Long-termism and Union company law: A pathway

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Abstract

Excessive short-termism in financial markets has been passionately debated since the late 1970s and became an even more prominent topic after the 2008 financial crisis. In the past decade, many jurisdictions used company law regulation to address this issue. This thesis joins the debate and proposes a better balance between short- and long-term behaviour in Union equity markets as its main argument. Considering recent legislative efforts in the European Union, company law is examined as a tool to achieve such balance.

The thesis divided into eight chapters. Chapter 1 discusses the main argument in contrast with the counter-arguments found in the literature. It builds on team production theory and the internal market principles in the Treaty on European Union as core normative foundations supporting the main argument. Chapter 2 combines institutional assessment, policy analysis and doctrinal restatement in the field of interpretative theory to form the epistemological framework for this study. Chapter 3 analyses previous quantitative and qualitative evidence to validate the existence of a trend of short-termism in equity markets since the second half of the twentieth century and the emergence of a counter-trend towards long-termism. This analysis leads to a definition of long-termism, which guides recommendations for Union company law. Chapter 4 examines the Union's regulatory policy for long-termism since the 2010s and the regulatory techniques available in this context. Based on the Union's policy and available techniques, chapters 5, 6 and 7 offer an in-depth review of the main directives addressing long-termism and recommends changes to them. Chapter 8 summarises the key findings and suggests further research.

This thesis contributes to the Union's legislative efforts to promote long-termism by recommending changes to its company law.

Keywords: Long-termism, company law, equity markets, listed companies, European Union.

Résumé

Le court-termisme excessif sur les marchés financiers a fait l'objet de débats enflammés depuis la fin des années 1970 et est devenu un sujet encore plus important après la crise financière de 2008. Au cours de la dernière décennie, de nombreuses juridictions ont utilisé le droit des sociétés pour résoudre ce problème. La présente thèse se joint au débat et propose, comme argument principal, un meilleur équilibre entre le comportement à court et à long terme des marchés d'actions de l'Union. Compte tenu des récents efforts législatifs dans l'Union européenne, le droit des sociétés est examiné comme un outil permettant d'atteindre cet équilibre.

La thèse est divisée en huit chapitres. Le chapitre 1 discute de l'argument principal par opposition aux contre-arguments trouvés dans la littérature. Il s'appuie sur la théorie de la production en équipe et sur les principes du marché intérieur du traité sur l'Union européenne en tant que fondements normatifs principaux soutenant l'argument principal. Le chapitre 2 combine l'évaluation institutionnelle, l'analyse des politiques et la reformulation doctrinale dans le domaine de la théorie interprétative pour former le cadre épistémologique de cette étude. Le chapitre 3 analyse les données quantitatives et qualitatives antérieures pour valider l'existence d'une tendance au court-termisme sur les marchés boursiers depuis la seconde moitié du XXe siècle et l'émergence d'une contre-tendance au long-termisme. Cette analyse conduit à une définition du long-termisme, lequel guide les recommandations pour le droit des sociétés de l'Union. Le chapitre 4 examine la politique réglementaire de l’Union pour le long termisme depuis les années 2010 et les techniques réglementaires disponibles dans ce contexte. Sur la base de la politique de l’Union et des techniques disponibles, les chapitres 5, 6 et 7 proposent un examen approfondi des principales directives relatives au long-termisme et recommandent des changements à ces directives. Le chapitre 8 résume les principales conclusions et suggère des recherches supplémentaires.

Cette thèse contribue aux efforts législatifs de l’Union pour promouvoir le long-termisme en recommandant des modifications à son droit des sociétés.

Mots clés: Long-termisme, droit des sociétés, marchés actions, sociétés cotées, Union européenne.

Zusammenfassung

Exzessive Kurzfristigkeit in Finanzmärkten wird seit den 1970er leidenschaftlich debattiert und wurde in Folge der Finanzkriese 2008 sogar prominenter. Im vergangenen Jahrzehnt entwarfen etliche Jurisdiktionen gesellschaftsrechtliche Regulierungen, um dieses Thema zu behandeln. Diese Arbeit schliesst sich dieser Diskussion an und fordert in ihrer zentralen These ein besseres Gleichgewicht zwischen kurz- und langfristigem Verhalten an europäischen Aktienmärkten. Die neuesten regulatorischen Bemühungen in der Europäischen Union in Betracht ziehend, wird untersucht in wie fern das Gesellschaftsrecht sich als Mittel zur Erreichung eines solchen Gleichgewichts eignet.

Die Arbeit ist in acht Kapitel gegliedert. Kapitel 1 diskutiert die zentrale These im Kontrast zu bekannten Antithesen. Ausgehend von der team production theory und den Prinzipien des Binnenmarkt des Vertrages über die europäische Union wird das normative Fundamente der Arbeit entwickelt. Kapitel 2 kombiniert institutionelle Bewertungen, Politikanalysen und Lehranpassungen um das epistemologische Rahmenwerk dieser Studie auszubilden. Kapitel 3 analysiert bisherige quantitative und qualitative Belege zum Nachweis einer Tendenz zur Kurzfristigkeit in Aktienmärkten seit der zweiten Hälfte des 20. Jahrhunderts, als auch des Aufkommens einer Gegenbewegung zur Langfristigkeit. Diese Analyse führt schliesslich zu einer Definition vom Begriff Langfristigkeit, welche die nachfolgenden Empfehlungen für das europäische Gesellschaftsrecht anleitet. Kapitel 4 untersucht die regulatorischen Strategien der Union für Langfristigkeit seit den 2010er und die damit verbundenen, verfügbaren Regulierungstechniken. Ausgehend von diesen Strategien und Techniken liefern Kapitel 5, 6 und 7 eine tiefgründige Überprüfung der wichtigsten Richtlinien bezüglich Langfristigkeit und empfehlen entsprechende Änderungen. Kapitel 8 fasst die wichtigsten Erkenntnisse zusammen und schlägt weitere Forschungsarbeit vor.

Diese Arbeit trägt zu den legislativen Bemühungen der Union zur Beförderung von Langfristigkeit bei und empfiehlt Änderungen für ihr Gesellschaftsrecht.

Schlüsselwörter: Langfristigkeit, Gesellschaftsrecht, Aktienmärkte, börsennotierten Gesellschaften, Europäischen Union.

Table of contents

Chapter I: Introduction

This chapter is divided into five sections. First, it states the main argument of this study. Second, it reviews the counter-arguments presented in the existing literature. Next, it lays out the normative foundations for the main argument, as found in the fields of corporate law, legal philosophy as well as the literature of business administration. Fourth, the scope of this study is specified and compared with other similar studies within the broad subject of long-termism in equity markets. Finally, this chapter closes with a description of how this study is structured.

1 Main argument

This study contributes to creating a legal framework that fosters long-term behaviour by equity market actors. Since the 1990s, a new behavioural pattern spread widely among corporate leaders, asset managers, investors and advisors. These equity markets actors started taking decisions primarily oriented towards short-term goals. According to a recent survey, most executives feel the pressure to deliver financial performance within one or two years, and only 2% of executives plan their company's strategy beyond five or six years.[1] This new behaviour has had negative short- and long-term consequences, both for these actors and for equity markets as a whole. Excessive risk-taking and low innovation investment are merely two examples.[2] Ultimately, the negative consequences also affect society and the environment.[3] The underlying rationale is that measures affecting society and the environment normally have long-term effects, whose extension and severity are difficult to forecast. Executives often neglect these consequences in order to achieve short-term financial results.

In contrast, decision-making oriented towards the long-term has produced consistent and stable results, as the financial sector illustrates. The Global Alliance for Banking on Values compares sustainability-focused banks (SFBs) and global systemically important financial institutions (GSIFIs). The former have a longer planning horizon than the latter. From 2007 to 2017, the average return on assets (RoA)

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1 Stoll (2018).
2 Strine (2017).
3 Paulson (2017) and Martin (2015) have summarised the discussion on this topic.

and return on equity (RoE) of both types of banks remained largely constant. The key difference became evident in the financial crisis. From 2007 to 2009, GSIFIs suffered a sharp decline in RoA and RoE, whereas SFBs figures remained stable. Although SFBs are more resilient, GSIFIs and SFBs may yield equivalent financial results over time. However, SFBs deliver social and environmental performance alongside financial performance. Central to the SFB business model is the triple bottom line[4], focusing on communities and serving the real economy for the long-term.[5]

In view of this contrast, short- and long-term behaviour in equity markets needs to be better balanced. I argue that achieving this goal requires overcoming the short-term logic governing current decision-making. This is necessary, I argue further, particularly when the prevailing short-term logic is applied to strategic decisions with long-term consequences.[6] Therefore, the legal recommendations proposed here seek to enable markets to take long-term decisions. They are a pathway for long-termism in Union company law. The shift — from a short- to a long-term logic — aims to achieve the balance mentioned above.

The better balance between short- and long-term goals and behaviour in equity markets has been widely discussed. Scholars in the fields of business, finance, economics and accounting have repeatedly studied this subject.[7] Moreover, the subject has received much practical attention from consultancies and other private organisations.[8] In legislation, Union law recently included the wording "long-term" in its principal company law directives.[9] In legal scholarship, however, this subject has so far received limited attention. Within this limited literature, most articles concern US company law.[10] Very few publications have dealt with Union company law.[11] This study

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4 Elkington (1997) coined the term "triple bottom line" to address business models that considered economic, social and environmental aspects.

5 Global Alliance for Banking on Values (2019).

6 Marginson and McAulay (2008), p. 274.

7 These studies are reviewed in chapter III (*Trend and counter-trend*).

8 Krehmeyer (2006) at the Business Roundtable Institute for Corporate Ethics, McKinsey (2017), World Economic Forum (2019).

9 Möslein and Sorensen (2018), p. 394.

10 Starting with Lipton (1979) up to Roe (2018). Dallas (2012) presents a very detailed analysis of the relationship between short-termism and the financial crisis, focusing on corporate governance.

11 Johnston and Morrow (2014) and (2015), as well as Möslein and Sorensen (2018) discuss long-termism in Union law.

seeks to close this research gap and contribute to the debate from a legal standpoint and by focusing on Union company law[12].

2 Counter-arguments

Two main counter-arguments against the goal formulated above have been made. First, that short-termism[13] is not harmful and that long-termism may not be desirable. Second, that even if short-termism is harmful legislators have no reason to take action.[14] Roe has discussed both arguments in detail in 2013 and 2018.[15] What follows considers Roe's criticism.[16]

2.1 Criticism as of 2013

Roe's first article includes very useful insights. First, he reviewed the numerous positions in the debate. He looked at diverse opinions in the United States (of the Delaware judiciary branch, lawmakers, international organisations, the media, and scholars in the fields of economics, finance, and business administration). These voices claim that short-termism is crippling the country's economy. Secondly, Roe's article offers illuminating insights into the mapping of structured research on short-termism and the law. For instance, Roe clearly explained so-called transmission mechanisms. These mechanisms transfer short-term pressure from the market to the boardroom and

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[12] Willey (2018) looks at regulation to determine what has been done globally to address the perceived harms of stock market short-termism. She also seeks to understand whether these regulatory reforms conceptually address the alleged stock market short-termism concerns.

[13] In this study, the terms short-termism and long-termism go beyond the temporal dimension. They are defined in detail sections III.1.1 (*Definition*) and III.2.1 (*Definition*).

[14] Hirschman (1991) studies the rhetoric of conservative authors, in their reaction to progressive changes. Hirschman identifies three types of conservative narratives: (i) perversity: The action to change only serves to exacerbate the condition one wishes to remedy, (ii) futility: Attempts at social transformation will fail to make a dent, and (iii) jeopardy: The cost of the change is too high and endangers a previous accomplishment. P. 7. Some of the criticism that Roe poses resemble these narratives. Especially the board insulation discussed in section I.2.1 (*Criticism as of 2013*). Hirschman concludes (p. 153-4) that there are risks in both action and inaction. This study assesses the risks –for instance, risks that Roe pointed out- before making recommendations. However, in truth, the potential negative consequences can never be anticipated with certainty.

[15] Mark J. Roe is a professor of law at Harvard University. He specialises in corporate bankruptcy and reorganisation, company law, corporate finance, and corporate governance. Roe is the only legal scholar to thoroughly criticise the fight against short-termism.

[16] A few other authors have opposed the existence of the problem of short-termism. Section III.2.4 (*Consequences*), last part, discusses their views.

onto management.[17] Finally, Roe considered whether modern company lawmaking should take short-termism into account or not. He argued that no legislative response is necessary based on five weaknesses of the short-termist argument. I discuss these below.

Lack of a system-wide view

Description: A short-term focus is not a systemic issue, but a very specific economic issue. In the equity market system, there are sufficient conduits that mitigate the effects of short-term tendencies. Examples include venture equity markets, private equity markets and privately-held corporate entities.

Roe contended that if short-termism destroyed value in the long run, market participants themselves would find a way out of this behaviour. He cited anecdotal evidence from Dollar General and Seagate Technologies to support this point. These two companies were suffering under Wall Street's short-term pressure and were delivering poor results. They were subsequently acquired by private equity firms. Private ownership allowed reorientation towards longer-term goals and better sustained success. Roe concluded: "Market problem, market solution."

Three points can be made in response to Roe's criticism:

- First, from a methodological standpoint, anecdotal evidence from two cases is not sufficient to confirm a hypothesis without an in-depth analysis;
- Second, from a logical standpoint, if evidence of the negative effects resulting from short-termism is correct, as Roe himself admitted, why have markets not corrected them until now? Thus, either the markets are unable to correct short-termism's negative effects, or the evidence is incorrect. Both statements cannot be simultaneously true.
- Thirdly, from a theoretical standpoint, Roe justified the argument of the lack of a system-wide spread with the Chicago School's efficiency of markets hypothesis.[18] This study, however, argues that this theoretical approach is inappropriate for contemporary company law. As explained in section I.3 (*Normative foundations*),

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[17] Roe (2013), p. 981 et seq. See box III.1.4 (*Transmission mechanisms*).

[18] For a review and critique, see Vanberg (2019) and Stout (2012), p. 63 et. seq. Stiglitz openly criticised this view and pointed to Milton Friedman's *Freedom and Capitalism* as a significant influence on rising inequality at the 2018 World Economic Forum. See https://www.businessinsider.com/joseph-stiglitz-milton-friedman-capitalism-theories-2018-3?r=US&IR=T (last retrieved on 15 July 2019).

this study suggests that contemporary company law calls for new foundations, including team production theory.

Inconclusive evidence

Description: The evidence as of 2013 shows that the market undervalues the short term and overvalues the long term. The dot-com bubble and the lofty share prices of Amazon, Apple and Google illustrate the overvaluation of the long term.

This study argues the opposite of Roe's position. Specifically, Roe's examples of short-term undervaluing highlight short-term hysteria. Most authors have seen the dot-com bubble as an example of short-term behaviour.[19] During this bubble, investors transferred long-term expectations into short-term overvaluation and hyperactive trading. Had they embraced a long-term perspective, they would have invested slowly and gradually. They would have waited for results to occur over time instead of trading to gain as soon as possible. Hence, contrary to Roe's assessment, the observed behaviour was not about overvaluating the future. In reality, it involved speculation, that is, betting on how much competing investors were willing to pay in advance for an alleged future potential.[20] [21]

Board insulation

Description: Shareholder pressure may cause short-termism. Hence, some authors have recommended board insulation from shareholders. However, according to Roe, CEOs and senior managers would exacerbate short-term behaviour if they had more freedom. The duration of executive pay packages is shorter than the average holding period of institutional investors. Hence, CEOs and senior managers would push poor results beyond their tenure and aim to achieve short-term success.

According to Roe, the problem of short-termism is that:

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19 Fox and Kenagy (2012), Rappaport (2012), Stout (2012) and Bowdren (2016).

20 Scholars sometimes use the oil and gas industry as another example of how the market is able to assess long-term investments and calculate long-term effects. See Hicks and Nelder (2008). The present study does not argue that investors are unable to act in a long-termist manner. It argues instead that, in most cases recently, they choose not to. Section III.1 (*The trend towards short-termism*) addresses this argument in detail.

21 This rationale applies to the lofty share prices of Amazon, Apple and Google. Another recent example is the cryptocurrency boom. In all these cases, investors acted to obtain instant profits. As always, it is hard to grasp the real intent of buyers and sellers. Chapter III.2.2 (*Quantitative data*) discusses publications analysing the perceptions and actions of investors and executives.

> “financial mechanisms induce corporate directors and managers to favour immediate but lower-value results over more profitable long-term results.”[22]

He argued that shareholders are these financial mechanisms and criticises board insulation as a reaction to short-termism. This study corroborates the view that board insulation is not the solution to short-termism[23], but differs from Roe’s outline in two aspects:

- First, I assume that shareholder pressure is only one of many factors causing short-termism. Others include analyst behaviour and the regulations on quarterly earnings reporting. Also, internal mechanisms, such as compensation agreements, can be a source of excessive short-termism.
- Second, this study does not claim that the reaction to counter short-termism should be manager and board insulation from shareholders. I argue instead that a checks-and-balances mechanism is needed for this triangular relationship. I make various recommendations to incentivise not only shareholders but equity market actors as a whole. In particular, I suggest measures that incentivise management to adopt long-term thinking in concert with shareholders and other stakeholders.

Courts lack capability

Description: Courts are poorly equipped to evaluate economic policy. Other institutions are better placed to assess the extent, location and capacity of the law to ameliorate excessive short-termism.

Roe argued that no reaction from courts, parliament or government is required in the United States.[24] Yet the statements leading him to this conclusion are inconsistent. For instance, he argues that the evidence on short-termism is insufficient. He pointed out that academia, judges, business leaders, the OECD, and major newspapers (The Washington Post and The New York Times) have paid much attention to this subject. Further, he presented evidence confirming short-term behaviour and its negative consequences. In conclusion, he stated that short-termism is a subject that is “ripe for out-of-court consideration.” Although relevant enough for consideration, Roe argued that the subject should not “influence election rules, proxy rules and the rules governing

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22 Roe (2013), p. 981.
23 Bebchuk (2013) also expressed views against board insulation.
24 Roe (2013), p. 984.

takeovers."[25] Unfortunately, he failed to either explain or solve the contradiction between these statements.

In contrast, evidence of short-termism, as provided by Roe's, leads me to the opposite conclusion: Short-termism is a subject that is ripe for consideration and ought to influence public policy.

Coming from a civil law background, I am not well suited to assess how well common law courts are able to correct company law in relation to short-termism. Nevertheless, Roe's line of reasoning need not be extrapolated to all policy recommendations. Consequently, I argue that the legislative and executive branches are well suited to handling corporate time horizons.[26]

Short-term trading evidence is misinterpreted

Description: Trading evidence has been misinterpreted and had led to a false notion of increased short-termism. Only the average holding period has become shorter. More importantly, the holding period of large mutual funds and pension funds has remained the same or has increased.

At first sight, this argument on holding period statistics seems quite compelling. Roe asserted that some commentators have overlooked the difference between the concepts of average and mean.[27] While the average holding period may have shortened dramatically, the mean has fallen less steeply. This, so Roe, is because a significant gap exists between holding periods for small and large investors. Arguably, the latter hold the majority of shares in the market for longer periods, while "small" investors hold fewer shares, but for very short periods.

While this argument may have some normative resonance, it is not conclusive. Roe advanced this view based on a hitherto unpublished manuscript.[28] This manuscript studied the holding periods of only two investors: Vanguard and Fidelity, in 1985 and

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25 Roe (2013), p. 983.

26 One could argue that the private institutions in the market could handle short-termism without any state intervention. However, various studies suggest that these institutions have been incapable of addressing short-termism. Rhodes (2016) discusses how Volkswagen's emissions scandal exemplifies this incapability. He shows how corporations prefer internal control mechanisms to avoid external monitoring.

27 Roe (2013), pp. 998–1001.

28 Roe (2013), footnote 108: Martijn Cremers, Ankur Pareek and Zacharias Sautner, Stock Duration and Misvaluation (14 February 2013) (unpublished manuscript).

2010. No other study has affirmed this view. On the other hand, several studies on holding periods have confirmed the market-wide shortening of holding periods.[29] In contrast, this study rejects the claim that the holding period of large mutual funds and pension funds has remained the same or has increased. It does so because no relevant evidence is available as of 2020.

2.2 Criticism as of 2018

The main argument of Roe's second article reads:

> "the overall, economy-wide evidence (…) mostly points to equity markets functioning well enough and not sharply biased against the long-term."[30]

It repeats Roe's original view articulated in 2013.

In comparison to this study, Roe's second publication has a different scope. Hence, most of his arguments do not apply here. The respective scopes can be distinguished along three lines:

- First, Roe failed to acknowledge that protecting managers from investor influence is but one of the many solutions proposed in corporate, judicial and academic circles. Especially in Union law, incentives concerning disclosure dominate the discussion.[31] Instead of concentrating on management and board isolation, this study explores a system-wide approach to devising a legal framework better able to balance short- and long-term behaviour.
- Second, Roe focused on what he calls "Type A" short-termism[32]. This type has consequences for the market and hence also for the economy. In contrast, this study takes a holistic view on the effects of excessive short-termism, which Roe called "Type B" short-termism. This view encompasses economic, social and environmental perspectives.

  One example of this conceptual difference is that Roe assumed a single-factor perspective. This led him to claim that Amazon, Apple, Facebook, Google, and Microsoft are future-oriented companies. For him, such companies are free from

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29 McKinsey (2017) summarises these studies.
30 Roe (2018), p. 74.
31 See chapters V (*Takeover Directive, Merger Directive and Insolvency Directive*) to VII (*Reporting Directive*).
32 I explain Roe's definitions of Type A and Type B short-termism in section III.1.1 (*Definition*).

short-termism. In contrast, I argue that short-termism is not determined by any single factor. If a company favours short-term profits over long-term value, it suffers from short-termism. It is, however, irrelevant whether the profits come from betting on next month's soy harvest or the next decade's smartphone trend.

– Third, Roe attempted to demonstrate that excessive short-termism has not increased trading, nor activist engagement and reduction in capital investment in recent decades. "Sharper technological shifts and enhanced global competition are the cause; stock markets are the messenger."[33] Some of his alternative explanations are indeed plausible. For instance, technological shifts and global competition are relevant influences besides regulatory incentives. However, the need for a better balance between short- and long-term behaviour in the equity market remains.

This study posits that the pressing need to address short-termism goes beyond increased trading, as well as beyond increased activist engagement and reduction in capital investment in recent decades. Hence, nothing in Roe's argumentation undermines the value of finding a better balance between short- and long-term goals in the equity markets as a whole.

In conclusion, this study benefits most from Roe's 2018 article, which shows how quantitative evidence of short-termism oscillates in economics and finance. In this context, McKinsey reported in 2017 that no evidence undisputedly confirms that short-termism detracts from corporate performance and economic growth.[34] I discuss this issue in section III.1.2 (*Quantitative data*).

3 Normative foundations

The present analysis and the resulting legal recommendations rest on two normative foundations:

(a) the normative framework developed by Blair and Stout, according to which company law works as a solution to the economic problem of "team production"[35]; and

33 Roe (2018), p. 76.
34 McKinsey (2017).
35 Blair and Stout (1999).

(b) John Rawls' theory of justice, specifically justice as fairness, as elucidated by Kedar.[36]

When combined, these foundations directly oppose the concepts of shareholder primacy[37][38] and the applicability of agency theory.[39] These two concepts should no longer be the sole guiding principles of company law, as discussed below. Contemporary corporate governance requires new models[40].

I examine the two normative foundations only to the extent needed to understand my main argument.[41] As mentioned, this study aims to recommend legal rules capable of ensuring a better balance between short- and long-term behaviour in equity markets.

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36 Rawls (2001) and Kedar (2015). Also Pace (2019), a law assistant-professor in the United States, reviews the liberalism of both John Rawls and Robert Nozick in respect of Delaware company law. He focuses on a case where the Delaware courts ruled against the directors of Walmart for their decision no longer to sell long guns to 18- to 20-year-olds. The judges found that the directors violated their duty of loyalty because they acted against the law that prohibits discrimination based on age. The economists Fia and Sacconi (2018) discuss Rawls and corporate governance. Blanc (2016), an assistant-professor of business ethics in Belgium, defends the applicability of Rawls's political conception of justice to corporate governance. Norman (2015)), an ethics professor in the United States, makes the connection between the Rawlsian egalitarian theory of justice and company law.

37 Shareholder primacy or shareholder value maximisation is understood here as "An approach to business planning that places the maximization of the value of shareholders' equity above all other business objectives" Law (2018).

38 The principle of shareholder primacy has influenced most company law since the 1970s, especially in the United States. In continental Europe (mainly Germany and France), this principle has been less influential. See Grundmann (2011), p. 266 and Trigo Trindade (2000), p. 292. Keay (2010), while arguing that this model has significant flaws, affirmed that it is likely to survive in Anglo-American markets, p. 412.

39 Agency theory is "The theory of the contractual relationship between a principal and an agent. Agency theory analyses the issues that arise when a principal delegates a task to an agent but there is asymmetric information and an incomplete contract. The basis of the analysis is that the principal and the agent have different objectives. For example, the owner of a firm (the principal) may wish to maximize profit but the manager of the firm (the agent) aims to maximize a utility function that is increasing in income but decreasing in effort" (Hashimzade et al., 2017).

40 Principal-agent issues are still considered in Union law-making. For instance, the preparatory works of the Shareholder Directive often refers to the shortcomings in the relationship between shareholders and directors under the principal-agent terminology. At the same time, the preparatory works do not place shareholders as owners of a listed company. Moreover, these documents recognise the importance of employees and other stakeholders for the good governance of a company.

