Moalem
Weitemeyer

Moalem Weitemeyer
Advokatpartnerselskab
Amaliegade 3
DK-1256 Copenhagen

Tel. +45 7070 1505
moalemweitemeyer.com

CVR 3162 7885

CORPORATE SUSTAINABILITY

7 December 2020

Introduction

A study published by the EU Commission in 2020 reached the conclusion that listed companies tend to focus on short-term shareholder benefits as opposed to the long interests of the company. The EU Commission also found that the most efficient way of changing this perceived focus would be through changes in legislation applicable to listed companies within the EU in order to force such change.

This article contains a description of the proposed rules, and how the perceived short-term focus does not reflect current paradigms and approaches currently taken by US and Danish listed companies.

The study has been subject to heavy criticism by legal scholars in the US and EU, e.g. due to the biased and political nature of the study, its failure to understand principles of corporate law, and the damaging effect of its recommendations. Based on our experience and analyses of new corporate paradigms and approaches in place in listed companies, we have to agree with the criticism raised. Long-term interests of listed companies and the involvement of all stakeholders are already integral parts of the workings of listed companies. We do not recognize the short-term focus found in the study. Instead, we see a focus on sustainability, long-term goals and involvement of stakeholders. However, this is occurring and developing within the context of existing corporate law and principles of governance.

The Study published by the EU Commission

The "Study on directors' duties and sustainable corporate governance" published by the EU Commission in July 2020 states that EU listed companies tend to focus on short-term shareholder benefits instead of long-term interests of the company. In the study, seven perceived problematic areas are identified, and options for EU intervention within each of these are presented, ranging from raising awareness, through requiring member states to prepare recommendations, to introducing minimum EU common rules through legislation.

Within each of the seven areas, the introduction of minimum legislation is concluded to be the most efficient option, resulting in the following:

1. Requirement for directors to balance the interests of the company (long-term), employees, customers, the environment, and society alongside the interest of shareholders. In addition, sustainability requirements would be imposed.

2. Requirement for member states to incentivize longer shareholding periods and prohibit both earning guidance and quarterly reporting for listed companies.

3. Requirement for corporate boards to integrate sustainability in business strategy and to disclose related information.

4. Requirement for listed companies to align executive remuneration policy with long-term and sustainability goals. This would include regulating the rights to sell shares received as remuneration and a requirement to include compulsory environmental, social and governance metrics linked with sustainability targets, in executive compensation schemes.

5. Requirements with respect to the board composition of listed companies, including a requirement to consider sustainability in the nomination process.

6. Requirement for corporate boards to establish mechanisms for engaging with and involving internal and external stakeholders in identifying, preventing, and mitigating sustainability risks and impacts as part of their business strategy.

7. Requirement for EU members states to strengthen the enforcement of the directors' duty to act in the interest of the company.

With respect to the last of the proposed rules, it should be noted that it would not be a matter reserved for shareholders or authorities to pursue. Accordingly, the report states that judicial mechanisms must be in place with respect to all stakeholders affected. The threat of a possible lawsuit is thus explicitly stated in the study to have a positive effect in that it may put pressure on companies to avoid such threat. It should also be noted that the rights of stakeholders to pursue legal action is not limited to cases where the stakeholders in question are able to demonstrate a loss.

The US Approach

The classic US paradigm has been summarized as follows: "The Social Responsibility of Business is to Increase its Profits" (Milton Friedman, New York Times, 13 September 1970).

In recent years, the scope has, however, been somewhat redefined in this "new paradigm": "The purpose [...] is to conduct a lawful, ethical, profitable and sustainable business in order to ensure its success and grow its value over the long term." (Martin Lipton, World Economic Forum, 2 September 2016 – Davos Manifesto 2020, 2 December 2019).

The "new paradigm" recognizes the need to consider a number of stakeholders other than the shareholders (employees, customers, suppliers, creditors, and communities), without seeing this as being opposed to the long-time value creation of the company.

