustainable business policies. A key issue, here too, is to pursue a coherent evolution of measures aiming to foster sustainability, i.e., to dovetail new statutory provisions with the recently introduced due diligence obligation relative to social and environmental concerns in business law. In each particular situation that arises, management must decide, on the basis of this duty, which stakeholder groups—e.g., employees of suppliers or locally impacted communities—are to be included in the due diligence review process. Participation of the stakeholder groups deemed relevant in any given situation thus takes place, mutatis mutandum, on the basis of the general sustainability-based due diligence obligation incumbent on the management body. Independently of that, of course, law-makers may also consider statutory incentives to foster diversity in the composition of management bodies more generally—a demand which is being heard for various reasons, not all of which are relevant to sustainability.[137]

[137] Thus, for instance, the legislative bill on an Act Supplementing and Modifying the Rules on the Egalitarian Participation of Women in Leadership Positions in Private Business and in the Public Service (Regierungsentwurf für ein Gesetz zur Ergänzung und Änderung der Regelungen für die gleichberechtigte Teilhabe von Frauen an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst, oder Zweites Führungspositionen-Gesetz – FüPoG II) from 6 January 2021.