41 The scrutiny of the normative foundations of this study's main argument would be the subject of another dissertation. Legal philosophers like Rawls and Dworkin, as well as economists like Smith, Keynes and Hayek would have to be looked at more thoroughly. However, this limitation is necessary to focus on the practical side (i.e. the discussion on the recommended measures). Hence, this study concentrates on analysis and recommendation (as explained in Chapter II (*Methodology*)). The fact that the normative foundations are studied only briefly is one limitation of my research.

Analysis and recommendation,[42] first require interpreting and understanding the nature of such rules.[43] I begin with their normative foundations.

Attempts to establish deontological normative foundations for company law have so far yielded poor results. Nesteruk and other business ethics scholars have complained that corporate legal scholarship has failed to grasp the philosophical dimension of company law.[44] Nesteruk made this point in 1991. Now, decades later, the point is still valid. So far, authors have tended to focus on the role of economic theory — in particular, agency theory — in company law.[45]

Very few authors have examined company law through a justice lens or based on other elements of legal philosophy.[46] Other scholars have discussed ethics and morality in the field of corporate social responsibility. However, corporate social responsibility has been treated in no more than a few paragraphs in company law reference books.[47]

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42 As explained in section II.4.3 (*Archetypal legal scholarship*), this study is mainly an exercise in policy analysis, i.e. the analysis and recommendation of legal rules.

43 Interpretation is a tool for understanding legal rules. Larenz and Canaris (1995), p. 25 et seq. The discussion in section I.4.2.1 (*Principles of Union company law*) complement the interpretative exercise.

44 Nesteruk (1991) and Norman (2015). However, some legal scholars have looked at ethical influences in company law. See also discussion in Gelter (2009), p. 131. He noted that Zetzsche (2007) conclude that Lutheran and Catholic nations were more stakeholder-oriented than Calvinist and Anglican, p. 23; while Licht (2004) examined cultural backgrounds to suggest that Anglo-Saxons were more prone to embrace shareholder primacy, p. 733 et seq.

45 In *The End of History for Company law* (2001), Hansmann and Kraakman predicted that the shareholder-oriented model of company law would prevail as equity markets evolve throughout the developed world. From the perspective of company law in the United States, see Dodd (1932), Berle (1932), Gelter (2011) and Bratton (2014).

46 One interesting discussion by a legal scholar is Dworkin's on why liberals should look at equality and how this should reflect in policy. Company lawyers, though, often do not see the need for company law as an instrument for correcting unequal market allocations.
"So a liberal cannot, after all, accept the market results as defining equal shares. His theory of economic justice must be complex, because he accepts two principles, which are difficult to hold in the administration of a dynamic economy. The first requires that people have, at any point in their lives, different amounts of wealth insofar as the genuine choices they have made have been more or less expensive to the community, measured by what other people want for their lives. The second requires that people do not have different amounts of wealth just because they have different capacities to produce what others want, or are differently favoured by chance. This means that market allocations must be corrected in order to bring some people closer to the share of resources they would have had but for these various differences of initial advantage, luck, and inherent capacity" (Dworkin, 1985, p. 207).

47 For instance, Cheffins (2006), Hicks and Goo (2008), Grundmann (2016), Hannigan (2016) only dedicate a few paragraphs to the topic. Corporate social responsibility relates to but differs from long-termism, because it does not concern longer timeframes by definition. "The Commission has defined CSR as the responsibility of enterprises for their impact on society and, therefore, it should

Sociologists have studied distributive justice and stakeholder theory in firms.[48] Adopting a deontological standpoint, Boatright suggested that role morality should provide the guiding principles for company law.[49] Still, these studies remain in the field of business ethics and are no central concern for company lawyers or scholars.[50] In 2016, over fifty law professors from all five continents signed a statement on company law.[51] This statement summarised the fundamental rules of company law, yet none had an ethical dimension. Kedar linked company law to the theory of justice and is one of the very few authors addressing this dimension of company law.

After applying a fair degree of internal scepticism over the limited choices available,[52] I found the normative pillars for this study at the intersection of the concepts of team production in economic theory and of justice in legal philosophy. Saying this, I am aware that these normative foundations are not part of mainstream company law

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be company led. Companies can become socially responsible by: Integrating social, environmental, ethical, consumer, and human rights concerns into their business strategy and operations; and following the law". (Retrieved from: https://ec.europa.eu/growth/industry/corporate-social-responsibility_en. Last accessed 15 July 2019) However, it is a very important instrument in the economy. European governments recognise this fact. For instance, see the CSR Position Paper and Action Plan of the Swiss Federal Council (Retrieved from: https://www.seco.admin.ch. Last accessed 15 July 2019) and Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions dated 25 October 2011, document number COM(2011) 681. Many authors called the 2014 amendment to the Reporting Directive the "2014 CSR Directive" or "CSR-Richtlinie" – see Leyens (2018) or Habersack and Verse (2019).

48 Maitland (2001) and Etzioni (1998).

49 Boatright (1996) and (2002). Among legal authors, Nader (1999) and (2004) discussed corporate ethics in law firms, as well as corporate ethics in criminal law and corporate crimes.

50 John W. Noble, vice chancellor at Delaware Court, affirmed in 2000 that the law, and unlike ethics, does not necessarily address moral issues. Some of its rules are motivated by ethical considerations; others are designed to efficiently allocate economic resources. Finally, some rules are designed to provide certainty to business professionals about the consequences of their acts. As transcribed here: https://www.scu.edu/ethics/focus-areas/business-ethics/resources/the-intersection-of-corporate-law-and-ethics/ (last accessed 15 July 2019)

51 Retrieved from: https://commons.allard.ubc.ca/cgi/viewcontent.cgi?article=1418&context=fac_pubs (last accessed 15 July 2019).

52 Dworkin (1986), p. 86. "The only scepticism worth anything is scepticism of the internal kind, and this must be earned by arguments of the same contested character as the argument it opposes." This study is also based on my previous research on the regulation of social and environmental risk management in European and South American financial institutions, as well as on legal aspects of impact investing during 2015 and 2016. I interviewed more than fifty participants and their empirical insights have helped me navigate the lines of argumentation here. The previous research was part of an exercise of exploring several avenues within the field of equity markets and sustainability. It helped me frame this dissertation and opt to focus on long-termism.

theory.[53] Nevertheless, as demonstrated below, these foundations are both (i) solid, even under strict legal scrutiny, and (ii) aligned with the legal nature of the company.[54]

3.1 Company as team

In 1999, Blair and Stout presented an alternative to the view of the company (referred to as "corporation" in the United States' scholarship) prevailing among economists.[55] At the time, scholars were equating the company with the firm, and thus saw it as property belonging to shareholders.[56] To these scholars, the shareholders, as owners of the corporation, granted control over their property to directors. This separation of ownership and control was the source of agency costs. These may arise, for instance, when directors use the corporation's resources to their own benefit. Blair and Stout challenged this view of the corporation based on agency theory and instead proposed that economists understand the corporation as team production[57].

3.1.1 Property approach

The property approach to the corporation had two practical consequences.[58] First, it redefined the function of company law in the United States. Company law became a

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53 Various authors have defended other normative foundations for company law. In economic theory, property theory (principal-agent) and nexus-of-contracts theory (or bundle of contracts) are still very popular. See Stout (2017), p. 343 et seq. Also Ayotte and Hansmann (2014). In political science, the franchise government's theory has been applied to explain the nature of the corporation. Ciepley (2013).

54 Here, I use the term company in its general definition: "A succession of persons or body of persons authorized by law to act as one person and having rights and liabilities distinct from the individuals forming the corporation. (…) Corporations [or companies] can hold property, carry on business, bring legal actions, etc., in their own name" (comment added) in Law (2015). I use the term "company" as a synonym for corporation. As explained in section I.4.3 (*Equity markets*), this study focuses on listed companies, which are a type of company. Hence, the digression on companies in this section (*Company as a team*) applies to listed companies.

55 The corporation is the primary object of company law. The approach adopted to understand the corporation guides the entire design and interpretation of this legal field. For this reason, this section (*Company as a team*) analyses different views on the concept of the corporation.

56 The economists Jensen and Meckling (1976) pioneered the notion of agency costs. They advanced a positive (non-normative) statement: "The relationship between the stockholders and manager of a corporation fit the definition of a pure agency relationship," p. 309.

57 Meese (2001), a law professor in the United States, opposed to the application of team production theory to Delaware company law. Harris (2014), a law professor in Tel Aviv, defends that one size does not fit all. He discusses team production, agency and asset partioning and concludes against the application of one single theory to all corporations.

58 Blair and Stout (2001), pp. 248–249.

tool for reducing agency costs and for protecting shareholder interests.[59] Second, it redefined the purpose of the company as the maximisation of shareholder value.

This study rejects these two redefinitions. First, as most scholars agree, the function of company law is to regulate: (a) corporations, their creation, operation and termination; (b) the capitalisation of corporations, as well as the relationship between the corporation, capital providers and capital managers; and (c) the protection of creditors and (partly) of the corporation's employees.[60] Second, under the laws of many Members States[61], the corporation's primary purpose is to profitably pursue its object, as defined in its articles of association[62]. Moreover, Stout argued that three assumptions underlying the property approach are mistaken from a legal standpoint:[63]

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59 See discussion of the possible agency problems in United States company law by Armour et al. (2017).

60 Grundmann (2011), p. 2. This is also in line with a statement on company law signed by over fifty law professors from around the world in 2016. See footnote 52.

61 The laws listed in Table I.3.1.1b (*European company law*). Regardless this similarity, Europe embodies the dilemma between a more shareholder-centric practice of English company law and a more stakeholder-oriented company law in the continental nations. Moore (2016), p. 30.

62 Mayer (2019). Möslein and Sorensen (2018) found that company law faces the dilemma of reconciling the purpose of the company with the concepts of sustainability and long-termism. They concluded that legislators in most jurisdictions have opted for not solving that problem and for prioritising the private autonomy, leaving freedom of choice to the company's founders. For profit-with-purpose businesses, legislators have adopted new exceptional regulation, p. 393-4. See section I.4.2.3 (*New company law*).

63 Stout (2012), p. 36 et seq.

Table I.3.1.1a - Property approach

Assumption in economics	**Statements in law**[64]
Shareholders are the principals who own corporations as their property.	Shareholders own shares, which represent a stake in the corporation's share capital. Corporations are independent legal entities. They have their own legal personality and the capacity to acquire rights and obligations.
Shareholders are residual claimants of whatever profits remain after the other creditors (suppliers, employees, banks, customers, etc.) have been paid.	Corporations are under no obligation to pay dividends to shareholders.
Shareholders hire directors to act as their agents.	Shareholders have the right to vote and appoint directors, but retain no control over the actions of directors. Directors undertake duties towards the company, not towards shareholders.

The above assumptions are also incorrect from a hermeneutic standpoint. Company law cannot be interpreted to mean that the company is an asset owned by shareholders who hire directors as agents. The reason being that this interpretation would run contrary to the wording (and meaning) of the law. While it is possible to interpret the law extensively, it is not possible to interpret the law contrary to the literal meaning of the text.[65] In legal texts, the nature of the corporation is that of a separate legal entity, and that of shareholders is that of subscribers. Attempting to include the notion of property in the corporation would contradict the wording of the law. The examples below illustrate that the law does not substantiate the property approach[66]:

64 This is the case in company law in most countries listed in Table I.3.1.1b (*European company law*), as well as in the United States.

65 Larenz and Canaris (1995), p. 141.

66 This is a selection of the jurisdictions representing the largest part of the equity markets in the European Union for the purpose of exemplification.

Table I.3.1.1b – European company law

Country	Corporation
Germany[67]	§ 1 Wesen der Aktiengesellschaft (1) Die Aktiengesellschaft ist eine Gesellschaft mit eigener Rechtspersönlichkeit. Für die Verbindlichkeiten der Gesellschaft haftet den Gläubigern nur das Gesellschaftsvermögen. § 2 Gründerzahl An der Feststellung des Gesellschaftsvertrags (der Satzung) müssen sich eine oder mehrere Personen beteiligen, welche die Aktien gegen Einlagen übernehmen.
France[68]	La société anonyme est la société dont le capital est divisé en actions et qui est constituée entre des associés qui ne supportent les pertes qu'à concurrence de leurs apports [*responsabilité*]. Le nombre des associés ne peut être inférieur à sept.
Italy[69]	Art. 2325 Nozione Nella società per azioni per le obbligazioni sociali risponde soltanto la società con il suo patrimonio. Le quote di partecipazione dei soci sono rappresentate da azioni (2346 e seguenti). Art. 2325. Responsabilita' Nella societa' per azioni per le obbligazioni sociali risponde soltanto la societa' con il suo patrimonio. Art. 2325-bis. Societa' che fanno ricorso al mercato del capitale di rischio Ai fini dell'applicazione del presente ((titolo)), sono societa' che fanno ricorso al mercato del capitale di rischio le societa' con azioni quotate in mercati regolamentati o diffuse fra il pubblico in misura rilevante.
Spain[70]	Artículo 1. Sociedades de capital. (…) 3. En la sociedad anónima, el capital, que estará dividido en acciones, se integrará por las aportaciones de todos los socios, quienes no responderán personalmente de las deudas sociales.

67 Aktiengesetz vom 6. September 1965 (BGBl. I S. 1089), das zuletzt durch Artikel 9 des Gesetzes vom 17. Juli 2017 (BGBl. I S. 2446) geändert worden ist. Retrieved from: https://www.gesetze-im-internet.de (last accessed 15 July 2019).

68 *Loi n°66-537 du 24 juillet 1966 sur les sociétés commerciales*. Retrieved from: https://www.legifrance.gouv.fr. (last accessed 15 July 2019)

69 *REGIO DECRETO 16 marzo 1942, n. 262, Approvazione del testo del Codice civile.* Retrieved from: https://www.gazzettaufficiale.it (last accessed 15 July 2019).

70 Real Decreto Legislativo 1/2010, de 2 de julio, por el que se aprueba el texto refundido de la Ley de Sociedades de Capital. Retrieved from: https://www.boe.es (last accessed 15 July 2019).

Portugal[71]	Artigo 271.º Características Na sociedade anónima, o capital é dividido em acções e cada sócio limita a sua responsabilidade ao valor das acções que subscreveu.
England[72]	A “public company” is a company limited by shares or limited by guarantee and having a share capital— (a) whose certificate of incorporation states that it is a public company, and (b) in relation to which the requirements of this Act, or the former Companies Acts, as to registration or re-registration as a public company have been complied with on or after the relevant date.

In conclusion, the property approach is not suitable for company law. It is inconsistent with the legal rules concerning the corporation. For this reason, this study adopts the team production approach.[73]

3.1.2 Team production approach

According to Blair and Stout, team production exists when a productive activity requires the combined investment and coordinated effort of two or more persons.[74] Thus, problems about the distribution of economic surpluses among team members may arise if:

> “(a) the team members’ investments are firm-specific (i.e. it is difficult to recover once committed to the project), and if
> (b) output from the enterprise is non-separable (i.e. it is difficult to attribute any particular portion of the joint output to any particular member's contribution).”[75]

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[71] Código das Sociedades Comerciais (republicado pelo Decreto-Lei n.º 76-A/2006, de 29 de Março e alterado pelo Decreto-Lei nº 8/2007, de 17 de Janeiro e pelo Decreto-Lei nº 357-A/2007, de 31 de Outubro). Retrieved from: https://www.cmvm.pt (last accessed 15 July 2019).

[72] Companies Act 2006. Retrieved from: https://www.legislation.gov.uk (last accessed 15 July 2019).

[73] There are other approaches to defining the corporation, such as “nexus of contracts” and “franchise governments,” as Stout (2017) has explained in detail. Mayer (2018) offered a remarkable approach to the purpose of businesses, namely “prosperity.”

[74] The authors based this explanation on the principal reference work on the concept of team production problems: Armen A. Alchian, and Harold Demsetz (1972). *Production, Information Costs, and Economic Organization*. The American Economic Review, 62(5), 777.

[75] Blair and Stout (1999), p. 249. Kaufman and Englander published a series of articles on the managerial and ethical aspects concerning team production and corporate governance (2005), team production and the OECD Principles of Corporate Governance (2007), as well as team production and stakeholder theory (2011).

In this case, *ex-ante* rules of distribution invite shirking behaviour, while *ex-post* agreements create incentives for opportunistic rent-seeking behaviour. Blair and Stout argued that preventing shirking and rent-seeking via explicit contracts would be too difficult and costly. Hence, company law, as the institutional substitute for explicit contracts, should work to address such team production problems.[76]

Blair and Stout proposed a fully independent board — or "disinterested hierarch" — as a solution to team production problems: "The board is not part of the team and is well-positioned to weigh in the competing interests of the team members." By analogy, they cited the "referee in a football game; the trustee who administers a trust for multiple, competing beneficiaries; and the judge who renders a decision in litigation between parties."[77]

I disagree with this solution,[78] not least because boards are not truly independent. They made essential contributions to productive activity and have interests in this activity (among others, to at least receive compensation). Hence, directors are also team members.[79] A referee, a trustee and a judge mediate between parties with mostly competing interests and very little in common. A board, however, mediates between parties with mostly converging interests, i.e. the success of productive activity.

Although this study disagrees with the proposed solution to team production problems, it follows the team production approach as a normative foundation. Two key aspects inform this choice. First, the fact that shareholders, as well as directors, employees, suppliers, consumers and communities are team members[80]. They all make

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76 Blair and Stout (1999), p. 250. Team production problems resemble those of the tragedy of the commons, which Hardin (1968) and later Ostrom (1990) and Poteete et al (2010) observed. Both concern the moral hazard of rent-seeking from a shared pool. However, the tragedy of the commons stems from (i) a public good, i.e. no private property and (ii) the conflict between the freedoms of the commons. In the corporation, the team production problems of shirking or rent-seeking stem from the two characteristics (a) and (b) in the main text above. Recently Deakin (2019) drew this parallel and postulated the view of the corporation as commons.

77 Blair and Stout (1999), p. 284.

78 Casey and Henderson (2015) also disagreed with this solution. In their view, the corporation "is controlled by a series of relationships—some of which are governed within the firm and some of which are governed and enforced externally." Hence, it is not really a team that needs a hierarchically superior "coach." Gilson (2016) also criticises having the board as the mediating hierarchs, because this "leaves the hierarchs on a very long leash", p. 21.

79 Across this study, the term "directors" includes executive and non-executive directors, as well as managers (such as a chief executive officer or a chief financial officer) that are not members of the board. For a discussion on the distinction of such roles, see Johnston and Segrestin (2018).

80 See section III.2.1.1 (*Three conditions*) on stakeholders as team members.

essential contributions to the corporation's productive activity and participate "in a common enterprise (and) have reason to want all of the other participants to cooperate fully."[81] Second, the shift away from the principal-agent model emphasises "the cooperative aspects of the team, focusing on the integrated contribution of each team member."[82]

Consequently, the team production approach reaches beyond the widely upheld dichotomy concerning the nature of the corporation: Should the corporation serve the public good or increase its shareholders' wealth?[83] In my practical experience, people are still struggling to take either position.[84] It is thus both useful and pragmatic to move forward regardless of these opposing opinions.[85]

This study sees the corporation as a team seeking to achieve not only the best possible results for itself (i.e. preserving its existence and auspicious continuation), but also to further the short- and long-term interests of its team members' interests as best as possible. Here, the concept of team members includes everyone contributing directly or indirectly to the corporation's productive activity. Therefore, the recommendations made in this study address team production problems and the conflicting interests of team members.[86]

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81 Blair (2012), p. 3.

82 Kedar (2015), p. 591.

83 Nesteruk (1991), p. 726, and Nesteruk (1992) explored the moral status of the corporation.

84 I have been criticised for adopting this position: An Austrian professor once accused me of reading "too much Piketty," while my centre-left friends see me as a heartless neoliberal.

85 Schön (2016) argued that Union company law has not answered the question about the purpose of the public limited company, p. 280: "*Entschieden wurde diese Debatte letztlich bis heute nicht; nach wie vor ist offen, ob den Aktionärsinteressen ein prinzipieller Primat zukommt oder der Vorstand in der unternehmerischen Praxis auch anderen gesellschaftlichen Interessen (über die Erfüllung von Rechtspflichten hinaus) den Vorrang einräumen darf.*" Union law contains rules that protect shareholder interests and rules tending towards corporate social responsibility.

86 Blair and Stout (1999, p. 254) also argued that the team production approach is consistent with the nexus-of-contracts approach. The latter sees the corporation as a bundle of social contracts between and among actors like the corporation, shareholders, employees, consumers, suppliers, governments, the local community, etc. In my view, both approaches complement each other.

3.2 Principles of justice

This study's second normative foundation is an attempt to identify guiding principles for the recommended company law rules.[87] The literature linking legal philosophy with company law is still very scarce.[88] Kedar's contribution is so valuable, as it has the potential to initiate a debate in this direction.[89] Regarding team production and company law, Kedar complemented Blair and Stout's beginning very well. Whereas Blair and Stout placed team relations at the heart of the corporate idea, Kedar focused on the fair allocation of goods among team members. Kedar applied Rawl's principles of justice to achieve efficient decision-making procedures as well as fairness. She argued that these principles should also apply to corporations because they are part of the basic structure of society: They are major social institutions, construct power relations, shape the public sphere and allocate significant goods.[90] Finally, Kedar demonstrated how boards can apply the Rawlsian principles of justice in their decision-making.[91]

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87 Coming from a Brazilian law background, I was bound to consider constitutional principles when interpreting company law. As per Article 170 of the Federal Constitution, economic activity is an instrument for pursuing social justice and a life with dignity for all. Carvalhosa (2013), pp. 598–9. For this reason, it was important for my research to identify a normative connection between Union company law and the overall legal principle of justice. Roth and Kindler (2013) wrote the book "The spirit of corporate law: Core principles of corporate law in Continental Europe". These authors focused on principles like "minimum capital and capital protection", "general competence", "protection of minority interests", "external control of corporations" to explain Union company law. These principles are useful for understanding the framework in which company law provisions are inserted. However, they provide little guidance when establishing the overall objective of the European (economic) legal system. To this end, Article 3(3) of the Treaty on European Union discussed in section I.4.2 (*Company law*) and the preparatory works examined in section IV.1.1 (*Trajectory*) are more useful.

88 The main company law textbooks omit the considerations of legal philosophy. Mainly business ethics scholars have tried to correlate deontology and corporate governance. Walt and Schwartzman (2017) discussed moral theory with a view to determining the conditions for assigning rights and duties to corporations. Sison (2008) analysed corporate governance under the lenses of Aristotelian political theory.

89 Business ethicists like Heath et al. (2010) called for a greater significance of political philosophy, including Rawlsian principles, within corporate governance.

90 Kedar (2015), p. 586. Singer (2015), an assistant professor of political science in the United States, directly opposed to this view. To him, corporation are not part of the basic structure of society. Norman (2015) has an opinion closer to Kedar's. To him, the applicability of the Rawlsian theory to the corporation is also consistent with the notion of the corporation as a nexus of contracts, p. 55.

91 Kedar (2015), p. 592 et seq. Hagen and Mulder (2013) connected Rawls' principles with stakeholder theory to determine which stakeholders should have a right to board-level representation.

Rawls' two key principles are:

"(a) Each person has the same indefeasible claim to a fully adequate scheme of equal basic liberties, which scheme is compatible with the same scheme of liberties for all; and

(b) Social and economic inequalities are to satisfy two conditions: first, they are to be attached to offices and positions open to all under conditions of fair equality of opportunity; and second, they are to be to the greatest benefit of the least-advantaged members of society (the difference principle)."[92] [93]

Kedar translated each of these principles to corporate governance practice. The first principle — equal liberties — concerns the right of employees (a) to unionise (analogously to the right of free association), and (b) to participate in management (analogously to the right to vote and participate in government).[94] The second principle — equal opportunity — refers to counteracting inequalities, which emerge in any system. Even when the initial scheme of equal liberties is fair, the diversity of innate characteristics may generate gaps in opportunity and resources. Hence, the corporation ought to aim for diverse employment and diverse board composition.[95] Finally, the

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92 Rawls (2001), p. 42-48.

93 This is a revision of his initial statement in *A Theory of Justice*. See Rawls (2005), pp. 302–3.
"First Principle: Each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all. Second Principle: Social and economic inequalities are to be arranged so that they are both: (a) to the greatest benefit of the least advantaged, consistent with the just savings principle, and (b) attached to offices and positions open to all under condi-tions of fair equality of opportunity.
First Priority Rule (The Priority of Liberty): The principles of justice are to be ranked in lexical order and therefore liberty can be restricted only for the sake of liberty. There are two cases: (a) a less extensive liberty must strengthen the total system of liberty shared by all; (b) a less than equal liberty must be acceptable to those with the lesser liberty.
Second Priority Rule (The Priority of Justice over Efficiency and Welfare): The second principle of justice is lexically prior to the principle of efficiency and to that of maximizing the sum of advantages; and fair opportunity is prior to the difference principle. There are two cases: (a) an inequality of opportunity must enhance the opportunities of those with the lesser opportunity; (b) an excessive rate of saving balance must mitigate the burden on those bearing this hardship.
General Conception: All social primary goods—liberty and opportunity, income and wealth, and the bases of self-respect—are to be distributed equally unless an unequal distribution of any or all of these goods is to the advantage of the least favoured."

94 Kedar (2015), p. 588.

95 This means that some form of affirmative action must be taken to correct unfair social and economic inequalities.

"difference principle mandates that a corporation may carry out an unequal policy only if the inequality favours the worse-off."[96]

Kedar's contribution to the debate answers my attempt to identify guiding principles. She offered an extended interpretation of where Rawls' principles of justice might best apply. Rawls envisaged that his principles should apply to both individuals and institutions, as the two principal components of the political system. Kedar extended Rawls to persons as part of the team-production corporation.