The classic Danish Approach

It is a basic principle of Danish company law that the object of a Danish limited company is to carry out commercial business. In the preparatory works to the current Danish Companies Act of 2008, as amended, reference is made to the 1964 white paper, which formed the

basis of previous legislation, in which it was stated that a Danish limited company has as its purpose to obtain financial profits. The preparatory works further point out that all limited companies in practice are deemed to carry out business activities, and that it was thus not necessary to include such specific provision in the Companies Act.

This classic Danish approach has been summarized by prominent Danish legal scholars Bernhard Gomard and Torbjørn Sofsrud as "The purpose is to generate profits".

Accordingly, it is deemed a common characteristic for all limited Danish companies that they are considered as having the purpose of carrying out commercial activities and to generate a profit for the purpose of either distributing it to the shareholders as dividends or making investments. This also meant that the interests of the company were, and generally still are, deemed to be similar, or even identical, to the interests of the shareholders seen as a whole, except in the case of distressed companies, where the interests of creditors were the focus point. This is also reflected by the fact that legislation focused on the equal treatment of shareholders, subject to share ownership, and protection of the capital and assets to the detriment of creditors.

Any management carrying out the business of the company with a view to maximize profits and dividends, using its best business judgement and having the appropriate basis for making its decision, would thus be unlikely to incur any other negative consequence than a potential dismissal, requiring the consent of the majority of shareholders. If management thus considered the best way of generating profits to focus on short-term goals, shareholders disagreeing would thus have to gather a majority to have the management replaced, unless such focus was to the detriment of creditors. An issue that would arise only in case of the company becoming distressed, in which case courts were reluctant to second-guess the business judgement of the management, provided that (1) management's decisions were not obviously in violation of legislation or interests of shareholders and (2) were made on a duly informed basis.

This shareholder-creditor centered approach has, however, been modified to some extent in recent years in a more modern Danish approach.

The modern Danish Approach

In his ground-breaking doctoral thesis from 1991 "The Corporate Mask", Erik Werlauff stated that "Other interests are included in the Company's interests than those of its shareholders."

In case law, Danish courts have started to introduce a separate requirement of "corporate benefit" in order for transactions, such as certain security arrangements, to be upheld. It is thus not sufficient that all shareholders benefit from a transaction if the transaction does not benefit the company itself. This is in addition to the stated requirement of the Danish Companies Act that financial assistance, not comprised by an exemption, must serve the interests of the company itself.

Also, the importance of "soft law" plays a major role with respect to Danish listed companies. The Danish Recommendations on Corporate Governance thus set out a number of principles considered to be best practice. Each listed company must report on its compliance with the recommendations on a "comply-or-explain" basis.

In the recent recommendations of 2 December 2020, the specific concepts of ”Sustainability” (e.g. with respect to the company's economic, financial and innovative sustainability, CSR, ESG etc.") and ”Purpose" (overall aim for long-term value creation, delivered to shareholders, other stakeholders and society).

The current legal framework and modern Danish approach mean that listed companies may take their individual circumstances into consideration. Transparency and reporting obligations mean that a short-term focus only will quickly be subject to criticism and a requirement for a more balanced approach. In this context, it should be noted that not only the companies themselves, but also the typical institutional investors, are subject to much public scrutiny. Such investors therefore also need to consider long-term interests.

Moalem
Weitemeyer

If you have any questions or require further information regarding any of the above, please do not hesitate to contact us:

Dan Moalem
Partner
Dan.moalem@moalemweitemeyer.com

Henning Hedegaard Thomsen
Senior Associate
Henning.thomsen@moalemweitemeyer.com

The above does not constitute legal counselling and Moalem Weitemeyer does not warrant the accuracy of the information. With the above text, Moalem Weitemeyer has not assumed responsibility of any kind as a consequence of any reader's use of the above as a basis for decisions or considerations.

This news piece has been produced in the English language only. Are you a client or a prospective client, and should you require a Danish version, please email us at news@moalemweitemeyer.com with a link to the article that you would like to request to receive in Danish, and we will attend to your request without undue delay.