This study moves one step further. Kedar included shareholders, employees and directors as the main "characters" of the justice game. These leading actors need to be taken into account in determining what makes a just corporation.[97] Neither Kedar nor Blair and Stout[98] explored the other team members in detail. Building on their work, I consider consumers, suppliers, other creditors and other stakeholders relevant team members, because of their team-specific investments. Law shall account for their investments and interests in two respects: (i) their rights to unionise and to participate in governance; and (ii) to correct social and economic asymmetries to favour the worse-off.[99]

Kedar did not discuss the just savings principle in Rawls' theory within the context of company law. This principle, however, is very important for the company law rules discussed here. According to Rawls, intergenerational justice involves each generation's obligation to put aside "a suitable amount of real capital" to maintain just institutions over time. In his view, real capital includes not only factories and machines but also knowledge and culture, techniques and skills, learning and education.[100] This notion of

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96 Kedar (2015), p. 592. For instance, this happens when there is asymmetry of skin in the game. See Section V.2 (*Skin in the game*).

97 In this respect, this study comes closer to stakeholder theory, i.e. "An approach to business that incorporates all the interests of stakeholders in a business. It widens the view that a firm is responsible only to its owners; instead it includes other interested groups, such as its employees, customers, suppliers, and the wider community, which could be affected by environmental issues. It thus attempts to adopt an inclusive rather than a narrow approach to business responsibility." See Law (2018), who summarises Freeman et al's theory (2010).

98 Blair and Stout (1999) concentrated mainly on shareholders, directors and employees, saying that "perhaps other stakeholders such as creditors or the local community" may also be team participants, p. 278. Stout (2017) mentioned "investors, employees, and others." Blair (2012) listed "directors, managers, and employees" as key participants.

99 These two respects are discussed in Chapter V (*Takeover Directive, Merger Directive and Insolvency Directive*).

100 Rawls (2005), p. 285 et seq. See also Paden (1997). The just savings principle was included in Rawls'

intergenerational justice is linked directly to a company law (also) aimed at fostering long-term behaviour in actors. For this reason, the just savings principle, as a token of intergenerational justice, also forms parts of this study's normative foundations.[101] Section I.3.2 (*Principles of justice*) shows how the recommended measures are related to both Rawlsian principles.

Rawls' theory of justice attracted diverse criticism.[102] Some scholars of utilitarian ethics have maintained that the difference principle does not maximise utility.[103] Another point of criticism concerns desert-based principles, according to which differentials may be justified by increasing the total social product.[104] Nozick claimed that the difference principle infringes on liberty, whose protection stands above inequality.[105] This study sets aside these reservations, because it does not focus on utility maximisation, social product maximisation or libertarianism. Instead, it follows Rawls and concentrates on justice as fairness.

However, there is one limitation to applying Rawls' theory as a normative foundation. This concerns the original position behind the veil of ignorance, i.e. a position (like that in the womb) oblivious to race, social class, gender, religious beliefs. I disagree with this position and do not see it as necessary for applying Rawls' principles. Freeman explained the main criticism of this position as follows[106]: In the original position, parties are deprived of so much information that they are psychologically incapable of making a choice. In reality, people have their primary ends, or fundamental values and commitments. For Rawls, the original position was the foundation for the application of his principles (originally, by the State). However, Scalon showed how this position is not necessary for the application of principles.[107] In sum, the rationality

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statement of the principles of justice in *A Theory of Justice* (written in 1971). However, he removed it from the statement of the principles in *Justice as Fairness: A Restatement* (written in 1985).

101 Wall (2003) points out that Rawls initially justified intergenerational justice by the fact that parties should be seen as heads of households and family lines. Thus, they would have an interest in the well-being of the direct next generation, at least. In *Justice as Fairness*, Rawls revisits the justification affirming that the just savings principle is justified by the fact that each generation must want all previous generations to have followed it (p. 81).

102 This paragraph includes a simplified version of the criticism, whose complexity translates into dozens of books and articles. I have reviewed only a few selected works.

103 Choptiany (1973), p. 150.

104 Lamont (1997), p. 34.

105 See discussion in Van Parijs (1997), p. 13 and Cohen (1985), p. 95 et seq.

106 Freeman (2019), section 3.

107 Scalon (1973).

required to construct this original position is irrelevant to the moral justification of the principles.[108]

3.3 Long-term capitalism

Sections I.3.1 (*Company as team*) and I.3.2 (*Principles of justice*) have explained the normative foundations underlying the notion of the corporation and the role of company law. This section (*Long-term capitalism*) discusses the connection between these normative foundations and this study's main argument. It explains how team production and the principles of justice in company law (normative foundations) are related to better balancing short- and long-term behaviour in equity markets (main argument). To this end, I draw on Barton's definition of long-term capitalism.[109] Lawmakers design company law within and for capitalism.[110] For this reason, Smith's political philosophy complements the normative foundations of this study.

In defining long-term capitalism, Barton revisited Smith's original theory[111] and argues:

> "Smith's insight into the profound interdependence between business and society, and how that interdependence relates to long-term value creation, still reverberates."[112]

He cited two extracts from Smith's *Theory of Moral Sentiments*: "All the members of human society stand in need of each other's assistance, and are likewise exposed to

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108 Freeman (2019), section 7.
109 Barton (2011).
110 Some readers may find it paradoxical to cite Adam Smith in the context of company law. This is because Smith's "free markets" are popularly synonymous to markets being free from the state, and free from regulation. However, Mazzucato (2018), p.72, explains that Smith actually defended markets free from rent, i.e. free from unearned income derived from moving existing resources from one hand to another. For Smith, rents extracted value from the market, and governments should intervene to prevent them. Hence, there is no paradox in this citation. Sjåfjell (2009) also sees Smith's theory to encompass a "'*regulated* market economy' amongst the basic values of European liberalism", p. 474-475.
111 Only few authors have linked Smith's theory to long-term thinking. For example, Ashraf et al. (2005) do so indirectly. These authors primarily analyse Smith as a pioneer behavioural economist. Barton has been the only author to establish a direct connection.
112 Barton (2011), p. 89.

mutual injuries"; "The wise and virtuous man (…) is at all times willing that his own private interest should be sacrificed to the public interest."[113]

One consequence of Smith's assertions is that capitalism is embedded within mutual assistance among its participants. A second consequence is that this scenario implies the balancing of private and public interests at all times. Ashraf et al. strengthened this line of reasoning through observing how Smith's favours the command of the passions in "choices that involve short-term gratification but long-term costs."[114]

Based on his own experience, Barton argued that a shift towards long-term capitalism is necessary. He defined three essential elements of this shift: (i) new incentives and structures to redirect organisations towards long-term; (ii) organisations serving the interests of all stakeholders[115]; and (iii) engaged and less dispersed ownership combined with committed boards.[116] Therefore, Barton connected the notion of capitalism — in line with its main philosophical advocate — with the shift towards long-termism[117].

Barton's three essential elements complement the concepts of team production and principles of justice. Hence, they sustain the main argument of section I.1 (*Main argument*). Table I.3 (*Normative foundations*) summarises the above normative foundations:

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113 Smith (2005) [1790], p. 213. Retrieved from: https://www.ibiblio.org/ml/libri/s/SmithA_MoralSentiments_p .pdf (last accessed 15 July 2019)

114 Ashraf, Camerer and Lowewenstein (2005) in their analysis of the "impartial spectator," p. 132.

115 Smith states in *The Wealth of Nations*: "Every individual is continually extending himself to find out the most advantageous employment for whatever capital he can command. It is his own advantage, indeed, and not only that of the society, which he has in view. But the study of his own advantage naturally, or rather necessarily leads him to prefer that employment which is most advantageous to the society." This further confirms that Smith's capitalism did not defend a capitalism where one's private interests stands above all others. Smith (2007) [1776], p. 348. Retrieved from: https://www.ibiblio.org/ ml/libri/s/SmithA_WealthNations_p.pdf (last accessed 15 July 2019)

116 Barton (2011), p. 86.

117 The theory of capitalism has its axiomatic origin in Smith. At the same time, it has a "constant tendency to transform itself". The spirit of capitalism has adapted and evolved as a condition of survival. See Boltanski and Chiapello (2007), p. 489.

Table I.3 - Normative foundations

Team production	Principles of justice
• A corporation consists of a team working towards a productive activity; and • Team members make team-specific contributions to the corporation and have some conflicting interests.	• Equal liberties and equal opportunities for all team members; • Different liberties to favour the worse-off team members; and • Team members saving sufficient real capital to maintain just institutions for future generations.
Long-term capitalism	
• Incentives and structures to redirect teams towards the long term. • Team (corporation) serves the interests of all team members. • Engaged and less dispersed shareholders and committed directors.	

4 Scope

The scope of this study is Union company law on equity markets' long-termism. Four other studies have a similar scope, while bearing significant differences to the present dissertation as shown below:

Table I.4 - Scope

Author	Scope	Main difference to this study
Dallas (2012)	This article of discusses why financial and nonfinancial firms engage in short-termism with particular attention given to the financial crisis of 2007-2009. It further reviews the regulatory responses to mitigate short-termism.	Dallas focuses on the law of the United States, while this study looks at Union law.
Bowdren (2016)	This article analyses whether the legal landscape facilitates short-termism.	Bowdren focuses on English law, while this study looks at Union law.

Author	Scope	Main difference to this study
Moslein and Sorensen (2018)	This article examines how different jurisdictions have introduced regulations on long-termism and sustainability, especially the European Union. The authors focus on nudging.	Moslein and Sorensen assume that there is a wish to promote long-termism and sustainability, while this study gathers data to confirm this wish as a “counter-trend”. They recommend general regulatory strategy, while this study recommends concrete incentives to equity markets’ long-termism.
Willey (2019)	This study examines the regulatory responses to the problem of stock market short-termism. It aims at identifying effective reforms for sustainable long-term investment in publicly listed companies.	Willey looks at regulation worldwide, while this study focuses on Union law. She assesses whether existing regulation is effective or not, while I aim at recommending incentives to equity markets’ long-termism.

4.1 Union law

In January 2020, the European Parliament adopted the resolution on the EU Green Deal. Amongst other goals, it set the target of reducing EU’s domestic greenhouse gases emissions by 55 % compared to 1990 levels, with a dedicated budget of one trillion. The President of the European Commission Ursula von der Leyen stated “The transformation ahead of us is unprecedented” and “it will only work if it is just — and if it works for all. We will support our people and our regions that need to make bigger efforts in this transformation, to make sure that we leave no one behind.” The parliament noted that policy actions and legislative amendments would be necessary to support all the objectives of the Green Deal.

This study focuses on Union law. There are two reasons for investigating this regulatory framework. First, Union company law, especially equity markets regulation, strongly influences other legal systems worldwide.[118] Second, European companies,

[118] Many examples, especially in business law, exist worldwide. The European directive on bank

together with those in the United States, are among the world's largest.[119] Their financial power and market footprint allows them to impact business behaviour globally. Union law influences law-making processes worldwide, indirectly by way of inspiration, as well as directly, via third-country applications of Union law. Thus, Grundmann concluded:

> "The strongest "will to global reach" can be found in those rules on transactions which are primarily aimed at the public good; for instance, a smooth functioning of the markets".[120]

Union law has evolved most vibrantly in the area of long-term equity market behaviour.[121] Therefore, analysing the path of Union law towards long-termism is a promising exercise in seeking to attain this goal.[122]

Another reason for focusing on Union company law are my career and home university. I have twenty-year practitioner experience of Brazilian and German business law, often working with English and New York law. My research has concentrated on Brazilian, Union and Public International Law, and, since 2014, on Swiss private law.[123] The University of St. Gallen is famous for its practice-oriented research and its European law experts, combined with a commitment to a positive impact in society.[124]

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recovery and resolution influenced Swiss and US regulation. See Schelo (2015), p. 20.; see further Castro in Schelo (2015), p. 167 et seq. The European directive on takeover bids influenced Brazilian regulation. See Sester (2014), p. 33. Union law influenced public law in the United Kingdom, The Lord Chancellor and Lord Irvine of Lairg in Markesinis (2000), p. 11.

119 Among the top fifty largest global companies (according to Forbes Global 2000) in 2019, thirteen were European and seventeen were from the United States. The third largest group was Chinese companies, followed by Japanese ones. See https://www.forbes.com/global2000/list (last retrieved on 15 July 2019). In November 2019, the approximately eight thousand European listed companies had a market capitalisation of over EUR 10 trillion, according to the data of the Federation of European Securities Exchanges.

120 Grundmann in: Cremona and Micklitz (2016), p. 168.

121 Chapter IV (*Regulatory strategy*) analyses this evolution.

122 Still, authors like Roth and Kindler (2013) saw that Union company law has a limited influence due to its focus in listed companies. In their view, the real "spirit" of company law is in rules governing small and medium-sized companies that constitute the majority in Europe. These rules have not been harmonised at the supranational level, p. 7.

123 Union law mixes and matches different legal cultures and regulatory approaches, as I have in my career.

124 Several sustainable businesses and impact investments have been initiated by St. Gallen alumni and professors. See https://nachhaltigkeit.unisg.ch/ Last accessed 31 January 2020.

4.1.1 Selected documents

This study reviews five directives in particular (see below). As confirmed by the literature review, these directives have the potential to regulate long-term behaviour.

(i) Directive 2004/25/EC of the European Parliament and of the Council on takeover bids, as amended by Directive 2014/59/EU of the European Parliament and of the Council dated 15 May 2014 (the "**Takeover Directive**");

(ii) Chapter II of Title II on cross-border mergers of limited liability companies of Directive 2017/1132 of the European Parliament and of the Council relating to certain aspects of company law (codification), as amended by Directive (EU) 2019/1023 of the European Parliament and of the Council dated 20 June 2019 (the "**Merger Directive**");

(iii) Directive 2013/34/EU of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, as amended by Directive 2014/95/EU of the European Parliament and of the Council dated 22 October 2014 on the disclosure of non-financial and diversity information by certain large undertakings and groups (the "**Reporting Directive**" and the amending document the "**CSR Amendment**");

(iv) Directive 2007/36/EC of the European Parliament and of the Council on the exercise of certain rights of shareholders in listed companies, as amended by Directive (EU) 2017/828 of the European Parliament and of the Council dated 17 May 2017 on the encouragement of long-term shareholder engagement (the "**Shareholder Directive**" and the amending document the "**Engagement Amendment**"); and

(v) Directive (EU) 2019/1023 of the European Parliament and of the Council dated 20 June 2019 on restructuring and insolvency (the "**Insolvency Directive**").

4.1.2 Other laws

In spite of focusing on Union law, this study includes examples of national and international law, as well as self-regulation initiatives. These (non-exhaustive) examples are not the core of the analysis, but serve to illustrate experience in other jurisdictions. They also enhance the analysis of the recommended regulatory measures by way of analogy. The examples have been chosen because they serve the purposes of analysis.

4.2 Company law

Within the general field of law, this study is part of company law research. The chosen pieces of Union law have a clear emphasis on the company law of equity markets[125]. More specifically, they focus on corporate governance. As the European Commission defines:

> "Corporate governance is traditionally defined as the system by which companies are directed and controlled and as a set of relationships between a company's management, its board, its shareholders and its other stakeholders. The corporate governance framework for listed companies in the European Union is a combination of legislation and 'soft law', including recommendations and corporate governance codes."[126]

As a result, this study looks at each of these actors: Management, board, shareholders and other stakeholders. The responsibility of good corporate governance lies primarily with the company, and should be executed by its management. However, like every governance system, mechanisms of checks-and-balances are required[127]. Shareholders, boards, employees and other stakeholders need to be given tools to ensure that no single actor becomes excessively powerful.

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[125] Pargendler (2016) advanced her observation of an ongoing obsession over corporate governance as the remedy for all problems, including societal problems. However, she did not reach a conclusion on what the role of corporate governance should be. In this study, I see corporate governance as one alternative to address the issue of excessive short-termism and, consequently, some societal problems deriving from excessive short-termism.

[126] See Commission Green Paper: The EU Corporate Governance Framework dated 5 April 2011, COM (2011) 164 final, p. 2.

[127] Impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, p. 15.

4.2.1 Principles of Union company law

The study of Union company law is inserted in the context of the internal market[128] and of its foundation in two main treaties of the European Union.[129] First, the Treaty on the Functioning of the European Union ("**TFEU**") lays out the delegation of company law regulation and harmonisation within the Union.[130][131] Second and most important, Article 3(3) of the Treaty on European Union ("**TEU**") lays out the directive principles of the internal market[132]. I defend that, just like constitutional principles in national

[128] The European Union's institutions use the terms "internal market" and "single market" interchangeably. As pe article 26 TFEU, it is "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties".

[129] Union company law is an instrument for realisation of the internal market. See Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions entitled "Action Plan: Union company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies" dated 12 December 2012, document number COM(2012) 740: "Union company law is a cornerstone of the internal market", p. 4. See Gerner-Beuerle (2019), p. 107.

[130] With respect to directives and regulations, this delegation stems from the combination of Article 50(1) and (2)(g) and 54 on the right of establishment, with Article 114 and 115 on the approximation of laws and Article 26 on the internal market. With respect to recommendations, Article 292 determines the competence. Article 352 gives special powers to the Council to adopt measures. Grundmann (2012) explained how the interpretation of Article 50 (former Article 44) was extended to encompass securities instead of just measures to foster freedom of establishment in the strict sense, pp. 86-87. See also Sjåfjell (2009), pp. 133-138.

[131] Some of the directives and regulations in the scope of this study were first enacted before the TEU came into force. Article 3 of the TEU repeats and supplements the content of Articles 2 and 3 of the Maastricht Treaty. These laws shall now be interpreted under the validity of the TEU.

[132] Directive principles are binding principles that orientate State action and serve as policy goals. They differ from structural principles, which guide the State in the form it should act. Sommermann (2013), p. 160.

legislation,[133] the objectives in Article 3(3) of the TEU are principles of teleological interpretation[134] of Union company law as discussed in this study.[135]

Box I.4.2.1 – Principles of company law in Article 3(3) of the TEU

First subparagraph (economic dimension)
Sustainable development (based on balanced economic growth and price stability)[136]
Social market economy (highly competitive, aiming at full employment and social progress)
Quality of the environment (high level of protection and improvement)
Scientific and technological advance

Second subparagraph (social dimension)
Combat social exclusion and discrimination
Social justice and protection
Equality between women and men
Solidarity between generations
Protection of the rights of the child

Third subparagraph (community dimension)
Economic, social and territorial cohesion
Solidarity among Member States

[133] Maduro (2008) stressed how the use of European treaties' principles as constitutional principles can be complex in legal practice. For instance, courts have to tackle a pluralism of sources of constitutional principles (e.g. European treaties and principles in national constitutions), pp. 138-139.

[134] This is consistent with the systematic and the teleological (or purposive) interpretation methods of Union company law. The Court of Justice of the European Union has often used these methods. See analysis of interpretation methods for Union law in Rösler (2011), Lenaerts and Gutierrez-Fons (2014) and Ceruti (2019). Sommermann (2013): "The objectives enumerated in Art. 3 TEU can be considered the cornerstone of a multi-layer teleology contained in primary Union law." and there is "The obligation of all Union organs to interepret the whole Union law in conformity with these principles", pp. 160-161. This is also consistent with the interpretative tradition in the decisions of the European Court of Justice. Already in the 1960s, this court affirmed the purposive or teleological interpretation in Case *Van Gen den Loos v. Nederlandse administratie der belastingen*. See Cini et al (2016), pp. 169-170.

[135] Bogdandy (2010) cited a series of cases in which the European Court of Justice has interpreted secondary law (i.e. directives and regulations) based on conformity with primary law (i.e. European treaties), pp. 99-100. These are Case C-314/89, Rau [1991] ECR I-1647, para 17; Case C-98/91, Herbrink [1994] ECR I-223, para 9; Cases C-465/00, C-138/01 and C-139/01, ORF [2003] ECR I-4989, para 68; Case C-540/03, Parliament v Council [2006] ECR I-5769, paras 61 et seq, 104 et seq.

[136] Sjåfjell (2009) examined how sustainable development is addressed in European primary law, p. 217 et seq.

Fourth subparagraph (cultural dimension)
Respect of cultural and linguistic diversity
Safeguard and enhancement of Europe's cultural heritage

It is a long list of complex directive principles for the internal market and for company law.[137] All of them are consistent with the definition of long-termism advanced in section III.2.1 (*Definition*). For the purpose of this study, there are five useful findings in the literature about these directive principles:

(a) They guide our interpretation of the rights and obligations derived from secondary law;[138]

(b) They are binding for all European Union's institutions and for Member States (including courts), but they do not create rights to individuals ("promotional obligations");[139]

(c) They limit the scope of the activity of the European Union's institutions;[140]

(d) They are very heterogenous and conflict among principles may arise in specific case. Sophisticated balancing of these principles is necessary to address such conflicts; and[141]

(e) They are complemented by Articles 2 and 8-13 of the TEU, by Protocol (No 27) of the TEU as well as by the European Charter of Fundamental Rights, with respect to the overall policy goals of the European Union[142].

In a certain manner, these principles also frame the scope of this study and constitute normative foundations as those in section I.3 (*Normative foundations*) for it.

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137 Grundmann (2012) affirmed that no authors claimed or even considered "that general principles of European company law exist as law", p. 14. It is not clear whether this author means the there is no applicable principle at all (not even constitutional-like principles, as proposed here), or if he means only specific company law principles (such as no abuse of rights by majority shareholders or the invalidity of ultra vires acts by management).

138 Sjåfjell (2009), p. 254. She also affirmed that sustainable development "is a direct part of the ultimate goal of the EU", pp. 250-251.

139 Sommermann (2013), p. 162. Also Geiger et al. (2015), pp. 18-20.

140 Sommermann (2013), p. 159.

141 Sommermann (2013) indicated a three-step exercise: Identification of the competing principles, assessment of how such principles would be affected in each resolution option and weighing of principles. The goal is the highest degree of realisation for each of the principles at hand, pp. 165-166.

142 Sommermann (2013), p. 160.

In light of them, that I make the recommendations in chapters V (*Takeover Directive, Merger Directive and Insolvency Directive*) through VII (*Reporting Directive*).

4.2.2 Beyond company law

Other legal fields (e.g. environmental law and human rights law) are equally relevant to fostering long-term behaviour and might be the subject of further research. This study is situated at the crossroads between corporate governance and these other fields. For instance, chapter V (*Takeover Directive, Merger Directive and Insolvency Directive*) discusses the rights of employees, which is a subject of labour law. Nevertheless, the emphasis throughout this study is on company law. Labour and employment law, environmental law, consumer law and human rights law already have an immense impact and pursue intrinsic long-term goals. Company law is currently evolving towards this goal and will (hopefully) complement these other areas[143].

The success of the recommendations in this study depend largely on the dialogue between these recommendations and the other fields of law[144]. Lawmakers should avoid duplication of provisions, and ensure complementarity among them[145]. Bratton argued that matters relating to social welfare enhancement lie outside the scope of company law. However, I agree with the opinion of Moslein and Sorensen, who presented two reasons for including long-termism in company law:

(i) This may help to avoid conflicts between company law and other areas of law. If the legislator at least authorises directors to act in a long-termist manner, they will feel less pressured by short-termist shareholders. For instance, directors could use environmental law as a minimum standard and pursue higher environmental protection goals based on the company law permission[146].

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143 Johnston (2009), while discussing the Takeover Directive, affirmed that the team production model renders the "distinction between 'labour law' and 'company law' directives somewhat artificial", p. 313. The author then explains the legal basis in the Union treaties for this convergence between the two legal fields. On the other hand, the authors of the Winter Report argued that the "Shareholders should be able to decide for themselves and stakeholders should be protected by specific rules (e.g. on labour law or environmental law)", p. 21. In Winter et al. (2002).

144 Bosselmann (2016), p. 24.

145 Sjåfjell (2009), when examining employees' rights in the Takeover Directive, defended that compartmentalisation may lead to "sectors being counterproductive to each other's purposes" and that "each sector should ultimately contribute to the overarching goals", pp. 470-471.

146 Möslein and Sorensen (2018), pp. 451-453. One may argue that company law provisions on long-termism are too vague. However, this flexibility allows businesses to find the best way to achieve

(ii) Company law may be more effective to "catch" large corporations[147]. Multinational corporations often escape national regulations (on environmental standards, for example) by shifting the activity to a subsidiary in another country with less strict regulation[148]. If company law standards regarding long-termism apply at the parent level, the central unit of decision-making, they will have an effect on all subsidiaries.

4.2.3 New company law

In 2010, the State of Maryland passed the first law on benefit corporations.[149] Thirty-four states in the United States have since enacted legislation for creating a legal form of for-profit companies, which pursue economic, social and environmental goals.[150] Italy[151] and Puerto Rico[152] have also adopted similar legislation, while Australia, Argentina, Chile, Colombia and Canada are making similar advances. England has created the community interest company, which has many common features with benefit corporations. The European Parliament and the Council have adopted the SEF Regulation, which has been devised specifically for social entrepreneurship funds. These legislative decisions are evidence of a new trend in company law.

Company law is currently attempting to create specific rules for so-called "profit-with-purpose businesses."[153] Their expanded purpose (i.e. the triple bottom line) means

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their own path towards long-termism. Some degree of vagueness is also required, because legislators lack knowledge of the individual firms' realities, and of the outcomes from provisions. See Binder (2012), pp. 284-285.

147 Houben and Straetmans (2016) called them "systemic companies" in reference to the terminology "systemically important financial institutions" of the Basel Committee of the Bank for International Settlements, p. 628. The authors characterised such companies as "part of the core structures of (global) society" and whose "activities became vital for the well-functioning of the social order".

148 Muchlinski (1995), p. 3. This phenomenon –regulatory arbitrage– is well known in the financial industry, where banking corporations shift activities to other jurisdiction with laxer regulation.

149 SB690/HB1009 of 1 October 2010, available at http://mgaleg.maryland.gov/2010rs/bills/sb/sb0690t.pdf (last retrieved on 15 July 2019).

150 Other six states are discussing a new law. Up-to-date statuses are available at https://benefitcorp.net/policymakers/state-by-state-status (last retrieved on 15 July 2019). Some states created legal forms called low-profit limited liability company or L3C and social purpose corporation.

151 Law Nr. 233 of 24 December 2015, available at http://www.oslpr.org/2013-2016/leyes/pdf/ley-233-22-Dic-2015.pdf (last retrieved on 15 July 2019).

152 Law Nr. 208 of 28 December 2016.

153 In 2014, the Social Impact Investment Taskforce, established under the UK's presidency of the G8, issued a subject paper named Profit-With-Purpose Businesses (from the Mission Alignment Working Group (2014), p. 8. Available at). Retrieved from: http://www.markflorman.com/wp-

that such businesses function differently than ordinary for-profit limited liability companies. In addition, a new set of rules (e.g., SEF Regulation), applicable to their investors, has been created.

This study looks at ordinary for-profit companies and the applicable general company law.[154] However, it also reviews the specific rules on profit-with-purpose businesses. It does so because the lawmaking and enforcement of such rules may further enlighten how best to create a long-term framework. In fact, some features that are typical of profit-with-purpose businesses are even finding their way into mainstream companies.[155] Hence, experiences with profit-with-purpose businesses are constructive for the overall debate on long-term behaviour.

However, these new corporate forms are still a niche[156]. For this reason, this study contributes to the regulation of long-termism in the "traditional" corporate forms.

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content/uploads/2016/03/140901-Mission-Alignment-WG.pdf. This paper reiterates the relevance of long-term commitment to a purpose and long-term interests and long-term plans of businesses.

154 With respect to ordinary for-profit companies, the UK's Companies Act 2006 introduced the concept of "enlightened shareholder value" in its Section 172. This provision was drafted in a vague manner, and does not explain how this value concretely functions. Moreover, shareholders are the only ones with a right of action under this provision in case of violation. Secondary legislation is necessary to provide clarity to Section 172. Now with more than a decade of implementation, the practice of company law is still shareholder-centred. Bowdren (2016).

155 For instance, companies like Danone (sales in 2018 of EUR 24.65 billion), Natura (sales in 2018 of USD 10 billion) and Ben & Jerry's (sales in 2018 of USD 280 million) have incorporated rules of benefit corporations in their articles of association.

156 Authors discussed whether company law should create these new legal forms, or if companies should remain regulated as usual and aim at "profit-with-purpose" certifications. Sorensen and Neville (2014) sustained that certifications like that of B Lab's B Corporations are a preferred option due to the learning benefits of well-established corporate forms, p. 306. Johnston and Talbot (2018) found evidence that "the CIC [the English "profit-with-purpose" legal form] has not encouraged business to take a less shareholder value orientation. The availability of an alternative company form cannot alter the trajectory of capitalism per se. Instead the CIC has begun to adopt a more investor friendly regime. Its main use has been to accommodate the semi-privatisation of the NHS, a further retreat from the welfare society.", p. 139.

4.3 Equity markets

This study focuses on the regulation of equity markets.[157] Here, the definition of the term "equity market" is based on Union law. The impact assessment[158] of the Engagement Amendment defines equity as "a stock or any other security representing an ownership interest". Hence, equity markets are markets in which equity is traded. The companies that issue equity instruments admitted to trading on a market are here called "listed companies". The same document defines listed companies as "companies that issue securities admitted to trading on a regulated market situated or operating in a Member State".

Two points fundament the choice for this scope:

– The European directives that have addressed long-termism so far (see list in section I.4.1.1: *Selected documents*) relate to equity markets. It makes sense for this study to build on an evolving regulatory trend. The Commission encourages corporate governance guidelines for unlisted companies. Nevertheless, European rules on corporate governance apply to listed companies only, i.e. to companies that issue shares admitted to trading on a regulated market[159].
– The majority of the available empirical data, such as average holding period and annual turnover, refers to traded shares. Hence, the evidence of excessive short-termism is in equity markets. This study aims to address the excessive short-termism as evidenced to date.

Because of this choice, this study automatically excludes the regulation of debt markets and of privately held companies from its main scope[160].

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[157] The impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, provides an overview of the equity market in the Union: "The UK stock market is the largest with a market capitalisation of some 2,4 trillion euro after which come the French stock market with a market cap of some 1,4 trillion euro, the German stock market with 1,2 trillion euro and the Spanish stock market some 780 billion. These four Member States cover 70% of total market capitalisation in the EU and 66% of all listed companies.", p. 9.
[158] Ibid, p. 80.
[159] See Commission Green Paper: The EU Coporate Governance Framework, dated 5 April 2011, document number COM (2011) 164 final.
[160] Johnston and Sjåfjell (2020) argued that the majority of companies are privately held, and there is an increase in private equity activity. Still, this study recognises the listed companies' power of pioneering behaviour change. See discussion in Nowrot (2006) and (2011).

5 Roadmap

The study is structured in eight chapters. Chapter I (*Introduction*) explains the main argument and dissects the counter-arguments in the literature. Further, it supports the application of the team production approach and of the internal market principles in the Treaty on European Union to company law, as the core normative foundations. Chapter II (*Methodology*) presents the epistemological framework of this study, which combines institutional assessment, policy analysis and doctrinal restatement in the field of interpretative theory. Chapter III (*Trend and counter-trend*) looks at the evidence confirming the trend of short-termism in equity markets since the second half of twentieth century and the status of the counter-trend towards long-termism as of 2019, based on previous quantitative and qualitative studies. This chapter also establishes the two main assumptions of this study and advances a definition of long-termism that serves as guidance for recommending changes in Union company law. Chapter IV (*Regulatory strategy*) presents the Union's trajectory for regulating long-termism since the 2010s and the regulatory techniques available in Union law. Chapter V (*Takeover Directive, Merger Directive and Insolvency Directive*), chapter VI (*Shareholder Directive*) and chapter VII (*Reporting Directive*) offer an in-depth review of each Union company law directive addressing long-termism and recommends changes to them. Chapter VIII (*Final remarks*) summarises the recommendations and their features, states the limitations of this study and suggests further research based on these limitations.

Chapter II: Methodology

This chapter focuses on the methodology of the dissertation. It starts with a brief account of my personal view on legal methodology. Second, it sets out the ontological orientation for the knowledge in this study and how this knowledge relates to reality. Third, it defines the epistemological framework of interpretative theory in which I place my contribution. Fourth, it details the selected data and how the data was analysed. Finally, it explains my choice of a mixture of "research" and "exam" for the format of this study.

1 Legal methodology for non-legal researchers

Researchers in social sciences other than law often find it difficult to understand the methods of legal doctrine and legal science.[161] [162] Indeed, legal scientists have not documented and harmonised their methods as well as other social scientists.[163] Hence, legal methods may appear less scientific at first. For example, after reviewing empirical studies in economics, I also find myself struggling with the lack of methodological explanation in legal publications. However, this does not mean that legal publications completely lack methodology or methodological rigour. Many data analysis methods are capable of producing precise and valuable scientific work in the field of law. Section II.4.3 (*Archetypal legal scholarship*) lists examples.

This study adopts a combination of methods best suited to data analysis (section II.4.1: *Sources of data*) and to discussing my main argument (described in section I.1:

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[161] Simmonds (1984) considered legal doctrine "the corpus of rules, principles, doctrines and concepts used as a basis for legal reasoning and justification." As such, it represents "the heart of a legal system." Further: "Legal science is the systematic and ordered exposition of legal doctrine in the works of juristic commentators. Legal science, being itself a body of practices, can be understood only by reference to its own self-conception" (p. 2).
"The word 'doctrine' is derived from the Latin noun 'doctrina' which means instruction, knowledge or learning. The doctrine in question includes legal concepts and principles of all types — cases, statutes, and rules. 'Doctrine' has been defined as '[a] synthesis of various rules, principles, norms, interpretive guidelines and values. It explains, makes coherent or justifies a segment of the law as part of a larger system of law. Doctrines can be more or less abstract, binding or non- binding'" (p. 5).

[162] Hutchinson (2012). Even though the article has a strong focus on the UK and Australia, it also applies to civil law research.

[163] Rouviéré (2015), pp. 135 et seq.

Main argument).[164] These methods partly resemble and partly depart from highly developed and harmonised social science methods. Hence, I encourage researchers in social sciences other than law to discover the present study under the lenses of legal methodology. This requires briefly leaving aside the lenses of conventional social science methodology.

2 Ontological orientation

This study is guided by two ontological orientations.

First, it rejects the notion of absolute truth or apprehendable original reality[165]. What follows are *my* perceptions of the subject matters discussed here. In practice, I perceive a fundamental conflict in the equity markets: Between a short-termist hegemony and a long-termist minority.[166] Chapter III (*Trend and counter-trend*) substantiates this perception with methodological structure and evidence. This study favours long-termism, for the normative reasons analysed above and in keeping with my perceptions and preferences. These normative foundations are pragmatic, because they are useful for sustaining long-termism.

Second, this study is not concerned *per se* with the ethical notions of right and wrong. The recommendations in chapters V (*Takeover Directive, Merger Directive and Insolvency Directive*) through VII (*Reporting Directive*) are also pragmatic. They are pragmatic because the recommended rule is useful for achieving the objective of long-termism. This usefulness exists beyond whether long-termism is right or better. Hence, I do not set out to demonstrate that these recommendations are ethical. Indeed, I believe that a long-termist world, in which social justice and environmental protection prevail,

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164 Larenz and Canaris (1995) affirmed that opting slavishly for a single method would be too easy. The jurist must then allow herself to participate in the language game (*Sprachspiel*, referring to Wittgenstein) in the subject-matter of jurisprudence. The jurist must give room to the creative imagination (*die schöpferische Phantasie des Forschers*) which is the essence of research (p. 67). Van Gestel (2015) also defends the academic freedom, richness and diversity of the legal publication culture (p. 53).

165 As Bogdandy (2010) put: "A doctrinal construct can only propose *one* and not *the* system of positive law. In the past, a system was often crypto-idealistically believed to be inherent in the law and was sometimes dogmatically advanced as the single truth. This academic programme has been characterised as undemocratic or elitist; this criticism needs to be accommodated.", p. 100.

166 In Nietzsche's terminology, they are two opposing wills to power (*Willen zur Macht*); see Nietzsche (1968), pp. 70, 142–5, 177.

is a better world. However, this is a belief. Demonstrating that this belief is correct and better would be the subject of another type of study.[167]

Both orientations are situated in the constructivist paradigm of social sciences. From the ontological and epistemological perspective, truths and realities are understandings and reconstructs. Hence, the nature of the relationship between the would-be knower (me) and what can be known is subjective[168]. The would-be knower creates findings as the research proceeds. This creative process includes apprehension and interpretation consensus findings of previous investigations with honesty and authenticity[169]. In this respect, my research looks at positivist quantitative findings as well as at qualitative normative discourse.[170]

3 Epistemological framework

Some authors have seen legal science as an exposition of the law as it exists, namely, as “a descriptive account of the rules and principles of a legal system.”[171] Others have consider it a method for suggesting what the law should be or how it should be interpreted. Smith added a fourth type of accounting for the law: The historical account.[172] In summary, any area of law is susceptible to four types of account:

> “(i) Historical: They seek to explain how and why the law has developed the way it has, they reveal the law’s causal history; (ii) Prescriptive: Accounts of what the law should be, of the ideal law; (iii) Descriptive: Describe the law as it is now and as it was at a certain time; and (iv) Interpretative: Interpretive theories aim to enhance understanding of the law by highlighting its significance or meaning.”[173]

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[167] Numerous publications deal with these subjects, such as the work of John Rawls discussed in section I.3.2 (*Principles of justice*) and that of environmentalists such as Paul Collier, Rachel Carson, Michael Braungart, Vandana Shiva, etc.

[168] Guba and Lincoln (1994), pp. 110-111.

[169] Guba and Lincoln (1994), p. 112.

[170] Even though my research encompasses positivist quantitative findings, I employ a constructivist approach to analyse such findings. In part, this is because various research efforts have revealed the fallibility of positivist quantitative findings. For instance, the Reproducibility Project (Retrieved from: https://osf.io/ezcuj/, last accessed 31 July 2019) tried to replicate one hundred published studies in social sciences to finally ascertain that only 32 replicated the results. And these that replicated mostly did so with lower significance. See Carey (2015).

[171] Douglas and Goudkamp (2017).

[172] Smith (2004), pp. 4 and 5.

[173] Ibid.

Most current legal publications consist of a combination of historical, prescriptive, descriptive and interpretative elements. Authors have referred to this combination as "interpretative theory." Douglas and Goudkamp saw interpretative theory as the dominant approach in legal science today, in both common and civil law jurisdictions.[174]

This study applies all four elements mentioned above with a view to contributing to interpretative theory. Therefore, I:

(i) seek to explain how and why regulation concerning equity market long-termism in the European Union has developed and to reveal the causal history of this development;

(ii) make recommendations for how equity market long-termism ought to be regulated in the European Union;

(iii) describe regulation concerning equity market long-termism in the European Union as it is today; and

(iv) aim to enhance understanding of the regulation of equity market long-termism in the European Union by highlighting its significance.

I consider (i) and (iv) in chapters I (*Introduction*), III (*Trend and counter-trend*) and IV (*Regulatory strategy*). Points (ii) and (iii) are discussed in chapters V (*Takeover Directive, Merger Directive and Insolvency Directive*), VI (*Shareholder Directive*) and VII (*Reporting Directive*).

As may also be expected of interpretative theory, I (a) explain certain features (e.g. disclosure, management compensation, voting rights) of company law and their importance in relation to long-termism, and (b) identify connections between such features in order to reveal an intelligible order in the law as it is and as it should be.[175] Before reviewing the law, I look at research on individual and societal behaviour[176] In many instances, I borrow concepts and theories from other social sciences to the extent that they help reveal an intelligible order in the law.

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[174] Simon Douglas and James Goudkamp (2017).

[175] Smith also pointed out that: "In legal scholarship, the idea of interpretation is often associated with Ronald Dworkin's work. The above definition is broadly consistent with Dworkin's use of the term, but as I explain below, it does not commit one to endorsing Dworkin's particular understanding of interpretation" Dworkin (pp. 65–68).

[176] Bergel (2015), p. 167.

3.1 Interpretative theory and method

In most cases, the method of interpretative theory resembles that used by Rawls in the field of philosophy. In practice, I start with a reflective equilibrium between intuition and theory. This approach begins with my own moral intuitions and constructs a normative theory on that basis. Where my intuition conflicts with theory, I revisit my intuition or revise the corresponding theory to eliminate the conflict.[177] As this is a legal dissertation, I compare theory with the features of the law. Where conflict exists between the two, I either revise my theory or decide that the relevant feature of the positive law is erroneous and should be adapted.

3.2 Addressing the risks of interpretative theory

Despite its popularity, interpretative theory has also been criticised. Waddams' *Dimensions of Private Law: Categories and Concepts in Anglo-American Legal Reasoning* is a very prominent work representative of this critique.[178] He claimed that interpretative theory has five main flaws. Hence, this study (as any work in interpretative theory) bears the risk of containing those flaws. Beever and Rickett provided a structured rebuttal to each of the five flaws. In this study, I resort to the work of Beever and Rickett to address the risks of producing flawed interpretative theory. Table II.3.2 (*Risks of interpretative theory*) lists the five flaws and how to approach them.

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[177] Rawls (1999), pp. 18–19, 42–45. Beever and Rickett (2005), p. 324.

[178] Waddams wrote about law-making in common law systems. Still, the criticism of interpretative theory in relation to common law decision-making by a judge applies largely to civil law decision-making by legislators and regulators, as well as by civil law judges.

Table II.3.2 - Risks of interpretative theory

#	Flaw (Waddams[179])	Approach (Beever and Rickett[180])
1	No single theory can capture all possible arguments of a judge, hence it is inconsistent with the lack of consensus in law.	Interpretative theory should not attempt to describe all arguments, reasons and intentions leading to the decision of a judge (in this study, of a legislator, regulator or any other person). It aims to interpret a decision and to find the best explanation in theory for it. The best explanations are produced by examining and reflecting on the law, provide coherent and compelling conceptual narratives of the law, and attempt to reveal an intelligent and intelligible order of the law.[181] Interpretative theory, together with historical legal theory, attempts to understand legal concepts in terms of their meaning and in terms of their origin and development.
2	No single theory can map enduring concepts and categories of the law, and hence is inconsistent with legal change.	Interpretative theory should not attempt to find the absolute truth of the law's general structure. It attempts to draw an evolving theoretical map of law's enduring structure. Interpretative theory accompanies law as it evolves. It verifies the structures and the circumstances that remain and those that change or must be changed. Often it proposes changes.
3	Interpretative theory falsely posits exhaustive and mutually exclusive legal categories.	Interpretative theory should describe the elements in the evolving theoretical map of the law and its enduring structure. "Theoretical maps of the law elucidate the boundaries and connections between legal concepts."[182] Authors of interpretative theory recognise the inherent interrelationship between the categories of law.

179 Waddams (2003), pp. 5 et seq.
180 Beever and Rickett (2005), pp. 325 et seq.
181 Colona D'Istria (2015) also pointed out that the objective of the research in law is *construire le sens des textes* (p. 157).
182 Beever and Rickett (2005), p. 330.

#	Flaw (Waddams[183])	Approach (Beever and Rickett[184])
4	Interpretative theory plays down the complexity of the law.	Interpretative theory does not attempt to capture the complexity of the law as a whole. It focuses on clarifying reasoning, identifying poor argumentation, enunciating principles and leaving aside less relevant details in the theoretical map. Interpretative theory may simplify, but it should not falsify.
5	Interpretative theory misdescribes the activity of legal decision-making.	Interpretative theory does not attempt to make decision-making mechanical nor does it deny the need for legal judgement and reasoning of all (available and known) arguments. Interpretative theory and the ongoing theoretical maps should contribute as instruments to legal decision-making. In spite of theory, ad hoc reasoning is still needed to make sense of the ineliminable gap between facts and principles.

3.3 Contribution to interpretative theory

This study contributes to the ongoing theoretical mapping of company law concerning long-term behaviour in the equity market. It does so by:

– clarifying reasoning relating to rules on short- and long-term behaviour;
– learning from theories in fields adjacent to company law;[185]
– identifying poor argumentation with lower explanatory power;
– structuring principles; and
– eliminating less relevant details in the theoretical map, upon justified and informed decision-making.

Rather than drawing a conclusive theoretical map of company law concerning long-term equity market behaviour, this study draws the best map possible based on the available information (and within a limited scope of time).

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183 Waddams (2003), pp. 5 et seq.
184 Beever and Rickett (2005), pp. 325 et seq.
185 Roberts (2017) maintained that interdisciplinary legal research is not "necessarily a good thing." It may be applied in fields like company law, where knowledge of certain economic and financial concepts are useful. However, not every legal researcher must be a social legal researcher (p. 101).

This study is located under the umbrella of company law (private law) because it discusses the regulation of corporate governance and other typical company law matters.[186] Nevertheless, it is closely linked to banking regulation (public law) and other fields of law. These fields need to engage in dialogue rather than be mutually exclusive. In these terms, this study therefore exemplifies how the separation of private and public law has become less relevant in recent decades.[187]

Finally, by proposing changes to the law, this study might support the decision-making of legislators and regulators.

4 Data analysis

4.1 Sources of data

The research for this study included the following data sources: (i) as the first main source, European Union regulations and directives on equity market long-termism, including various preparatory works and related policy documents; (ii) as the second main source, relevant law books and journals; (iii) a few pieces of self-regulation as well as legislation and regulations of other jurisdictions; (iv) books and journals from other social sciences; and (v) industry reports. Table II.4.1 (*Sources of data*) provides an overview of the data sources:

[186] In particular, the ownership structure of listed companies, the functioning of boards and of management in Chapter VI (*Shareholder Directive*), the listed companies' obligations to disclose information in Chapter VII (*Disclosure*), and the relationship of companies with their stakeholders in Chapter V (*Takeover Directive, Merger Directive and Insolvency Directive*)).

[187] Supporting this view, see Van Den Berge (2018), p. 142; Rosenfeld (2013), p. 128; Markesinis (2000), p. 51.

Table II.4.1 – Sources of data

Source	Description
Union law	Directives, regulations, preparatory works and related policy documents, as listed in Part IV of the Bibliography.
Books and journal articles	As listed in Part I of the Bibliography, including authors from all five continents mostly from the 21st and late 20th centuries in the fields of law, economics, business administration, finance, psychology, sociology and history.
Self-regulation and legislation; regulations of other jurisdictions	As listed in Part IV of the Bibliography.
Newspaper articles and speeches	As listed in Part III of the Bibliography.
Government and industry reports	As listed in Part II of the Bibliography.

I review the relevant literature on an ongoing basis. The review includes database selection (Metasearch of the University of St. Gallen[188] and Google search engine), choosing relevant search terms, applying screening criteria, reviewing books and articles and systematising them within the context of this study. The starting point for the research were the journal articles of Barton[189] and of Moslein and Sorensen[190], as well as Stout's book[191]. Based on them, I identified the main search terms for continuing the research. Moreover, the consulted authors led me to valuable books, journal articles and reports, which were included in their own bibliography.

The literature review of legal sources looks at and questions the available accounts of the topic.[192] The literature review of non-legal sources identifies theories, concepts and empirical data useful to this research.

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188 Available at: https://www.unisg.ch. Last accessed 5 February 2020.
189 Barton (2011).
190 Möslein and Sorensen (2018).
191 Stout (2012).
192 Hutchinson (2012), p. 112.

4.2 Five-step analysis

I analyse the data in five steps:

Step 1: Data analysis on short-termism

Step 1 involves understanding whether the data evidence a tendency towards short-term behaviour in the equity markets. The data show that this tendency occurred as equity market participants moved from longer-term decision-making to shorter-term decision-making. Based on empirical data from business, economics and finance scholarship, I demonstrate that this trend took place and what the drivers leading to it were.

Step 2: Data analysis on long-termism

Step 2 focuses on understanding whether the data evidence current drivers towards long-termism. That is, this step researches whether a counter-trend to short-termism is underway. Data in business, economics, and finance scholarship support this counter-trend. Normative theory about millennials and climate change further confirms the factors influencing this counter-trend.

Chapter III (*Trend and counter-trend*) includes steps 1 and 2.

Step 3: Long-termism and regulation (form)

Step 3 organises the data on Union law to explain policy decisions and to choose a regulatory strategy. In particular, the data demonstrate that the drivers described in step 2 have reached the executive and legislative branches of the European Union. Hence, legislative and regulatory decisions (e.g. the preamble and preparatory works of Union law) and policy decisions evidence the counter-trend towards long-termism.

Here, I propose to support and enhance the counter-trend towards long-termism. To this end, the prospective legal framework must incorporate rules for best long-termist practices. Hence, the law ought to be amended and to evolve further by (a) creating more incentives for long-termism and (b) punishing excessive short-termism.

Step 3 is found in chapter IV (*Regulatory strategy*).

Step 4: Long-termism and regulation (substance)

Step 4 gathers data to describe the current state of affairs, i.e. the legislation and regulation validating this counter-movement. This step is repeated in three chapters: V

(*Takeover Directive, Merger Directive and Insolvency Directive*), VI (*Shareholder Directive*) and VII (*Reporting Directive*).

Step 5: Policy recommendations

Finally, step 5 analyses the data and recommends amendments to the law. I make recommendations in each of the three chapters mentioned above. [193]

4.3 Archetypal legal scholarship

In 2013, Minow published a taxonomy of "archetypal legal scholarship." It outlines the types of intellectual contribution resulting from legal research and is based on her experience as a professor and dean of Harvard Law School.[194] Table II.4.3 (*Minow's archetypes*) classifies the data analysis described in section II.4.2 (*Five-step analysis*) according to Minow's taxonomy:[195]

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[193] The goal of these contributions is not "to find a final and ultimate solution of a certain legal problem", but as Dworkin put, to contribute as one among the endless chain of authors characterizing both the making and investigating of the law. Dworkin (1966).

[194] According to Hutchinson in Watkins and Burton (2018), p. 15, the Pearce Committee Report was another respected taxonomy, especially in common law countries. See Roper (1987), *Australian Law Schools: A Discipline Assessment for the Commonwealth Tertiary Education Commission.* This report is a simpler version of Minow's taxonomy. The Pearce taxonomy includes only three types of research: Doctrinal, reform-oriented and theoretical research. According to this classification, the methodological steps, as described in section II.4.2 (*Five-step analysis*), are mainly an exercise in reform-oriented research, including some elements of doctrinal research and none of purely theoretical research.

[195] Minow (2013).

Table II.4.3 - Minow's archetypes

Archetype	Method	Data analysis' steps
Study, explanation and assessment of legal institutions, systems, or institutional actors	a. Offer historical analysis of the behaviour of legal actors or institutions, exposing complexity, gaps between theories and practice, dynamics, and layers of meaning and effects; b. Use empirical or interpretive methods; c. Offer a normative assessment or agenda for further study.	Steps 1 and 2 a. Chapter III (Trend and counter-trend) offers the historical analysis of the behaviour of equity market participants, and section IV.1 (Legal landscape) does the same for legal institutions in the European Union b. The entire study applies different interpretative methods to review the literature and the law. c. section I.3 (Normative foundations) offers a normative assessment.
Policy analysis	a. Present a problem; canvass alternatives; propose an evaluative scheme or method; recommend preferred solution; b. Attribute problem to: Distance between goal and implementation; conflict with a powerfully competing goal; the lacking fit between legal rules or practices when compared with changing social and environmental circumstances; or mistaken assumptions as demonstrated by historical review, economic model, psychological research or evidence from other fields; c. Include fair analysis of a range of alternatives and alternative criteria; offer useful analyses for those who do not agree with the assumptions, methodology or conclusion.	Steps 3, 4 and 5 a. This study identifies the issue of excessive short-termism, proposes alternative regulations and recommends preferred solutions in chapters V (Takeover Directive, Merger Directive and Insolvency Directive) through VII (Reporting Directive). b. In this study, the problem of excessive short-termism is attributed to several causes laid out in section III.1.4 (Causes). I discuss the influences leading to a counter-trend towards long-termism in section III.2.3 (Influences). c. Chapters V (Takeover Directive, Merger Directive and Insolvency Directive) through VII (Reporting Directive) include a review of the alternatives. Section I.2 (Counter-arguments) offers an analysis of authors who do not agree with the assumptions and conclusions.

Archetype	Method	Data analysis' steps
Doctrinal restatement[196]	a. Organise and reorganise law into coherent elements, categories and concepts; b. Acknowledge distinction between settled and emerging law; c. Identify difference between majority and "preferred" or "better" practice-ideally with some explanation of the criteria to be used.	Steps 4 a. Chapters V (Takeover Directive, Merger Directive and Insolvency Directive) through VII (Reporting Directive) aim at organising legal provisions into three main groups, based on the elements of focus (stakeholders, shareholding and disclosure). b. The majority of the laws discussed here have been enacted in the past ten years and are emerging. c. Chapters V (Takeover Directive, Merger Directive and Insolvency Directive) through VII (Reporting Directive) recommend better legal provisions based on the criteria in section IV.2 (Proposed strategy)

196 According to Hutchinson (2012), doctrinal research methodology can be explained as follows: "It is the location and analysis of the primary documents of the law to establish the nature and parameters of the law. The 'screening criteria' for legal primary materials are necessarily more rule bound and intricate. It requires a trained expert in legal doctrine to read and analyse the law — the primary sources: The legislation and case law. It includes 'reading, analysing and linking' the new information to the known body of law. It is centred on the reading and analysis of the primary sources of legal doctrine and seeks to achieve more than simply a description of the law."

In terms of Minow's classification, the present study is mainly an exercise in policy analysis. More specifically, it analyses the regulation of equity market long-termism, as a result of policy decisions in the European Union. In parallel, it contains elements of doctrinal restatement and of the study, explanation and assessment of legal institutions, systems or institutional actors. In a few instances, this study includes elements of comparative inquiries in that it describes other legal regimes or sample corporate practices. However, the latter are used solely as an illustration to enrich the discussion.

Specifically, with respect to policy analysis, this study reviews a new legal development, namely, the legislative and regulatory decisions in the European Union directed at establishing long-termism in equity markets. This study applies the policy analysis method recommended by Pauline Westerman:

(i) describe how the new development fits within the area of company law;
(ii) address the question of how the new development can be made consistent with the existing legal system; and establish how other related concepts are affected and how current distinctions should be adapted and modified; and
(iii) recommend measures in order to accommodate the new development.[197]

5 Format

Several formats for doctoral dissertations in law have been proposed. Mauro Zamboni, a professor at the Stockholm University's Centre for Commercial Law, identified the two most common ones (the exam format and the research format). According to Zamboni, the key differences between these formats are:[198]

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[197] The Pearce Committee Report would be reform-oriented research, i.e. "research which intensively evaluates the adequacy of existing rules and which recommends changes to any rules found wanting." See Hutchinson (2015), p. 4.

[198] Zamboni (2010).

Table II.5 - Research and exam formats

Aspect	Research format	Exam format
(a) Goal of the dissertation	To say something new or to paint a better picture of something already said by others. To guide readers through difficult parts of an author, field, or theory or leading readers to a certain solution to practical or theoretical problems in an area of legal regulation.	To test the author's capacity to master certain knowledge, find points of discussion and offer plausible explanations. To prove that the author knows: - a certain situation in a specific legal area - what the possible problems are, and - how to "remedy" them.
(b) Legal system	More common in the United States and the United Kingdom	More common in German-speaking countries and Sweden
(c) Field of law	More established	Less established
(d) Source of data	A few central authors	Long bibliography and many footnotes
(e) Future career objectives	Inside academia	Outside academia

Like most doctoral dissertations,[199] this study contains a mixture of both formats. Regarding its goals — aspect (a) of table II.5 (*Research and exam formats*), steps 1 to 4 of this study follow the examination format, as described in section II.4.2 (*Five-step analysis*). The reason being that steps 1 to 3 identify previous research on short- and long-term behaviour in equity markets. The literature review found very few sources in law and various sources in other fields (e.g. business and finance), as well as evidence from reports and news (to the extent relevant for law). In step 4, I review the relevant company law that was valid in 2019. All these four steps contain some elements of the research format, as I systematise the written knowledge on long-termism in equity markets so that it can be assimilated into interpretative legal theory. To paraphrase Zamboni, I attempt to "paint a better picture" of this knowledge. The fifth and final step consists of recommendations for amending the law, which is a typical research-format exercise.

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[199] Zamboni (2010).

Regarding the legal system — aspect (b) of table II.5 (*Research and exam formats*), this study was written in Switzerland, i.e. a German-speaking civil law country mostly favouring the exam format of legal dissertations.[200] With respect to the field of law — aspect (c) of that table, I study a very dynamic and constantly evolving field of law, i.e. transnational company law. Concerning the data sources — aspect (d) of that table, this bibliography contains a longer list of relevant authors and research.

Zamboni's aspect of future career objectives — aspect (e) in table II.5 (*Research and exam formats*), is interesting, as this concerns this study's envisaged audience. This aspect becomes relevant when deciding how to write a dissertation. The content of this study is technical, as it is a piece of academic research. However, the main goal is to reach legislators, regulators, self-regulatory organisations and private businesspersons around the world. From analysts to asset managers, final beneficiaries to chief operating officers, employees to environmental activists, lawyers to consumers and so on. Consequently, this study provides simplified background knowledge, in order to enable its discussion to stand on its own and to enable readers to understand its arguments without having to constantly refer to other sources.

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[200] According to Häfelin *et al*, Bundesstaatsrecht, margin number 86, subsumption is a very common methodology for doctoral dissertations in civil-law systems. This is perhaps the most well-known and tested legal method, also called subsumption or problem-based method. It is the methodology used in judicial decisions and legal practice. This study does not apply this method, because it is not suited to recommending legal reform. Nevertheless, every legal research somehow includes the exercise of subsumption. The problem-based method consists of "assembling relevant facts, identifying the legal issues, analysing the issues vis-à-vis the law, reading background material, synthesising all the issues in context, and coming to a conclusion." Many of these actions are present in this study, just not with the same intent as that of a judge or lawyer.

Chapter III: Trend and counter-trend

This chapter focuses on steps 1 and 2 of the methodology introduced in section II.4.2 (*Five-step analysis*). It first provides evidence for a trend towards short-term behaviour in equity markets. This trend consists of equity market participants shifting from longer- to shorter-term decision-making. Empirical data and normative constructs from business, economics and finance scholarship support steps 1 and 2. Specifically, empirical data and normative constructs demonstrate how this trend unfolded and what its driving forces were.

Second, this chapter provides evidence for the current drivers towards long-termism. It argues that these drivers constitute a counter-trend evidenced by significant empirical observations. This counter-trend is further confirmed by normative argumentation about millennials and climate change.

For both the trend and the counter-trend, the evidence is solid but not conclusive. Hence, this chapter establishes two fundamental assumptions:

Assumption 1: Empirical studies demonstrate that excessive short-termism has negative consequences. Theoretical analysis leads to the same conclusion. However, these empirical and theoretical studies do not yet constitute conclusive evidence. Therefore, this study assumes that excessive short-termism is negative both for the economy and for society.[201]

Assumption 2: Empirical studies demonstrate that long-termism has positive consequences. Theoretical analysis leads to the same conclusion. However, these empirical and theoretical studies do not yet constitute conclusive evidence. Therefore, this study assumes that long-termism is positive both for the economy and for society.[202]

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[201] This assumption does not explicitly mention the environment because of the findings in the literature review. The reviewed literature (empirical qualitative studies) supports the correlation between short-termism and negative consequences for equity markets. Several studies have shown how equity markets problems affect society: Among others, see Ötker-Robe and Podpiera (2013) and Mukunda (2018). The causal chain between short-termism and negative environmental impact is longer, and hence more difficult to evidence empirically. Negative consequences for the environment are per se also negative for society (implicitly included in this definition).

[202] Nor does this assumption mention the environment in terms of the same rationale as in the previous footnote. That is, the reviewed empirical studies provide no evidence for a direct correlation between long-termism and benefits for the environment.

This chapter also introduces two key definitions[203] relevant to further discussion:

Short-termism: Decision-making favouring short-term results that is detrimental to long-term value creation for all stakeholders.

Long-termism: Decision-making that favours long-term value creation for all stakeholders.

1 The trend towards short-termism

1.1 Definition

Since the early 1990s, scholars have adopted relatively harmonised definitions of short-termism. Even if worded differently, the intrinsic meaning of short-termism is quite similar. For example, Mullins defined this as "seeking short-term gain to the exclusion of long-term achievement."[204] Laverty phrased it as "decisions and outcomes that pursue a course of action that is best for the short-term but suboptimal over the long run."[205]

In the noughties, the notorious report of the Business Roundtable Institute for Corporate Ethics specified the conflicting nature of short- and long-term objectives: "Corporate and investment decision-making based on short-term **earnings expectations** versus long-term **value creation for all stakeholders**."[206] In 2008, Marginson and McAulay reduced the language, yet broadened the terminological scope, by defining short-termism as "detrimental intertemporal tradeoff."[207] In 2012, Rappaport added another broadly scoped definition of short-termism as "the obsession with short-term results irrespective of the long-term implications."[208] These three authors removed the qualification of short- and long-term objectives. Hence, expectations could refer to share price, takeover protection, etc. This is a more holistic approach to short-termism.

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[203] Möslein and Sorensen (2018) suggested that the vagueness of the concepts of sustainability and long-termism in Union law makes it challenging for practitioners to understand the overall regulatory aim. For this reason, it is important to have definitions, at least for the purposes of this study.

[204] Mullins (1991), p. 20.

[205] Laverty (1996), p. 826. In 2004, he defined it as "decisions in which firms pursue short-term gains (for example, seeking to maximize quarterly profits) at the expense of long term strategies (for example, investing in basic research or laying the groundwork for new core competencies)", p. 949.

[206] Krehmeyer (2006), p. 1.

[207] Marginson and McAulay (2008), p. 274.

[208] Rappaport (2012), p. 33.

In 2018, Roe innovated the discussion on definition and differentiated two types of short-termism.[209] Based on the nature of short- and long-term results, he distinguished "Type A" from "Type B" short-termism. He described "Type A" short-termism as follows:

> equity market pressure that is seen to induce executives to forgo long-term spending on R&D and capital (both physical and human) and to buy back their stock (and thereby lose cash needed for the future), even if more R&D, fewer buybacks, and more capital investment would be profitable in the long run.

On the other hand, "Type B" consists of:

> corporate decisions that damage the economy via environmental degradation (which boosts profits today but degrades the economy tomorrow), an unwillingness to protect corporate customers, employees, and other stakeholders, and an unwillingness to act in a public-spirited way.

This differentiation is relevant in studies like Roe's, who only considers the consequences of short-termism in the corporation and in corporate governance. In contrast, this study looks at short-termism in a broader context, one including all stakeholders. Hence, Roe's differentiation is not suitable here.

In 2018, the European Commission adopted a definition that follows those advanced by various scholars:

> The focus on short time horizons by both corporate managers and financial markets, prioritising near-term shareholder interests over long-term growth of the firm.[210]

Building on previous definitions, this study combines Rappaport's concepts with those of the Business Roundtable Institute for Corporate Ethics and of the European Commission. Here,

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[209] Roe (2018), p. 81.

[210] Call for advice to the European Supervisory Authorities to collect evidence of undue short-term pressure from the financial sector on corporations. Retrieved from: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190201-call-for-advice-to-esas-short-term-pressure_en.pdf (Last accessed 11 September 2019)). This definition has been repeated in later European documents such as the explanatory note to the survey on undue short-term pressure on corporations from the financial sector by the European Securities and Markets Authority dated 24 June 2019.

short-termism means "Decision-making favouring short-term results that is detrimental to long-term value creation for all stakeholders."[211] In practice, this means any decision that produces the best short-term results as a trade-off for long-term results for stakeholders. For example, short-termism is not restricted to investors' buy-or-sell decisions. Any stakeholder may act in a short-termist manner. Moreover, all types of consequences, inside or outside equity markets, are relevant.

1.2 Quantitative data

Short-termism is not a new phenomenon. Legal scholarship reported its existence already in the late 1970s. Lipton phrased the issue around the fact that corporate and investment behaviour could jeopardise

> the long-term interests of the nation's corporate system and economy [to the benefit of; my insertion] speculators interested not in the vitality and continued existence of the business enterprise in which they have bought shares, but only in a quick profit on the sale of those shares.[212]

However, the dot-com bubble in the 1990s is said to mark the real beginning of mass-scale short-termism.[213]

Many scholars have based the existence of short-termism on two variables in equity markets: The average holding period and the annual share turnover.[214] The table and figure below summarise developments in the world's largest stock exchanges, since 1960 and 1991 respectively:

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[211] The original definition by the Business Roundtable Institute for Corporate Ethics qualified decision-making as "corporate and investment decision-making." This qualification is deliberately omitted here in order to include other short-termist actors. For instance, consumers and governments may take short-term decisions.

[212] Lipton (1979), p. 104.

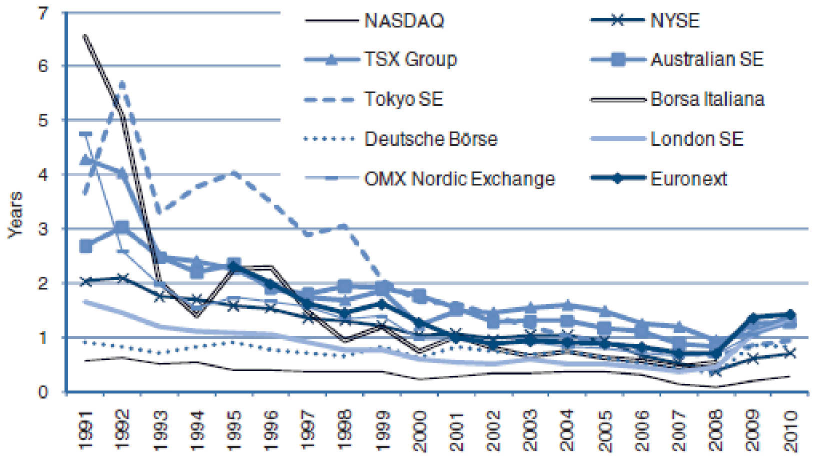
[213] Fox and Kenagy (2012), p. 46.

[214] For example, Barton (2009), Sappideen (2011), Fox and Kenagy (2012), Stout (2012), Bowdren (2016).

Table III.1.2 – Annual share turnover[215]

Year	Annual share turnover
1960	12%
1970	73%
2010	300%

Figure III.1.2a – Average holding period[216]



The holding period is the time frame between the date on which shareholders buy and the date on which they sell shares. For example, during the 1960s investors at the New York Stock Exchange held their shares for eight years on average. Thus, they expected to have their financial return spread across this period. In 2010, investors held shares for four months on average, hence expecting financial return to occur within this brief time frame.[217]

Since the 1970s, the shortening of the average holding period has been accompanied by an increase in annual share turnover. This metric reflects the total number of traded shares divided by the total number of tradeable shares in a given year. At the New York Exchange, share turnover in 2010 was 300%. In contrast, only 12% of tradeable shares were actually traded there in 1960. The global annual average share

[215] This table includes data according to Barton (2009) and Stout (2012). In response to my request for data concerning other years, the New York Stock Exchange replied that it no longer maintains this data.

[216] Della Croce et al. (2011), p. 151.

[217] Barton (2009) and Stout (2012).

turnover is lower than at the New York Stock Exchange. Nonetheless, it increased from 64% in 1988 to 105% in 2018.[218]

The acceleration of both factors during the past fifty years is remarkable. Societal developments (e.g. the thirst for instant gratification) and facilitating trading through information technology and deregulation have played a role in this acceleration.[219] As technology aids transactions and eliminates obstacles like relationship with intermediaries, telephone calls and the physical signing of documents, investors require even more self-control to avoid acting on pure impulse to buy or sell.[220]

Despite obvious market hyperactivity, the evidence of short-termism has been and still is disputed.[221] Some authors have found empirically that CFOs in the United States indeed refrain from making long-term investments if these would have a short-term negative financial impact.[222] However, Laverty observed:

> The fundamental problem facing researchers is the difficulty of reliable observation and measurement: How to determine objectively whether either an isolated decision or an organization's strategy reflects an appropriate evaluation of outcomes that will occur only over the long run.[223]

Reviewing the relevant literature shows that Laverty is not alone. Many authors have believed that it is probably impossible to irrefutably evidence short-termism. In spite of these reservations, this study constructively works with the subjective empirical evidence of market participants' perceptions of short-termism, as well as with the normative discourse on the existence of short-termism[224] in the literature.

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[218] The World Bank Data, Stocks traded, turnover ratio of domestic shares (%). Retrieved from: https://data.worldbank.org/indicator/CM.MKT.TRNR?end=2018&start=1975&view=chart. Last accessed 20 June 2019.

[219] Stout (2012), p. 66. Woolley (2010) discussed these changing patterns and momentum trading, p. 118. Well before the turn of the millennium, Jacobs (1991) felt that business myopia was getting worse, due to new technologies transforming shares and loans into mere commodities (instead of long-term investments), and also due to new laws impeding communication between capital providers and capital users, p. 16.

[220] Mischel (2014) also tested the effect of "Siren-like tempters" in children and confirmed how difficult it is to resist them, pp. 61–65.

[221] Section I.2.1 (*Criticism as of 2013*) also states this.

[222] Graham et al. (2004), p. 37.

[223] Laverty (1996), pp. 826–827.

[224] This normative discourse is addressed in sections III.1.3 (*Economic theory and its influence*) to III.1.6 (*Potential benefit*). To understand this study's perspective on truth and reality, please refer to

Citing a 2006 study by McKinsey & Company, the report of the Business Roundtable Institute for Corporate Ethics[225] confirms that market participants perceive short-termism as present and increasing. It mentions that investors, asset management firms, corporate managers, and analysts are convinced that short-termism exists. Market participants also believe that short-termism leads to long-term value destruction, decrease in market efficiency, reduction of investment returns, and impeding efforts to strengthen corporate governance. Similarly, in 2016, FCLT Global published a survey that provides three robust pieces of evidence[226]:

Figure III.1.2b – Executives' perception

First, executives perceive short-termism as present and increasing. They also report that decisions are taken based on short-term targets.[227]

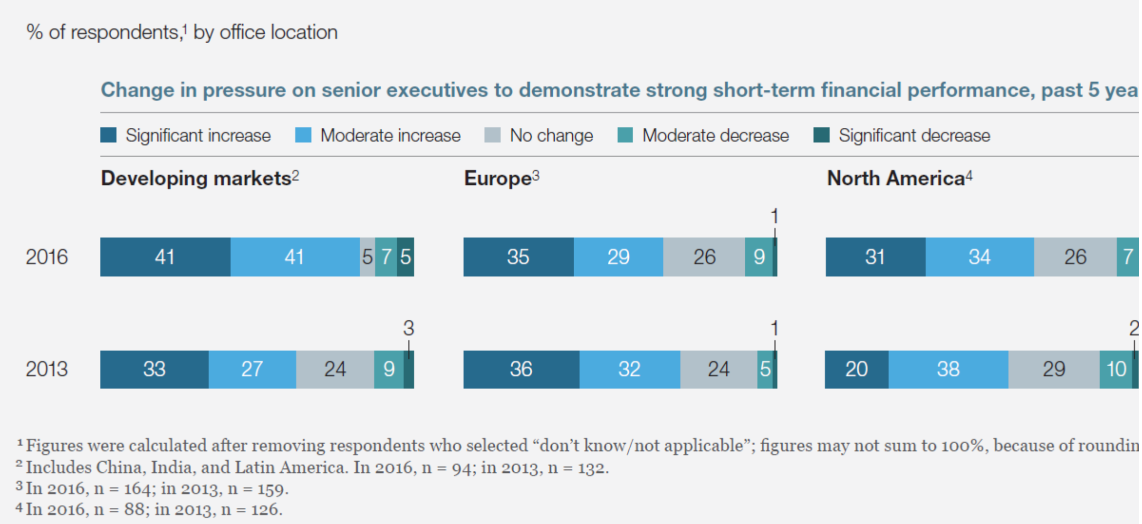
section II.2 (*Ontological orientation*). The normative discourse is relevant because of the performativity of economics and other social sciences. Hence, the discourse itself is a form of social action that leads to changes in the markets. For a general discussion on performativity, see Mackenzie, Muniesa and Siu (2007), Callon (2007), and Muniesa (2014).

225 Krehmeyer (2006), p. 4.

226 Barton, Bailey and Zoffer (2016).

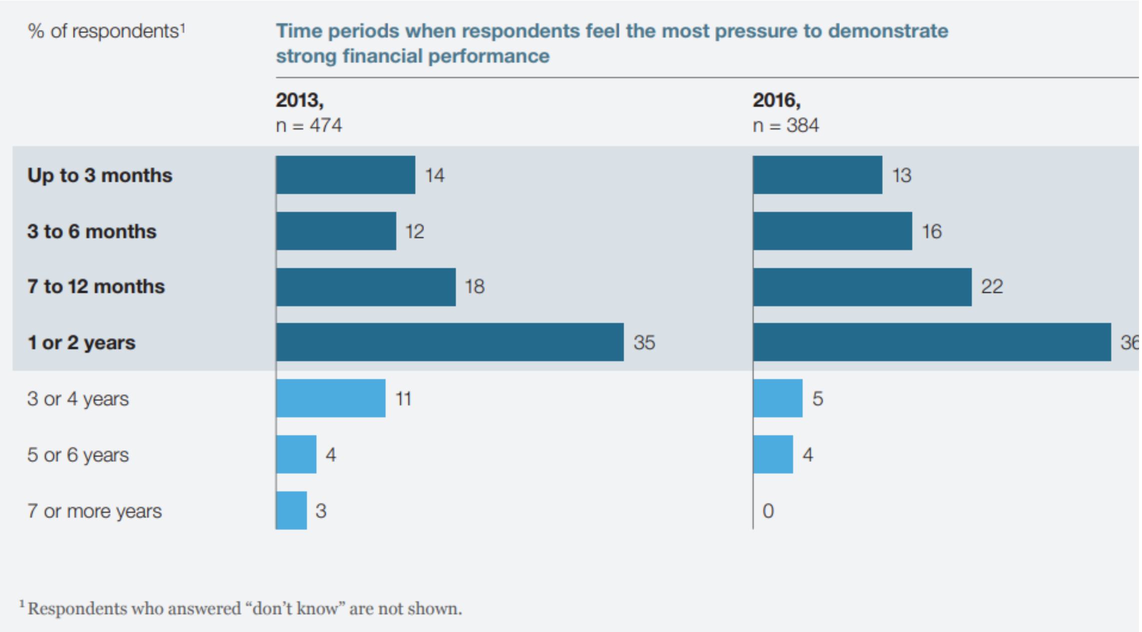
227 A public consultation of the Commission also yielded similar results in 2016. For instance, "the majority of respondents from different groups acknowledged that financial markets still focus predominantly on short term"; "the large majority of respondents of different categories (…) recognised that ESG issues were not sufficiently taken into account"; "Many responses showed that incentives used in the investment chain (asset managers, brokers and investment consultants) were rather short-term focussed"; and "The majority of respondents from all sides were of the view that (…) mainstream equity and credit research were still predominantly short-term oriented". See Summary of the Responses to the Public Consultation on Long-term and Sustainable Investment, dated October 2016 (document number JUST/A3), p. 2-3.

Figure III.1.2c - Global spread



Second, the perception of the pressures for short-termism is spread across the globe.

Figure III.1.2d – What short means



Third, there is a herd behaviour towards short-termism[228]. Virtually nobody in the equity markets reports considering the effects of their decisions beyond seven years.

[228] According to Law (2018), herding is "the tendency for investors to be influenced by the decisions of other investors, rather than relying on their own independent analysis. This may lead to a situation in which large numbers of investors make a choice that few individually believe to be economically rational. Herding behaviour can produce large, unidirectional movements in the market and has been posited as a leading cause of panic selling, market bubbles, and similar phenomena." Stein (1989) discussed the fact that managers believe that other managers are behaving myopically and consequently act myopically themselves, like in the prisoners' dilemma, p. 656.

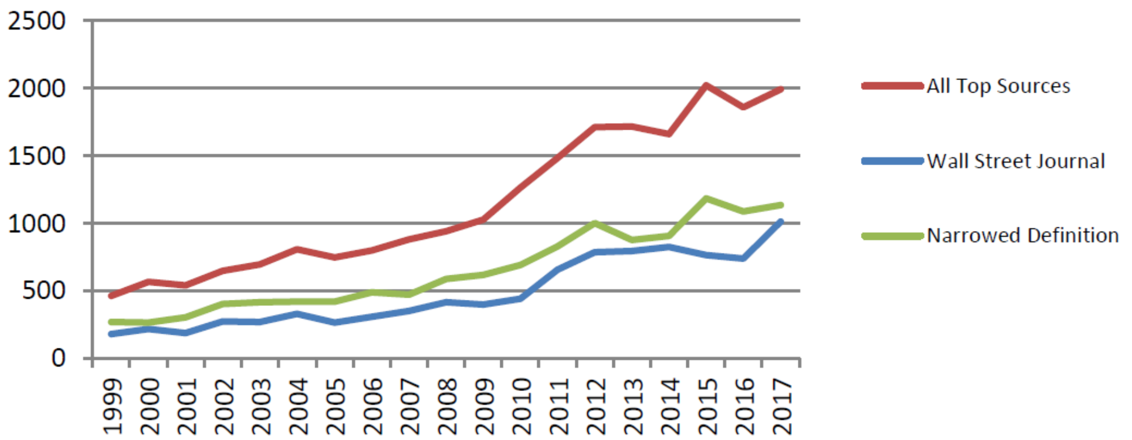
Managers' perceptions count, as they impact practical decision-making. Demirag's (1995) empirical study reached the conclusion:

> Whether short-term pressures from equity markets actually exist or not matters little; for if the group finance directors perceive equity markets as short-termist, they will behave in such short-term manner.[229]

If managers **feel** that there is pressure to achieve short-term results, they **act** accordingly, to achieve such results.[230]

Willey evidenced that the media attention around short-termism has increased exponentially since the 2008 global financial crisis. This shows that the media discourse confirms and supplements the perception of market participants. Willey compiled citations from the world's major financial newspapers and magazines[231]:

Figure III.1.2e - Citations of the term 'short-termism'



[229] Demirag (1995), p. 248. This finding demonstrates the performativity not only of scholarship, but also of market discourse. However, Brisset (2016) informed that there are limits to performativity in economics.

[230] As discussed in section I.2 (*Counter-arguments*), Roe affirmed that there is no actual short-termism. In view of the perceptions discussed in this chapter, even if Roe's affirmation were correct, the social phenomenon of self-fulfilling prophecies would be triggered. Merton (1948) defined this as follows: "The self-fulfilling prophecy is, in the beginning, a false definition of the situation evoking a new behaviour which makes the originally false conception come true," p. 195. Already in 1990, Flood and Hendrick demonstrated that self-fulfilling prophecies occur in equity markets, particularly in speculative bubbles.

[231] Willey (2018), p. 11.

To conclude, this study rests on the perceptions (rather than on the sheer existence of short-termism) of short-termism as empirically validated to date, as well as on the actual consequences of such perceptions.

1.3 Economic theory and its influence

Economic theory has strongly influenced the shortening of corporate and investment horizons.[232] It has also been one of the key drivers shaping the overall discourse on corporations in legal theory and in society. Specifically, the efficient market hypothesis[233] and the agency theory[234] have strongly impacted company law.[235] What follows hence analyses economic theory to help better understand short-termism and its underlying rationale.

The 1970s and 80s were the heyday of the efficient market hypothesis. Three beliefs were crucial at the time. Executives and investors were convinced that the market players could capture all price-relevant information available in the market. Second, any decision that would harm the company in the long run (to the extent accessible by the market) would immediately impact one's share price. Third, markets would be efficient at the individual and at the aggregate level. In this view, the concept of harmful short-termism had no logical foundation. Nevertheless, the belief in the efficient market long remained unanimously accepted — as long as markets did not crash.

However, confidence in the efficiency of markets began eroding after the Black Monday of 1987.[236] Confidence was even further shattered after the dot-com bubble burst in the late 1990s, as well as after the Enron and Worldcom accounting scandals in

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232 Woolley (2010), Sappideen (2011), Fox and Kenagy (2012), Stout (2012).

233 Law (2018) defined the efficient market hypothesis as "A central theory of modern finance holding that transactors in financial markets cannot make abnormal returns on the basis of exploiting information, since market prices incorporate all available information."

234 Agency theory in company law is discussed here in section I.3.1 (*Company as team*). Regarding short-termism, agency theory has led to pursuing high share price at all costs. In this realm, short-term earnings for shareholders have priority even if they lead to long-term value erosion.

235 Stout (2003).

236 Law (2018) explained the term: "The stock exchange crash experienced on Monday 19 October 1987, when the Dow Jones Average inexplicably lost 23%. So-called Black Monday triggered heavy equity market falls around the world."

the early noughties.[237] These events challenged the very assumptions of the efficient market hypothesis:

> (a) economically rational behaviour by market participants (utility maximisation behaviour), (b) homogeneous expectations of participants in the marketplace, and (c) price movements based on the instantaneous transfer of information by arbitrageurs. [238]

Stout and Sappideen's research demonstrated that behavioural theory and entrepreneurship theory have challenged the above assumptions. Regarding assumption (a), behavioural finance has shown that market participants do not, and often cannot, function rationally.[239] Hence, human irrationality and emotions may distort prices and affect markets. Regarding assumption (b), different investor profiles (e.g. individual vs. institutional, hedge funds vs. family offices) have heterogeneous expectations and behave differently in the market. Entrepreneurship theory confirms "dynamic markets are volatile, in a state of flux, and constantly adjusting and readjusting themselves in the face of actions taken by its various participants to make a gain."[240] Finally, regarding assumption (c), arbitrage is limited in terms of time and content[241]: Publicly available information on listed companies is very complex and technical,[242] as well as difficult to

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237 Stout (2012), p. 64. She concluded: "It is nearly impossible today to find a finance economist under the age of fifty who would claim equity market prices always capture true value."

238 Sappideen (2011), p. 426. Several authors have discussed this. Sunstein (2014) alleged "In practice, however, some people procrastinate or neglect to take steps that impose small, short-term costs but would produce large, long-term gains.", p. 35 and "Procrastination, inertia, hyperbolic discounting, and associated problems of self-control are especially troublesome when the result is a small short-term gain at the expense of large long-term losses. There is a close connection between procrastination and myopia, understood as an excessive focus on the short term.", p. 36. He concludes that long-term costs are not salient. Jones et al. (2013) affirmed that emotions influence human behaviour consciously and unconsciously; and that when they govern behaviour, humans tend to favour short-term gain over long-term costs, p. ix. Mitchell et al. (2011) inferred "short-sighted decision-making occurs in part because people fail to consider their future interests as belonging to the self: MPFC activity should distinguish between judgments of one's present and future desires", p. 857.

239 Stout (2003), pp. 651–659.

240 Ibid.

241 Ibid.

242 Anyone who has ever read filings of listed companies, especially the offering memorandum for an initial public offering, would agree. For instance, Amazon's (currently one of the most trade shares in the world) latest 10-Q has eighty-nine pages written in font size 10. From January to May 2019 alone, Amazon published over fifty SEC filings. Having co-authored several filings for stock exchanges in countries like the United States, Brazil, Hong Kong, England and Germany, I admit

find in terms of an immediate effect on price. As in the Enron and Worldcom scandals, accounting tools allow raising the share price without improving a company's real value. [243]

Nowadays, scholars agree that markets can be value-inefficient, as prices may be inaccurate. Still, the above evidence shows that markets are only slowly responding to the changing views in scholarship. As Quiggin observed, the efficient markets hypothesis is a "zombie idea," neither living nor quite dead yet. He concluded that some old myths of economic theory still need to be fully debunked.[244]

1.4 Causes

Evidencing short-termism includes examining its causes. The literature review shows that these causes are rooted in three levels: Individual, organisational and market.[245] Often, the causes encompass more than one level simultaneously. For instance, pressure from investors occurs: (a) at the market level, where shares are purchased and sold; (b) at the organisational level, as shareholders influence the board's decision-making; and (c) at the individual level of company directors, who may be pursuing their opportunistic self-interest in advancing their career.

Fox, based on other research, usefully listed seven factors that trigger short-termism:

(i) **Pressure from shareholders**: Shareholders[246] demand that directors run the company to generate short-term earnings and to reduce the focus on long-term

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that we work with legal and financial jargons in the struggle to paint an honest and beautiful picture of the company. The result is often discouraging for recipients deeply interested in obtaining a simple and complete overview.

243 The quest for high share price is very much discussed in the debate of short-termism. Sappideen (2011) stated some benefits of high share prices: "For the corporation, access to cheaper capital from the marketplace, a readymade defence against hostile bidders, and the corollary power of acquiring targets more cheaply; for shareholders, a higher exit price; and for managers (as well as Board members) higher remuneration, higher realisation price for the stock based component of their remuneration packages, as well as longer tenures of office when corporate raiders are kept at bay." He warns, though, that "the company loses value and reputation (in the equity markets) in the long run. Overall, the evidence is that short-termism encourages excessive risk taking and risk shifting from managers to shareholders, from shareholders to debt holders, and from subordinated debt holders to senior debt holders", p. 428.

244 Quiggin (2010), pp. 35 et seq.

245 Marginson and McAulay (2008), p. 274.

246 Already in 1998, Bushee confirmed that institutional investors showing "transient ownership characteristics" (i.e. high portfolio turnover, diversification, and momentum trading) influenced managers to reduce R&D expenditures to boost short-term profits; p. 330.

value.[247] Consequently, directors are incentivised to adopt high-leverage and high-risk strategies to achieve stock price increases ad infinitum as rapidly as possible.[248] This pressure has also led to greater portfolio turnover by shareholders and to increased trading costs.[249]

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[247] Fox and Kenagy (2012), p. 45. The Myners Report (2001) stated that the long chain of intermediaries between the invested company and the ultimate beneficiaries accentuates the pressure.

[248] Jensen et al. (2004), p. 18.

[249] Bolton et al. (2006) posed another shareholder-related cause for short-termism. In their view, disagreement between shareholders (especially in new industries, where knowhow is not solidified) leads to short-termist high share turnover, p. 600. They debunked the myth that short-termism should be countered by board insulation and encouraged "intervention in the direction of a more long-term orientation of boards".

Box III.1.4 – Transmission mechanisms

Some authors have addressed the question of how short-term pressure gets transferred from the markets into the boardroom. Building on Lipton's 1979 article[250], Roe discussed the so-called "transmission mechanisms"[251]. Hostile takeovers were the transmission mechanism of short-term from the market to the board room in the 1980s. Under the threat of having the company bought by savvy investment funds, directors tried to maintain the company's share price and earnings per share high (and increasing) at all times. Directors were also afraid because such acquisitions usually led to their dismissal.

Roe[252] (for the United States' market) and Bowdren (for the English market) considered that shareholder activism and executive remuneration could be transmission mechanisms in 2010s. In respect of shareholder activism, Bowdren put: "Shareholder activists are often viewed as investors who are dissatisfied with some aspect of a company's management or operations, and try 'to change the status quo through "voice," without a change in control of the firm.' Actions range from threatening the sale of shares ('exit'), to asking questions at shareholder meetings and using corporate voting rights ('voice')."

With respect to executive remuneration, this occurs because several executives are paid based on the financial performance of the shares. To solve the perceived agency dilemma, companies linked equity and remuneration. [253]

Hence, shareholder activism and executive remuneration work to put pressure on directors to perform quickly and frequently.[254] In most cases, long-term investors cannot compete with short-term activists in a level playing field. [255] The former are usually retail investors with diversified portfolios (to reduce risks) and thus have lower capacity to concentrate in one invested company. As a consequence, short-termist shareholders have more power to transmit their short-term goals into the companies' executive bodies.

(ii) **Analysts' forecasts**: Until the 1990s, the role of analysts was to understand a company in detail and to analyse its strategic choices. Based on their studies, analysts would predict a company's earnings. Over time, peaking during the dot-

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[250] Lipton (1979), p. 101.
[251] Roe (2013), p. 979.
[252] Roe (2013), pp. 982 et seq. and Bowdren (2016), pp. 287 et seq.
[253] Bowdren (2016), p. 302.
[254] Roe's and Bowdren's reasonings are in line with the scholarship confirming that short-term investors also participate less with regard to issues that have a long-term impact. See Gelter (2009) and Helms et al. (2012).
[255] Stout (2012), p. 70.

com bubble,[256] analysts' forecasts became targets for directors to meet.[257] Directors became eager to fulfil market expectations and to provide instant gratification to impatient shareholders.

(iii) **Focus on quarterly earnings**: Regular reporting requirements lead directors to focus on quarterly earnings. These requirements also entail unproductive and wasted efforts to produce reports while neglecting long-term results, as well as disproportionate internal and external reactions, a false sense of predictability, etc.[258] Hence, directors quickly curb spending, thus delaying new projects and compromising long-term technological competitiveness.[259] Scholars have long shown that markets overreact in relation to declared earnings and that directors always operate on the verge of being penalised by investors.[260]

(iv) **Remuneration of directors**: In many companies, director remuneration varies depending on share prices or earnings. This is the case with share and equity options, asset returns, bottom-line profit, and residual income. In addition, the average CEO tenure declined from ten years in 1995 to six years in 2010. There is a positive correlation between CEO turnover (also due to shorter tenures) and directors' short-term behaviour.[261] This is because directors often fail to look beyond their time in the company. Besides changes in ownership structures, Roger Carr (former chair of Cadbury) attributed short-termism to fund management performance measures focusing on immediate gains.[262]

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[256] This refers to the "dot.com bubble of 1999–2000, in which the share prices of Internet start-up companies rose to wildly inflated levels before collapsing amidst panic selling." For a definition, see Law (2015).

[257] Fox and Kenagy (2012), p. 46

[258] Fox and Kenagy (2012), p. 50.

[259] Hayes and Abernathy (1980, 2007), p. 139. The authors contrasted American vs. Japanese and German CEOs and concluded that the latter have a more hands-on and insightful form of management with very high technical (less purely managerial) knowledge of the business. These characteristics allowed them to achieve better long-term performance for their companies and stakeholders.

[260] De Bondt and Thaler (1985, 1987, 1990), Graham et al. (2006).

[261] Palley (1997), p. 548. The author mentioned that this correlation is common in US companies. In contrast, Japanese companies have a wider horizon as well as the tradition of lifelong employment.

[262] Roger Carr, former chair of Cadbury (recently acquired by Kraft Foods), gave a Distinguished Speaker Seminar at Saïd Business School on 9 February 2010 on the subject of hostile bids and takeovers. Podcast available at: https://podcasts.ox.ac.uk/roger-carr-cadbury-hostile-bids-and-takeovers.

(v) **Ownership and networks**: Family-owned businesses, as well as other privately owned businesses, tend to be more long-term focused. This implies that their CEOs are more worried about securing their relatives' future livelihood. In contrast, institutional investors and independent board members acting in the market are less emotionally attached to long-term outcomes.[263] Privately owned businesses also foster closer relationships with their customers, competitors and suppliers.[264] However, listed companies may also pursue a long-term value- and purpose-oriented approach. At the 49th St.Gallen Symposium[265] in 2019, Colin Mayer discussed Novo Nordisk as an example of a company listed on the New York Stock Exchange that has a dominant shareholder base and is organised like a foundation. Mayer also affirmed that companies with dispersed ownership structure are more exposed to changes in views of their investor community.[266]

The European Commission[267] has found that cross-border holdings and long chains of intermediated shareholdings contribute to excessively short-term focused managerial decisions. This is because the distance between issuers, asset owners (institutional investors) and asset managers leads to a misalignment of their respective interests. The stakeholder consultations carried out by the Commission's staff confirmed this finding.[268]

(vi) **Social dynamics:** Colleagues, co-workers and influential outsiders strongly influence managers' decisions, just as objective information does. Laverty[269] and Marginson and McAuley[270] confirmed that the culture of short-termism spreads

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263 Mamman and Saffu (1998) distinguished Western companies and Japanese Keiretsu. These Asian conglomerates, despite their size and complexity, are long-term focused.

264 Fox and Kenagy (2012), p. 49. At this point, it is worth challenging this hypothesis and asking whether ownership structure really is the key influential factor. In fact, most small and medium-sized companies are privately held. Publicly held companies are larger and more complex. Although there are exceptions, size affects a company's ability to maintain relationships with customers, competitors and suppliers.

265 The St. Gallen Symposium is a Swiss conference often described as a boutique version of the World Economic Forum in Davos.

266 Mayer (2019), starting at minute 34:11.

267 Explanatory memorandum in the Commission proposal for the Engagement Amendment dated 9 April 2014, document number COM(2014) 213 final.

268 See "Summary of ad hoc discussion with stakeholders" in the Impact Assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, pp. 89–90.

269 Laverty (1996).

270 Marginson and McAulay (2008).

within companies due to the social dynamics among individuals. The pressure on supervisors, peers and subordinates imposes rigid short-term objectives on those involved.

(vii) **Lack of focus on the process**: Tinsley, Dillon and Madsen[271] studied catastrophes in business history, such as BP's Deepwater Horizon oil spill. In their view, this disaster could have been prevented had managers focused less on targets. In this context, two main cognitive biases played a role. First, over time, people (and managers are no exception) become less sensitised to outcomes that deviate from the standard. In sum: "These things never happen." Second, managers who experience long-standing success shift their focus to targets and forget about the process leading to their achievement. Finally, they concluded that the higher the pressure to meet short-term results is, the higher chances are that signals of long-term risks will be missed.

(viii) **Overarching acceleration:** Roe, while defending short-termism, alleged that the world is moving faster in the twenty-first century compared to the previous century. He identified three causes for this general acceleration and argues that these also affect short-termist behaviour in the equity markets[272]:

- Accelerating technology: "Technological change is faster, the internet is destroying old distribution systems, computers change how business is done."[273] In 2011, high-frequency trading accounted for 35% of the European equity market and about two-thirds of the equity market in the United States.[274]
- Increasing globalisation makes local businesses global, i.e. susceptible to a much broader (geographical) range of constantly changing patterns; and

[271] Tinsley, Dillon and Madsen (2011).

[272] Roe (2013), p. 1001. Ernst & Young Poland also regards technologies, globalisation and more developed financial intermediation services as causes. See report *Short-termism in business: Causes, mechanisms and consequences* (2014), p. 14. Retrieved from: https://www.ey.com/Publication/vwLUAssets/EY_Poland_Report/%24FILE/Short-termism_raport_EY.pdf

[273] This is also clearly shown in the Michael Lewis' best-selling *Flash Boys* (2014), which portraits high-frequency trading as an example of short-term profit seeking. Here, technology is the most influential factor in myopic speculation.

[274] Haldane (2012), p. 250.

– Unstable and uncertain government policies in the United States and in the European Union burden those business leaders who are trying to plan for the long-term.

In 2011, Sappideen presented an additional factor:

(ix) **Intertemporal bias**: In his review of Thaler[275] and Zaheer,[276] Sappideen concluded that "humans are innately biased towards the immediate and the certain, even when a distant and less certain alternative is likely to be more valuable" and that "actions that have a longer life span may be ignored or missed, or underweighted in one's responses."[277] Earlier, Laverty simplified the notion of intertemporal choice in management decision-making as follows: "The course of action that is best in the short term is not the same course of action that is best over the long run."[278] This is equally true for decisions taken by investors and analysts. Awareness of this psychological bias is crucial to tackling short-termism. Easterbrook and Fischel have also contributed to this discussion by confirming that firms cause harm (e.g. pollution) when costs fall on third parties rather than on companies themselves as private costs.[279] The authors also argued that as long as firms consider fines and other related costs *ex-ante*, illegal actions may be taken to maximise profit.[280] In reality, while costs will fall on the firm, they will be deferred in time.[281]

Another human trait plays a role in short-termism: A certain inability to delay gratification, as Mischel observed in his famous marshmallow test.[282] Thus, most humans experience inherent difficulty in exercising self-control if tempted with

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275 Thaler and Shefrin (1981).

276 Sappideen (2011), p. 414, citing Stuart Albert, Akbar Zaheer and Srilata Zaheer, "The Importance of Time Scales" in Carey L. Cooper and Denise M. Rousseau, eds., Trends in Organisational Behaviour, Vol 7 (Chichester, England: JohnWiley and Sons Canada, Ltd, 2000).

277 Sappideen (2011), p. 416.

278 Laverty (1996), p. 828.

279 Easterboork and Fischel (1991), p. 39.

280 See critical discussion in Heath (2014), p. 18 et seq.

281 This example shows how the School of Chicago's view contributed to short-termism. As Friedman (1970) famously stated in the New York Times Magazine: "The Social Responsibility of Business is to Increase its Profits." Profit maximisation at all costs has also led to intertemporal biases such as those discussed by Easterboork and Fischel (1991).

282 Mischel (2014), pp. 15–23. The Austrian-American psychologist tested the ability of children to exercise self-control and to delay gratification in the 1960s. He accompanied experiment participants until they were fifty-five years old. In the initial experiment, seventy-five percent of the children opted for instant gratification.

instant gratification. Investors have also expressed impatience towards delayed gratification.[283]

1.5 Consequences

The literature reviewed so far suggests that excessive short-termism has several negative consequences.[284] For instance, Sappideen[285] and Strine[286] studied the main consequences of short-termism and found consequences at the micro- and at the macro-level.

At the micro-level, investors take excessive risks to instantly achieve high share prices. Executives favour themselves and shareholders to the company's detriment. Moreover, they seek to pay more dividends to please investors.[287] In this process, companies tend to neglect investments that yield long-term returns (e.g. talent retention and skilling, investment in factories and equipment, as well as in research and development).

At the macro-level, scholars have found higher market volatility. Hence, prices fluctuated more frequently than usual. The main causes were high share turnover and shorter shareholding periods. In turn, the costs of capital and transaction costs increased for all market participants. This happened because investors consider the risks of volatility when pricing their transactions. Finally, some authors have alleged that short-termism has even more drastic macro consequences. For example, Nesbitt[288] affirmed that short-termism has stood at the heart of every financial crisis since 1982.

A few authors have challenged the above evidence on the consequences of short-termism. For instance, Roe[289] claimed that the available evidence looks at the firm-level,

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283 Pickford (2014). According to him, Mischel's work influenced behavioural economists such as Richard Thaler as well as executives in the wealth management departments of large banks.

284 The study of the unintended consequences of short-termist behaviour began decades ago. Early examples include Hayes and Abernathy (1980), Kaplan (1980) and Johnson and Kaplan (1987). In his 1992 article for Harvard Business Review, Porter listed eighteen papers published in connection with the Harvard Business School-sponsored research project on the time horizons of American industry.

285 Sappideen (2011), p. 413.

286 Strine (2010, 2014, 2017).

287 Haldane (2016), p. 70.

288 Nesbitt (2009). Rappaport (2012) explains in detail how short-term incentives led to the 2008 financial crisis, pp. 19 et. seq.

289 Roe (2018), p. 85.

not at the economy-wide level. He also held that the critics of short-termism had not yet been able "to show economy-wide degradation in the R&D, buyback, and capital spending channels." However, empirical studies have revealed a systemic trend towards short-termism: Examples include the Centre for Financial Market Integrity, the Business Roundtable Institute for Corporate Ethics[290] and the McKinsey Global Institute.[291] The latter, for instance, has devised specific metrics to identify a decrease in R&D expenditure and an increase of buybacks in the United States market.[292] Brossard et al. also confirmed that high portfolio turnover was correlated with a decrease in R&D investments in European companies.[293]

In conclusion, the literature review confirms a linkage between the observed negative consequences and excessive short-termism. This view is shared by most scholars in business administration, economics and law.[294]

1.6 Potential benefit

Short-term decisions certainly have a positive side. Corporations must pursue some short-term objectives in order to survive.[295] Examples include selling goods and services, and paying employees and suppliers. Rather than condemning every short-term decision, this study challenges **excessive short-termism**.

None of the reviewed authors defend excessive short-termism.[296] Some, however, recognise a potential benefit of short-term trading. They allege that short-term trading flushes liquidity into the market. On balance, regular trading provides liquidity,[297] but

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290 Krehmeyer (2006).

291 McKinsey (2017). Also Lazonik (2007 on R&D investments and long-term value compromise.

292 Roe (2018) acknowledges that capital expenditure (capex) indeed is down in the United States, but insists that this is also the case in Germany and in Japan, where short-termism is not seen as an acute problem. In his view, the rise in long-term borrowing is the main explanation for recent buybacks.

293 Brossard et al. (2013), p. 1059.

294 Also government reports confirmed this linkage. For instance, the Kay Review (2012) cited lower investment levels, hyperactivity in the capital market and reputation damage as consequences of short-termism in the United Kingdom.

295 Marginson (2008), citing Merchant (1990), Simons (1995, 1999) and Van der Stede (2000).

296 Fox (2012) dedicated one paragraph of his article to note that "results in more immediate time horizons are more predictable and are therefore perceived as less risky. Hence company leaders believe they can make accurate predictions and forecasts and set reasonable expectations one quarter at a time; but, as the timeline is drawn out risk increases," p. 47. This might suggest that any form of long-term thinking is *per se* too risky, and thus undesirable. However, the literature does not support this view.

297 Chordia (2001).

increased short-term trading boosts liquidity even further.[298] Hence, liquidity is considered beneficial for equity markets. For instance, the *Kay Review* states[299]:

> Investors benefit from liquidity to the extent that they are confident they can dispose of holdings within a reasonable time scale at a price close to the value they attribute to these holdings, and therefore need hold less prudential cash in their portfolios.

In contrast, Woolley[300] warned that increased trading and liquidity are very welcome in efficient markets. However, markets are often inefficient as prices do not reflect the real value of assets.[301] In markets subject to mispricing, liquidity fluctuates, hence leading to instability and volatility. Liquidity is necessary in times of crisis and acute market uncertainty. It is doubtful whether increased trading can ensure liquidity in such circumstances.[302] *The Turner Review* concludes[303]:

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298 Bowdren (2016), p. 290.
299 Kay (2012), p. 38.
300 Woolley (2010), p. 119.
301 Schleifer (2000) and Authers (2014) summarised the research of various authors confirming this statement.
302 Kay (2012), p. 38.
303 Financial Services Authority (2009), p. 42.

> The acceptance that financial markets are inherently susceptible to irrational momentum effects does imply that regulatory approaches should be based on striking a balance between the benefits of market completion and market liquidity and the potential disadvantages, which may arise from inherent instabilities in liquid markets.

This study corroborates the above conclusion. The potential benefit of short-termism is very uncertain. Therefore, it should not guide regulatory policy.[304]

2 Counter-trend: Long-termism

This section (*Counter-trend: Long-termism*) analyses a recent trend against short-termism, namely the counter-trend towards long-termism.

2.1 Definition

There are two challenges in defining long-termism. First, the literature review shows that there is no clear definition of long-termism. McKinsey and Krehmeyer have provided ballpark definitions of "long-term."[305] Barton and Wiseman have defined "long-term capitalism".[306] Even if authors insert long-termism in the capitalist system,[307] it is another object of study. McPherson has defined the term "long-term investor".[308]

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[304] Thakor (2016) put forward a second benefit of short-termism. In his view, short-termism may (i) allow CEOs to identify bad middle managers (who could otherwise "hide" behind the forecast of future good results of an ongoing project) and thereby (ii) allow the company to mitigate potential losses with bad projects. I differentiate my opinion from Thakor's in that I argue that it is possible to set shorter-term milestones within a long-term project. For instance, while the development of a new product (i.e. innovation) may require several years, a CEO may request the first prototype to be presented in six months, testing to start nine months and consumer feedback to be provided in twelve months. A line of research that criticises shorter-term milestones linked with long-term objectives has not been pursued by other authors. Again, this study opposes to excessive short-termism, but accepts that certain short-term decisions are necessary for listed companies.

[305] McKinsey (2017) and Krehmeyer (2006).

[306] Barton (2011) and Barton and Wiseman (2014). The concept of long-term capitalism resembles the patient capitalism that Jacqueline Novogratz proposes. Heery and Noon (2017) wrote the dictionary entry to describe patient capitalism as "a term sometimes applied to the capitalist systems of countries like Germany and Japan, where investors make long-term commitments of finance and are prepared to accept (in international terms) relatively low rates of return on capital. This investment strategy on the part of financiers is said to support a long-term orientation to workforce management in these countries. The latter is characterized by relatively heavy investment in training and development, secure employment, and a cooperative system of industrial relations."

[307] See section I.3.3 (*Long-term capitalism*).

[308] MacPherson (2018).

Most authors, including Rappaport,[309] have discussed how to achieve "long-term performance", "long-term value creation" and "long-term returns". A research group at the University of Cambridge has provided a wordy definition of "long-term, responsible and sustainable investment":

> investment that promotes increased long-term value creation by companies and in the economy as a whole, and more sustainable business practices by companies. Investment of this kind is characterised by a clear and disciplined investment philosophy, process and culture, rather than a rigid set of rules or criteria. It focuses principally on long-term factors that determine companies' earnings, rather than short-term factors that may predominate in determining share prices. Its time horizon is likely to be five years or more. Committed stewardship is an integral part of long-term, responsible and sustainable investment.[310]

In 2018, the European Commission stated:

> Long-termism describes the practice of making decisions that have long-term objectives or consequences. Investments into environmental and social objectives require a long-term orientation.[311]

This definition is very similar to the entry on long-termism in the *Oxford Dictionary of English*.[312] No consensus in defining long-termism in relation to equity

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[309] Rappport (2012). See also the World Economic Forum (2011), Standard & Poor (2016), Cambridge (2011) and Cambridge (2019).

[310] In 2016, the Investment Leaders Group at the Institute for Sustainability Leadership of the University of Cambridge issued a report titled *Taking the long view: A toolkit for long-term, sustainable investment mandates*. The definition is on page 3. In 2019, the group issued a second report titled *Applying the long view to investment funds: Introducing the Long-term Disclosure Framework*.

[311] Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions entitled Action Plan: Financing Sustainable Growth, dated 8 March 2018. It seems that the Commission does include environmental and social aspects as a condition for long-termism. Similarly, in the Summary of the Responses to the Public Consultation on Long-term and Sustainable Investment, dated October 2016 (document number JUST/A3), the Commission also liked long-termism with the factoring in of "environmental, social and governance (ESG) information and performance of companies or assets into investment decisions", p. 2.

[312] Stevenson (2017): "The practice of making decisions with a view to long-term objectives or consequences."

markets exists, neither among legislators nor among scholars. This lacking consensus poses a first challenge to defining the counter-trend towards long-termism.

Second, most authors have spoken about long-term orientation as something that equity markets should achieve. Few, however, have indicated how it occurs.[313] Some authors have provided examples of long-termist corporations under other designations (e.g. impact investors, responsible investors, sustainable investors, collaborative capitalists, conscious capitalists and others).[314] This also makes it difficult to define what long-termism really is.

2.1.1 Three conditions

This study addresses both challenges and proposes a working definition of long-termism. It defines long-termism as decision-making that favours long-term value creation for all stakeholders. To this end, this kind of decision-making meets three conditions: (i) extended time frame; (ii) instrumentality of profits; and (iii) fiduciary duty towards stakeholders.[315] These three conditions are construed based on the existing consensuses described below.

First condition: Extended time frame

This is the most intuitive condition. Long-term behaviour considers the consequences of decisions over a longer time span. The crucial question is what does long-term mean in terms of months or years. The answer in the literature is vague: It depends. The meaning of long-term depends on the nature of the decision, as illustrated by the types of definitions below.

Regarding **investment and other financial decisions**, the entry on "long-term" in the *Oxford Handbook of International Financial Terms*[316] states:

> 1. In bond markets, original maturities of **more than seven years**. 2. Under portfolio strategies, purchasing assets with the intention of realization after **at least a year**. 3. In terms of company balance sheets, debts with a maturity in

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[313] Examples are McKinsey (2017) and World Economic Forum (2019).
[314] For instance, Hebb (2016), Clark (2015) and Mackey (2013).
[315] Möslein (2018) did not define long-termism, but held that its political goal is longer time horizons and consideration of stakeholder interests.
[316] Moles and Terry (2005).

excess of **one year**.

Barton referred to McKinsey research to state that long-term is "the time required to invest in and build a profitable new business **at least five to seven years**."[317]

For decisions with high impact on the **environment**, the time frame must be longer. The entry on "long-term" in the *Oxford Dictionary of Environment and Conservation*[318] states "an extended period of time; in environmental terms often defined as of the order of **10–15 years**."

For decisions affecting **public health**, an even longer time frame may apply. For instance, in 2014, Novo Nordisk launched a long-term programme (together with two universities) to prevent diabetes globally. The pharmaceutical company aims to reduce the current increase in diabetes cases until 2045. This means **more than thirty years** of investment.

In conclusion, long-termism requires that decision-makers carefully examine the nature and the potential impact of a decision. On this basis, the decision-maker may determine the time frame to be considered., Barton argued that long-term cannot (as a rule) be less than two years.[319] This study corroborates his view.

Second condition: Profits are instrumental

The second condition is that decision-making considers profits instrumental. The final goal of a decision is to fulfil the company's purpose and to create value. For long-termist decision-makers, that purpose is to provide solutions that contribute to the creation of shared value for all the company's stakeholders and society at large. Profits are both a consequence and a requirement for achieving purpose. The means are the production and commercialisation of goods and services. The solutions vary from company to company, depending on economic activity. As Mayer noted:

> There is now a realisation that the purpose of business is not to produce profits; the purpose of business is to produce profitable solutions to the problems of people and planet. In the process, it produces profits. That is what successful businesses recognise. And they don't profit by producing problems for people or

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[317] Barton (2011).
[318] Park and Allaby (2017).
[319] Barton (2011).

planet.[320]

This second condition relates to "long-term value creation." By focusing on solutions, decision-makers create long-term value for the company and for all stakeholders. Mazzucato argued that it is time to place value back at the centre of economic thinking.[321] She showed that even if value is often equalled to price, prices do not reflect real value. Solving people's and the planet's problems certainly generates value, as Mayer claimed. Consequently, the purpose of the company, in the exercise of its economic activity, is to contribute to the long-term economic, environmental and societal value creation for all its stakeholders and society at large. Every decision-maker must define the solution, the value and the purpose. Hence, they should always ask: How does this decision contribute to the purpose of long-term value creation?

The condition that profits be instrumental does not affect their radical value for the company. Without profits, a company can neither exist nor prosper. Profits contribute to preserving the company's existence and its auspicious continuation. Still, short-term profit maximisation will not be pursued at the expense of long-term value creation. In this context, all decision-making becomes a careful exercise in mixing and matching the optimal amounts of (potential) profits and (potential) long-term value creation.

Third condition: Fiduciary duty towards stakeholders

Barton stated (see section I.3.3: *Long-term capitalism*) that long-term capitalism requires "organisations to serve the interests of all stakeholders." As discussed, long-termism is inserted in capitalism. Hence, the third condition relates directly to the concept of capitalism.

The rationale of capitalism lies in the existence of freedom: Free labour and free enterprise.[322] Consequently, it relies on parties choosing to engage in these two core values. To survive, capitalism needs to engage stakeholders. The tool for securing engagement is what Boltanski and Chiapello called the "spirit of capitalism."[323] They maintain that, over time, accumulating capital is not sufficient in itself, and thus necessitates a moral dimension. This study argues that even more is required. Among

320 Mayer (2019), starting at minute 9:12. See also Aschari (2019).
321 Mazzucato (2018), pp. 21 et seq.
322 This is undisputed in the literature. Regardless of how an author views capitalism (neoliberal or rather social), freedom is one of its key elements.
323 Boltanski and Chiapello (2007), pp. 485–6.

others, stakeholders need to feel that they are part of a system in order to engage in it.[324] For companies, stakeholders need to feel that they may have a voice in the company in case of decisions that affect them. This feeling grows from a sense that their interests are represented, and that they are able to participate in the markets.[325] Hence, the third condition of long-termism is that companies represent their stakeholders, i.e. that directors considers the interests of stakeholders.[326]

The first question resulting from this view is: *Who are the stakeholders* that form a team with the company? Freeman et al. defined stakeholders as "any group or individual who can affect or is affected by the achievements of the firm's objectives."[327] They distinguished a firm's primary and secondary stakeholders, as in table III.2.1.1 (*Comparison*).[328] Employees, customers, suppliers, financiers and communities are primary stakeholders. The media, government, competitors, consumer advocate groups and special interest groups are secondary stakeholders.

This study builds on Freeman et al.'s theory of stakeholders and adapts it for this study's examination of company law. To this end, I connect stakeholder theory[329] with team production. The company's team members are like Freeman et al.'s primary

324 Barack Obama repeatedly addressed this point in his speeches. Finally, he created the Obama Foundation to support young leaders in feeling part of and wanting to engage in their community.

325 The feeling of not belonging and the respective disengagement are a dangerous trend occurring in the late twenty-tens. Standing (2014) observed that the precariate class suffers most under this development. This class is the first ever in history whose level of education surpasses the level of labour it may expect to obtain. It is also the first ever in history to systematically lose its rights. The precariate is losing its civil, cultural, social, political and economic rights. It does not feel represented by its leaders (loss of political rights) and cannot produce what it is qualified to do (loss of economic rights). Barack Obama and Standing mainly talk about political engagement. I would add that this rationale also applies to political and economic engagement in the corporation.

326 A CEO of a large multinational (whose name escapes me, but whose statement I cannot forget) said something along these lines: "The truth is that the majority of the people affected by our decisions will never make it to the negotiation table, nor will they ever have someone of their own class sitting there. It is the responsibility of people fortunate enough to sit here to represent their interests in the best possible way." This was at the 46th St. Gallen Symposium in 2016.

327 Freeman et al. (2010), p. 23. For a useful categorisation of stakeholders based on managerial and stakeholder perceived determinants as well as managerial and stakeholder perceived relationship attributes, see Miles (2017). She concluded with four categories of stakeholders: Influencer, collaborator, claimant and recipient.

328 Freeman et al. (2010), p. 24.

329 As Keay (2010) observed, stakeholder theory is used as an "umbrella" concept that encompasses several normative theories, p. 4. Also Stoney and Winstanley (2001), p. 604. This study does not reflect all existing stakeholder theories, but focusses on the basic concepts developed by Freeman et al.

stakeholders: Directors (the firm)[330], shareholders (financiers)[331], employees, suppliers (including banks as suppliers of credit), customers and communities. In different degrees, they all make firm-specific investments and have interests in the company[332]. Even though the environment is not a stakeholder (i.e. it is not personified), it is concerned at the same level as primary a stakeholder because environmental law guarantees this protection.[333] Secondary stakeholders are less relevant, and hence seldom regulated, in company law.[334] Another adjustment from the concept of Freeman et al. is that the company is not the centre around which all stakeholders orbit. The company is the conjugation of all stakeholders working towards production.[335]

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330 I name directors separately from the general group of employees because the law grants directors more decision-making power. Directors are the human beings acting and deciding on behalf of the firm.

331 As explained in chapter VI (*Shareholder Directive*), the term "shareholders" in this studies refers to both direct and indirect shareholders. Direct shareholders are ones who own the shares of a listed company (often intermediaries like pension funds and other institutional investors). Indirect shareholders are the beneficiaries of a pension fund, for example.

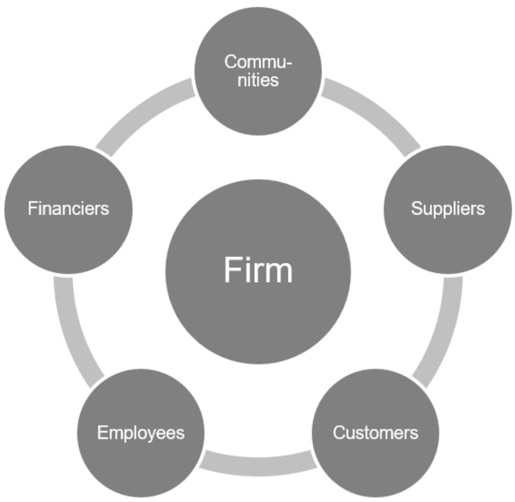
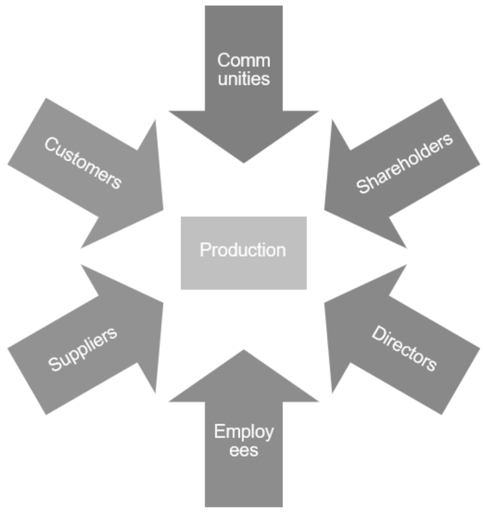
332 See section I.3.1.2 (*Team production approach*) for the normative foundation for stakeholders as team members.

333 Moreover, companies' actions affecting the environment consequently affect communities. For the purpose of this study, the environment is not seen as a legally personified subject. The analysis of the European directives in chapters V (*Takeover Directive, Merger Directive and Insolvency Directive*) through VII (*Reporting Directive*) includes affected stakeholders and implies that when the environment is affected, so are the communities related to it.

334 Hence, the regulation of secondary stakeholders lies beyond the scope of this study. Other laws do regulate them, e.g. constitutional law (right of association), civil procedure law (right of class action), administrative law (rights of the State to intervene in the economy).

335 Porter (1992) affirmed the need to "align the goal of capital providers, corporations, directors, managers, employees, customers, suppliers and society." He complemented: "It is possible to create a system of incentives and to alter the rules in a way that helps align the goals of all these constituencies, which share an inherent long-term commonality of interest", p. 77.

Table III.2.1.1 – Comparison

Stakeholders for Freeman et al.	Stakeholders as team members
	

The second question concerns the process: *How do decision-makers represent and consider the interests of their stakeholders?* The process implies a three-step exercise for the decision-maker. First, he or she identifies which stakeholders may be directly or indirectly affected by a particular decision. Specifically, the decision-maker needs to understand to which stakeholders he or she owes a duty in that particular decision.[336] Second, the decision-maker needs to identify which exact interests are at stake. [337] The final step in this process is to balance all these interests and to make a choice.[338]

The fiduciary duty mentioned above is a key component of the third condition of long-termism. It means that there is a duty "to take into account the effects of your actions on others."[339] In legal terms, this is an obligation of means. For instance, a

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336 Langford (2017) summarised the discussion on stakeholder interests and the duty of care, p. 1. Section V.3.2 (*Directors' fiduciary duties*) discusses this duty in detail.

337 Hodges and Steinholtz (2017) sustained that relationships with stakeholders must "go beyond merely one way in terms of information or consultation and demonstrate effective partnership", p. 205-6. They cited Sisodia et al. (2007) practical measures of endearment to show how such a partnership can be constructed. For example, companies should "assist suppliers to improve their quality, cost-effectiveness and environmental impact rather than just squeezing them on price" and "projecting a genuine passion for customers and emotionally connecting with them".

338 Goodpaster (1991) explained how this process takes place in detail, p. 56 et seq. Frazão (2011) also explains this process in the context of directors' duties in Brazilian company law. She stated that the duty of loyalty and the duty of care extend to the corporation's non-shareholding stakeholders, pp. 343–5 and 361–8. Mayer (2016) also described the director's duty as balancing the interests of all stakeholders, p. 9.

339 Freeman et al. (2010), p. 60.

director must take into account the interests of all affected stakeholders. It is not an obligation of result. Thus, a director need not ensure that all these interests are satisfied in every decision. Every decision-maker acts as a fiduciary for other stakeholders, ensures trustworthiness, and respects their interests. Directors offset their failure to satisfy interests in one situation with achieving satisfaction in another. It is a systemic and long-term obligation.[340]

2.1.2 Sustainability and sustainable development

The concepts of sustainability (and sustainable development) and long-termism overlap, and yet differ manifoldly. In terms of similarity, for instance, Moslein and Sorensen correctly suggested that these two concepts contrast with the shareholder primacy model.[341] They also recognised that both concepts entail longer time horizons. Union company law uses these terms side-by-side, though not as synonyms.[342] As this study concerns Union company law, it defines these concepts differently. Here, long-termism refers to decision-making processes that meet three conditions: (i) extended time frame; (ii) instrumentality of profits; and (iii) fiduciary duty towards stakeholders. While sustainability and sustainable development have become very much diluted concepts,[343] the latter has gained more precision based on the work of the United Nations.

Heads of state adopted this definition at the United Nations Conference on Environment and Development of 1992 (in Rio de Janeiro). The definition of sustainable

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340 The European Economic and Social Committee emphasised the need for regulation to address other stakeholders' engagement: "While accepting that for the most part, the proposed revisions to the Shareholder Rights Directive are aimed at fostering better long-term shareholder engagement, the EESC believes that such long-term engagement should involve all stakeholders, including employees and suggests that the Commission should reflect on how better to involve employees in the building of long-term value." Opinion dated 16 December 2014, document number 2014/C 451/14, paragraph 4.6.

341 Möslein and Sorensen (2018), p. 393.

342 The Reporting Directive mentions: "Change towards a **sustainable** global economy by combining **long-term** profitability with social justice and environmental protection." The Shareholder Directive states: "Effects on the **long-term sustainability** of Union companies and on corporate governance in the Union" and "necessary to serve the **long-term interests** and **sustainability** of the company as a whole." (emphasis added)

343 The European Commission's website on sustainability focuses primarily on sustainable development and on the agenda of the United Nations. See European Political Strategy Centre, European Commission > EPSC > Sustainability (status as of 3 July 2019, retrieved from: https://ec.europa.eu/epsc/topics/sustainability_en).

development in the Brundtland Report remains largely undisputed whenever the term is applied.[344] Here is Brundtland Report's classic definition:

> development which meets the needs of the present without compromising the ability of future generations to meet their own needs.[345]

The wording on sustainability first appeared in von Carlowitz's *Sylvicultura Oeconomica* (1713).[346] This book explained how to align forestry activity with nature to ensure "continued, durable and sustainable use." It also criticised the then short-term, profit-focused management of timber.[347] Von Carlowitz devised a principle later referred to as intergenerational equity.[348] The Brundtland Report's definition of sustainable development confirmed this principle 250 years later.

The World Summit of 2005 introduced the three additional components of sustainable development[349]: Economic development, social development and environmental protection. Introducing the three components serves an important function: To provide substance to the word "needs" in the Brundtland Report's definition. After 2005, the "needs" of present and future generations include economic, social and environmental aspects. These three components complement the principle of intergenerational equity in the definitions of 1713 and of 1992.

Voigt explained that the concept of sustainable development implies integrating environmental, economic and social objectives.[350] She reproached integration for merely balancing these three objectives. Moreover, she argued that integration must lead to ecosystem integrity. Ecosystem integrity means

> the ability of an ecosystem to function healthily, continue to provide natural goods

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344 Rao (2000), p. 87.

345 World Commission on Environment and Development (1987), p. 41.

346 Von Carlowitz, H.C.v., p. 85. Von Carlowitz drew from his own experience in German Saxony to conclude that cultivation should allow for re-growing wild trees. He argued that humans should not take more from nature than what nature is able to regenerate. This should ensure that both nature and future generations are not worse off than those living in the present.

347 Bosselmann (2016), p. 18.

348 Many legal authors, like Cane and Conaghan (2009), have seen intergenerational as a principle that "defines the rights and obligations of present and future generations with respect to the use and enjoyment of natural and cultural resources." See the entry on "intergenerational equity."

349 Resolution adopted by the General Assembly on 24 October 2005, named *2005 World Summit Outcome*, paragraph 10. See also Deipenbrock (2010), p. 2.

350 Voigt (2013), p. 147.

and services, and maintain biodiversity.[351]

Thus, integrating means combining environmental, economic and social elements to attain ecosystem integrity — or a healthy, functioning ecosystem — as a final product. The United Nations' documentation has confirmed Voigt's approach.[352]

In sum, as used in this study, sustainable development encompasses two key aspects: (a) intergenerational equity and (b) the integration of environmental, economic and social objectives to attain ecosystem integrity.[353] This indicates the differences between long-termism and sustainable development in terms of substance. In terms of function, most legal scholars see sustainable development as a guiding principle.[354] In contrast, this study defends long-termism as a mode of behaviour, as a decision-making process and as an action plan. Therefore, long-termism serves to "proceduralise" sustainability and sustainable development, i.e. to confer them practical character.

Technicalities aside, there is more commonality than independence within the terms "sustainable development", "corporate social responsibility", "sustainability" and "long-termism". The same happens with "conscious capitalism", "sustainable capitalism", "patient capitalism" and "long-term capitalism": The overall goals are very

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351 Park and Allaby (2013) defined this in the context of "ecological integrity."

352 See Resolution adopted by the General Assembly on 11 September 2012, named *The Future We Want*, paragraph 75.

353 The sustainable development goals exemplify what sustainable development ought to entail in practice. See Resolution adopted by the General Assembly on 21 October 2015, named *Transforming our world: The 2030 Agenda for Sustainable Development*, p. 14. The seventeen goals are: End poverty in all its forms everywhere, end hunger, achieve food security and improved nutrition and promote sustainable agriculture, ensure healthy lives and promote well-being for all at all ages, ensure inclusive and equitable quality education and promote lifelong learning opportunities for all, achieve gender equality and empower all women and girls, ensure availability and sustainable management of water and sanitation for all, ensure access to affordable, reliable, sustainable and modern energy for all, promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all, build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation, reduce inequality within and among countries, make cities and human settlements inclusive, safe, resilient and sustainable, ensure sustainable consumption and production patterns, take urgent action to combat climate change and its impacts, conserve and sustainably use the oceans, seas and marine resources for sustainable development, protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss, promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels, and strengthen the means of implementation and revitalize the global partnership for sustainable development.

354 Voigt (2009) and Bosselmann (2016). For authors who studied the connection between sustainability and corporate governance, see Burke et al. (2019), Elkington (2006) and Minciullo (2019).

close in their substance. Markets often re-label existing ideas and re-sell them with minor tweaks in order to make them fresher and more appealing. The technical definition of each term may be left with academics and legislators, while the private sector may focus on the outcomes.

2.2 Discourse data

The trend towards long-termism is hard to evidence. Section III.1 (*The trend towards short-termism*) has reviewed the work of scholars who criticise short-termism. They also call for a better balance between short- and long-termism. The evidence cited above shows that academics are actively engaged in favour of long-termism.

This section (*Discourse data*) presents relevant data about market participants and their discourse. The starting point was selecting market participants and opinion-shapers.[355] The selected market participants and opinion-shapers are think tanks, intergovernmental organisations, financial institutions, large listed companies, consulting companies, accounting companies, law firms and rating agencies. Data were gathered directly from the websites of the selected organisations. To understand the current picture of long-termism, data were collected from the twenty-tens.[356] For an overview, see table III.2.2 (*Discourse data*).

Data analysis shows that long-termism is rising to the top of the agenda of several global players. In practice, this means that global leaders are discussing long-term behaviour.[357] For instance, large listed companies are including long-term planning in their strategy, financial institutions are emphasising the benefits of long-term investments, and rating agencies are defending a shift towards long-termism. Financial institutions are also engaging in voluntary commitments to act in the "best long-term

[355] Roe and Bowdren presented discourse data in a similar manner. Roe also looked at Delaware courts, which I have excluded here. The present study does not address court decisions, as section VIII.3 (*Limitations and opportunities*) explains. Roe and Bowdren included information on how the media condemns short-termism. They do not, however, look specifically at market participants, so my data complement theirs. I look at think tanks, financial institutions, large corporations, consulting companies, accounting companies, and rating agencies. As to the specific participants, I have chosen ones either large in asset volume, famous and far-reaching (based on the number of Instagram followers) or most often mentioned in the media. Business schools are also relevant opinion shapers. They are excluded here because of lack of available information online.

[356] This discourse data is not conclusive empirical evidence, because it follows neither the rigorous method of econometrics nor that of discourse analysis.

[357] Fairfax (2007) concluded that corporate rhetoric has a concrete impact on corporate behaviour, based on empirical research and social psychology literature.

interests" of their beneficiaries[358]. Nevertheless, each selected group still includes organisations that pay no attention to long-termism. The long-termist front-runners remain a minority among large listed companies and financial institutions. Some organisations do not talk about long-termism as defined here. However, all those organisations that do not address long-termism directly are discussing sustainability.[359] As sustainability partly overlaps with long-termism, its discussion contributes positively to the debate. Other organisations are discussing how to combat short-termism, and are indirectly advocating a long-term approach.[360] Several organisations communicate about the interests of stakeholders[361], which also overlaps with the concept of long-termism of this study. Thus, all of the selected organisations are contributing to the increasing prominence of the long-termist discourse, either directly or indirectly.

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358 This commitment is included in the declaration of the Principles for Responsible Investment (PRI), which is increasingly gaining momentum. During the year of 2018, over 500 new organisations became signatories. In October 2019, the PRI had almost three thousand signatories. Retrieved from: https://www.unpri.org/pri/an-introduction-to-responsible-investment/what-are-the-principles-for-responsible-investment. Last accessed 28 October 2019.

359 The 2018 annual reports of the world's ten largest banks — ICBC, China Construction Bank, Agricultural Bank of China, Bank of China, JPMorgan Chase, Bank of America, Wells Fargo, Citigroup, HSBC Holdings and Mitsubishi UFJ (according to Business Insider at https://markets.businessinsider.com/news/stocks/top-10-banks-in-the-world-2019-2019-7-1028330545#10-mitsubishi-ufj-japan-146-billion1, accessed 1 August 2019) mentioned "sustainability" or "sustainable development" (only Asian banks). In 2018, of the world's ten largest non-banking companies (according to Forbes at https://www.forbes.com/global2000, accessed 1 August 2019): Apple issued an annual green bond impact report; Royal Dutch Shell, ExxonMobil, Samsung, Alphabet and the Volkswagen Group issued a sustainability report; Chevron issued a corporate responsibility report; and AT&T, Toyota Motor and Microsoft mentioned "sustainability" in their annual reports.

360 Aspen Institute (2009) and (2010), Ernst & Young (2014), Krehmeyer (2006), Mason (2015). Warren Buffett and almost thirty other business leaders signed the "Call for a More Responsible Approach to Investment and Business Management". See Aspen Institute (2009), p. 2.

361 See empirical research on the increasing rhetoric pro-stakeholders in Fairfax (2006), p. 690-8.

Table III.2.2 – Discourse data

Group	Participant	Source	Content
Accounting companies[362]	Deloitte	Opinion and report	In 2013, Deloitte published the report Drivers of long-term business value: Stakeholders, stats, and strategy. This includes data that supports long-termism. In 2019, Deloitte published Taking the long-term view, a report that discusses long-term value creation and the fourth industrial revolution.
	Ernst & Young	Reports and articles	Ernst & Young has a dedicated page on its website called Long term value. The page features twelve pieces about issues relating to long-termism published since 2018. It includes the report of the Embankment Project for Inclusive Capitalism, which presents metrics for measuring long-term value creation.
	KPMG	Reports and articles	KPMG has discussed long-termism in its reports about board supervision (2017), director compensation (2017) and reporting (2014, 2016). In 2019, KPMG issued a report called Winning strategies for the long term: How to create value and enhance competitiveness in the age of disruption and short-termism.
Consulting companies[363]	Boston Consulting Group (BCG)	Articles and surveys	BCG has published two articles based on its annual investor surveys in 2017 and 2019. Long-term value creation featured prominently among survey results: Investors favoured management that prioritised long-term value creation over short-term results (82%); and that actively considered environmental, social and governance factors (48%). Investors fear an emerging recession.

[362] Of the four largest accounting companies in the world, only PricewaterhouseCoopers has not published pieces focusing on long-termism.
[363] Of the three largest global consulting companies, only Bain & Company has not published pieces focusing on long-termism.

	McKinsey	Website, reports, articles, videos.	McKinsey has a dedicated page on its website called Long-term Capitalism: Encouraging a greater focus on long-term value creation. The site included the 2017 report Measuring the economic impact of short-termism, the 2019 article Short-term pain for long-term gain: The new CEO's dilemma, and the video Reimagining capitalism to better serve society. The website has published almost seventy pieces since 2010.
Financial institutions[364]	Berkshire Hathaway	Statement	Warren Buffet is known for his "buy and hold" strategy. As he told CNBC: "If you aren't willing to own a stock for 10 years, don't even think about owning it for 10 minutes."
	BlackRock	Letter	Larry Fink, BlackRock's CEO, writes an annual letter to CEOs. In 2019, he focused on the link between purpose and profit, as well as on the commitment to a long-term approach.
	BNP Paribas	Code of conduct	The bank issued a group code of conduct in 2016, in which it ensures solid long-term oriented management, protection of clients' long-term interests, long-term value creation. The code of conduct recommends: "Always put long-term success over short-term gain to protect the brand and reputation of the BNP Paribas Group."
	Goldman Sachs	Opinion	Goldman Sachs' EM Viewpoints – Short Term Pain, Long Term Potential Gain (2018) advocates a long-term focus in emerging markets.
	Morgan Stanley	Report	Morgan Stanley's Long-Term Conviction in a Short-Term World (2018) advocates long-term share ownership.

[364] While many global financial institutions have not published pieces focusing on long-termism, a few have discussed the problem of short-termism. See, for example, Barclays (2015).

Group	Participant	Source	Content
Intergovernmental organisations	Organisation for Economic Co-operation and Development (OECD) and G20	Project, reports, guidelines and summits	In 2012, these organisations launched a project to facilitate long-term investment by institutional investors. They have issued reports, policy guidelines, a set of principles on long-term financing and long-term growth. State leaders discuss these topics at the annual summits.
	United Nations	Report	The United Nations Global Compact (Principles for Responsible Investment) issued the report COPING, SHIFTING, CHANGING 2.0 Corporate and investor strategies for managing market short-termism (2017). The report contains twenty recommendations for companies and investors.

Group	Participant	Source	Content
Large listed companies	Amazon[365]	Report and letter	In its 2017 annual report, Amazon reprinted, as always, its 1997 letter to shareholders. In this letter, Jeff Bezos upheld the principle that "It's All About the Long Term." He emphasises long-term value creation, long-term profitability and capital management, long-term relationships, long-term vision.
	Danone	Report	The first page of the 2018 annual report states: "We are committed to creating long-term value for our shareholders as for everyone in our food system." This vision is repeated throughout the whole report.
	Natura	Report	The 2018 annual report presents the company's essence and uses the term "longevity": "The company, a living organism, is a dynamic set of relationships. Its value and longevity are linked with its ability to contribute towards the evolution of society and its sustainable development."
	Nestle	Report	The opening letter to Nestle's 2018 annual report states: "We believe that our Creating Shared Value approach enables us to optimize value for our shareholders and have a long-term positive impact on all stakeholders connected to our business. They include employees, consumers, business partners, as well as the communities in which we operate. We recognize that we need to continually earn the trust of all of our stakeholders."
	Unilever	Report	The 2018 annual report dedicates a whole section to explain how the company delivers long-term value for its stakeholders.

[365] The 2018 annual reports of the other FANGs are silent on long-term value for stakeholders. Facebook's and Netflix's reports do not talk about long-term impact. Apple's and Alphabet's reports mention long-term value creation for shareholders only.

Group	Participant	Source	Content
Law firms[366]	Allen & Overy	Articles and reports	In 2014, Allen & Overy published two pieces recommending a long-term vision for a reform of the banking system (Banking reform - we need a long-term vision and 2014 Annual review). In 2017, the firm published record results, which it explained in terms of its long-term international strategy.
	Baker McKenzie	Report	In 2019, Baker McKenzie cooperated with the World Economic Forum on the report The Modern Dilemma Balancing Short- and Long-Term Business Pressures. This report identifies long-termism in four listed companies: Hitachi, PepsiCo, Royal Bank of Canada and Royal Philips.
	Wachtell, Lipton, Rosen & Katz	Report	In 2019, this law firm published the report Some Thoughts for Boards of Directors in 2019 (Including The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth.
Rating agencies[367]	Standard & Poor's	Index and research	In 2016, S&P Dow Jones Indices launched a global index of long-term value creation, "designed to measure stocks ranking highly in global equity markets, using both proprietary sustainability and financial quality criteria." They published a research Long-Termism Versus Short-Termism: Time for the Pendulum to Shift? in the same year.

366 The two other largest global credit rating agencies Moody's and Fitch have not published pieces specifically addressing long-termism.

367 Among the largest law firms in the world, Freshfields Bruckhaus Deringer, Skadden Arps Slate Meagher & Flom, and Latham & Watkins Law have not published pieces specifically about long-termism. Clifford Chance published three pieces explaining European action and regulation relating to short-termism: *The European Long-Term Investment Fund Regulation* (2015), *The EU sustainable action plan: An update report* (2019), and ESMA *consultation on short-termism in financial markets – what are the issues for asset managers?* (2019).

Group	Participant	Source	Content
Think tanks[368]	Aspen Institute	Reports	They issued two reports in 2009 and 2010 - Overcoming Short-termism: A Call for a More Responsible Approach to Investment and Business Management and Short-Termism and U.S. Capital Markets: A Compelling Case for Change
	FCLT Global - focusing capital on the long term	Reports, tools and summit	Over twenty reports since 2014 cover topics such as Managing Risk across Multiple Time Horizons and Understanding the investment value chain. Twelve tools to encourage and assist business people to apply long-termism. For example, Contract Provisions and KPIs for Long-term Mandates and A CEO Guide to Long-term Roadmaps. In 2018, this organisation hosted a summit to discuss the topic.
	World Economic Forum	Reports, compact and annual meeting	The report The Future of Long-term Investing (2011) explains long-term investments; The Compact for Responsive and Responsible Leadership: A Roadmap for Sustainable Long-Term Growth and Opportunity (2016), signed by over 100, sets out commitments for business leaders to long-term goals of society. The report The Modern Dilemma Balancing Short- and Long-Term Business Pressures (2019) was produced in cooperation with Baker McKenzie. The forum's annual meetings debate these topics.

[368] Other think tanks, like the Roosevelt Institute and the CFA Institute, have raised awareness of the problem of short-termism.

In addition to the data mentioned in table III.2.2 (*Discourse data*), the counter-trend towards long-termism is also evident in Union law. As a reaction to the 2008 financial crisis, the European Union's legislative bodies have begun discussing long-termism. In chapter IV (*Regulatory strategy*), section IV.1.1 (*Trajectory*) refers to documents including discourse data on long-termism (among others, communications, green papers, opinions and resolutions). Section IV.1.2 (*Existing framework*) presents evidence for enacted law that addresses the three elements of long-termism defined in this study. The counter-trend described here has meanwhile reached the European Commission, the European Parliament and the Council of the European Union.

2.3 Influences

Both the discourse data and Union regulation reviewed here demonstrate that long-termism is an emerging trend. We are witnessing a change in orientation, from the short to the long term. This section (*Influences*) looks at the factors influencing this trend. It first explores the source of this preoccupation with human welfare and the planet's long-term future. Sustainability, impact investing and conscious capitalism all come from the same source. Still, the literature does not define this source unanimously. Collier summarised the debate about utilitarianism and propinquity from an ethical standpoint.[369] Indeed, it is human to want good things for others, and not only for oneself. Utilitarianism considers it ethical to pursue the greatest happiness for the greatest number. In contrast, the principle of propinquity acknowledges that we want greatness and happiness for those who are closest to us.[370] In the absence of definite ethical answers, let us turn to practical factors.

Mackey and Sisodia discussed political and psychological factors. Explaining the movement of conscious capitalism, they point to major events in the late 1980s.[371] These events, so the authors, transformed society and economic thinking in that: (a) capitalism and democracy prevailed; (b) technology connected humans, their problems and

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369 Collier (2010) discussed this in the context of the human exploitation of nature.

370 Closeness and proximity assume new dimensions in a world interconnected via the World Wide Web and globalisation.

371 Mackey and Sisodia (2013), pp. 27–29: The fall of the Berlin wall, the birth of the World Wide Web, and ageing populations in the United States, Europe and Japan. The proposition that midlife values are different from those in the earlier years of life is consistent with Mischel's and Kahneman's studies on the development of the pre-frontal cortex. This organ is responsible for the cool and slow decision-making process in the brain.

solutions; and (c) midlife values, such as caring and compassion, a greater desire for meaning and purpose, and concern for one's community and legacy, gained momentum.

Since 2015, many interview respondents have indicated that millennials[372] and climate change[373] significantly influence long-termism.[374] Millenials are controversial: They want to do good — and to do well — at the same time.[375] Deal and Levenson showed that over 80% of millennials find it important to make the world a better place and to engage in community and charity work.[376] Clark affirmed that millennials have a sense of purpose and a sense of agency: They want to improve society.[377] Deal and Levenson asked millennials around the globe why they want to make the world a better

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[372] In their dictionary, Heery and Noon (2017) defined this term as follows: "Generation Y (millennials, nexters) denotes those people born between 1981 and 1999. (...) In relation to employment, members of generation Y want to develop skills, are technologically astute, are keen to be exposed to new challenges, and have an international/global orientation. Like baby boomers they are highly driven and optimistic, but unlike them they do not value job security particularly highly. They are more positively disposed to collective action than generation X, are keen on teamworking and social aspects of work, value responsibility, and want to be involved in decision-making processes, and seek regular feedback about their performance from their managers—a tendency that previous generations might have considered to be micro-management. They are more concerned with the meaningfulness of work and working for socially responsible organizations—which has led to the term generation S being coined to emphasize this aspect." I discuss every generation here in generalised terms, based on the studied authors. These authors carried out empirical quantitative and qualitative evidence to make generalisations.

[373] Hashimzade et al. (2017) defined this term as: "A significant and lasting change in the statistical distribution of meteorological elements (e.g. wind speeds, temperatures, and precipitation) calculated for different periods but relating to the same area. The timescale of climate change may range from decades to millions of years. Climate change can result from natural factors such as changes in solar activity, long-period changes in the Earth's orbital elements (eccentricity, obliquity of the ecliptic, precession of equinoxes), or natural internal processes of the climate system. Climate change occurring through the activities of mankind is termed anthropogenic climate change." In this study, "climate change" refers to the current anthropogenic climate change.

[374] The interviews were conducted as part of research on social and environmental risk management, impact investing and capital for purpose. Some interviews involved a formal methodology and were questionnaire-based, others were less formal. Climate change and millennials were mentioned as factors influencing current trends in doing business (i.e. having a stronger long-term orientation) in the following interviews: Marcus Eguguiren, Executive Director, Global Alliance for Banking on Values; Fabian Huwyler, Head of Green Solutions, Impact Advisory and Finance of Credit Suisse in 2015; two impact investment fund managers in 2016 (these interviews were anonymised); James Manyika, Director, McKinsey Global Institute; Stephen Chambers, professor at the London School of Economics; and Marcel Fukayama, co-founder of Sistema B in 2018.

[375] Deal and Levenson (2016), p. 73. Mayer (2019) made an interesting point, starting at 25:10: "Doing well by doing good is a very dangerous concept. […] What happens if avoiding an environmental catastrophe is associated with having to earn lower profits? […] If ultimately it [*the purpose of business*] is constrained by not earning any lesser than the profits we are earning today, our ability to solve the problems [*of climate change*] is going to be very limited."

[376] Deal and Levenson (2016), p. 74.

[377] Clark (2015), p. 25.

place. They answered: 79% were passionate about this goal; 56% wanted to meet new people with the same interests; and 61% wanted to broaden their professional skills. Burstein thus defined millennials as pragmatic idealists.[378]

Various authors have compared millennials with previous generations. For instance, Dark posited that millennials are loud activists, but that Generation X[379] is actually going green and buying fair trade.[380] Generation xers are now in their forties and have become parents. Hence, they assume midlife values. Baby boomers[381] have accomplished better women's rights with the feminist movement and have fought for the civil rights movement.[382] Still, millennials see current business leaders (baby boomers and generation x) as too focused on profits, efficiency and sales.[383] The years to come will show how millennials perform when they assume the leadership positions currently held by boomers and generation x.

Let us turn to the second influence according to my interviewees: Climate change. Moslein and Sorensen also linked the attention given to long-termism with climate change. For them, social and ecological problems, like climate change, population growth, and environmental degradation, have triggered a need to conduct business differently. [384]

Climate change has established a firm grip on the economy. In 2016, MBA students at Harvard Business School created a website to explain how this happened. They posted over 900 examples of how climate change's physical manifestations and/or related

378 Burstein (2013), p. 23.

379 Heery and Noon (2017) defined this term: "Generation X describes the cohort of people born between 1965 and 1980. (...) In relation to employment, members of generation X are believed to be more cynical, pessimistic, and individualistic than the generation of baby boomers that preceded them. Importantly for organizations, generation X employees are said to be more comfortable with change and diversity; more likely to move job in search of higher salaries and new challenges (and so less committed to the organization); and more likely to have a strong sense of the need for work-life balance."

380 Dark (2017), pp. 208–212.

381 Heery and Noon (2017) defined this term: "Baby boomers are people born between 1946 and 1964. (...) In relation to employment, baby boomers are supposedly characterized by their concern for job security and a stable working environment, their loyalty to their organization, their drive, and their idealistic and optimistic outlook. The baby-boomer generation is no longer dominant in numbers in workplaces, so organizations have had to adapt to the new values and work orientations of generation X and generation Y employees."

382 Clark (2015), p. 27. More than 200 of the world's wealthiest baby boomers have joined Bill Gates' giving pledge initiative. They have agreed to donate over 50% of their wealth to philanthropy.

383 Buder et al. (2019), p. 7.

384 Möslein and Sorensen (2018), p. 439.

regulation affect companies.[385] The scientific data is alarming. In 2017, the World Economic Forum issued a report based on the research of hundreds of experts.[386] The report found that four of the top five global risks in terms of impact were environment-related: Extreme weather events, water crises, major natural disasters, and failure of climate-change mitigation and adaptation. In 2018, the United Nations' Intergovernmental Panel on Climate Change issued a new report calling for action in the public and private sector to counter climate change.[387]

The private and the public sector are attempting to tackle this issue. The private sector is responding to the effects of climate change in terms of cost-and-benefit and efficiency calculations.[388] Sullivan found that the response instead ought to be risk management.[389] Collier argued that state intervention is necessary to regulate the relationship between human (economic) activity and the environment.[390] In his opinion, economic and social prosperity can thrive only if technology and good governance regulation are applied in the relationship with nature. One example in this respect is the European Union's regulatory efforts on long-termism.[391]

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385 Climate Change Challenge. Retrieved from: https://digital.hbs.edu/platform-rctom/assignment/climate-change-challenge-2016/?sort=favorites-most&section=7752&submissions=1#assignment-submissions

386 World Economic Forum (2017), p. 4. Retrieved from: https://www.weforum.org/reports/the-global-risks-report-2017. Last accessed 24 January 2020.

387 IPCC (2018), pp. 20–5.

388 A survey of PricewaterhouseCoopers (2019) showed that only 19% of CEOs were concerned with climate change. The majority were worried about over-regulation, availability of key skills, trade conflicts, cyber threats and protectionism, p. 17.

389 Sullivan (2011).

390 Collier (2010).

391 See section IV.1 (*Legal landscape*).

2.4 Consequences

The evidence confirming the positive consequences of long-termism is scarce. This makes sense because the evidence on long-term behaviour is still only emerging[392]. In 2017, McKinsey issued a report on the performance of long-term companies. Its authors classified firms as long-term-oriented based on five indicators: Investment, earnings quality, margin growth, quarterly, management, earnings-per-share, and growth.[393] The sample comprised over six hundred listed companies in the United States.

The McKinsey report reached significant conclusions. First, from 2001 to 2014, the revenues of long-term companies grew 47% more than that of other companies. Their revenue was also less volatile during this period. Moreover, their profits grew 81% more than those of other companies. Long-term firms contributed more to employment and to economic output for the respective country. Finally, long-term firms also invested more in R&D than their counterparts, even during the financial crisis:

> long-term companies on average spent almost 50 percent more on R&D than other companies. More important, they continued to increase their R&D spending during the financial crisis while other companies cut R&D expenditure; from 2007 to 2014, average R&D spending for long-term companies grew at an annualized rate of 8.5 percent vs. 3.7 percent for other companies.[394]

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392 Proving a business case for corporate sustainability has also been a difficult goal. The difficulties regarding the the "materiality" is very similar for long-termism and for corporate sustainability. Salzmann et al. (2005) summarised the issue: "Materiality: The BCS may exist but may often be marginal in practice and/or difficult to detect. It appears to be mostly limited to the reduction of downside operational risk and to measures to increase eco-efficiency, the "no-brainers" of good (rather than corporate sustainability) management. The economic value of more sustainable business strategies is a lot more elusive, since it only materializes in the long term. Furthermore, effects on intangible assets (e.g. brand value, employee loyalty) are difficult to quantify", p. 33. See also Schreck (2009).

393 McKinsey (2017), p. 3.

394 McKinsey (2017), p. 7. Other authors confirmed the results from McKinsey's, i.e. the correlation between longer investment horizon and R&D investment and innovation. Barrot (2017) carried out quantitative research about venture capital funds that that usually have an investment horizon of ten years (i.e. long-term) and found that these funds are more willing to finance innovative companies. Such companies are then able to "grow their patent stock significantly more than companies financed by funds with a shorter horizon", p. 3021. Chen et al. (2012) found that companies with CEO contractual protection and in which CEOs felt less myopic pressure (e.g. because the investment horizon of shareholders was longer) "were less likely to cut R&D expenditures to avoid earnings decreases", p. 1.

Scholars have not yet tried to prove negative consequences of long-termism empirically. The literature has mainly focussed on the advantages of balancing short and long-term objectives[395].

The present study finds that the regulatory changes in the European Union provide evidence for the counter-trend while also being one of its consequences. These changes are examined in section IV.1 (*Legal landscape*).

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[395] See section I.1 (*Main argument*).

Chapter IV: Regulatory strategy

This chapter outlines the parameters of a regulatory strategy for long-termism in equity markets. To this end, it first reviews the trajectory leading to the regulatory framework for long-termism in force as of January 2020 (section IV.1: *Legal landscape*). It discusses the current elements of this regulatory framework and closes with the upcoming amendments to said framework. Second, it reviews the reasons for regulating, explains the available regulatory techniques and establishes some regulatory guidelines (section IV.2: *Proposed strategy*). This chapter works on step 3 of the methodology introduced in section II.4.2 (*Five-step analysis*).

1 Legal landscape

1.1 Trajectory

The Shareholder Directive is the European directive that most expressly addresses long-termism and related issues as defined in this study. In its preparatory work for this directive, the European Economic and Social Committee stated:

> Since the onset of the financial crisis, policymakers have embarked on the challenge of changing the culture in the European corporate and financial sectors away from short-term performance towards a more sustainable long-term investment perspective. Insofar as such a culture change can be achieved through regulation, then the Commission is moving in the right direction.[396]

Moreover:

> There is a sea change taking place with the emphasis on changing the culture in the European corporate and financial sectors away from short-term performance towards a more sustainable long-term investment perspective. This will not be a simple task. Insofar as such a culture change can be achieved through regulation, then the Commission is moving in the right direction.[397]

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[396] Opinion of the European Economic and Social Committee dated 16 December 2014, document number 2014/C 451/14, paragraph 1.5.

[397] Ibid, paragraph 4.7. As regards company law specifically, over twenty professors across Europe have endorsed a need to revise the existing rules "EU company and financial law may reconsider its

This sea change first became evident in Union law-making when the Commission issued a communication in 2013 encouraging "long-term, sustainable and responsible investment," as well as "transparency of information provided by businesses on social and environmental matters and respect for human rights."[398] Subsequently, other preparatory instruments marked the trajectory that resulted in the regulatory framework coming into force in January 2020. These instruments employ the phrase "long-term"[399]:

– In 2011, the Commission issued a green paper addressing the "long-term sustainability of the company," "long-term value creation," "long-term returns to shareholders," "long-term investors" and "long-term-oriented shareholders."[400] It also published a new corporate social responsibility strategy, which included building "long-term employee, consumer and citizen trust" and adopting a "long-term strategic approach to CSR."[401]
– In 2012, the European Parliament issued a resolution discussing "sustainable long-term remuneration policies," "long-term functioning of the individual and his company," "long-term viability of companies," "long-term sustainability," "long-term investment" and "long-term focus."[402] The Commission published an action plan mentioning "long-term financing," "long-term shareholder engagement,"

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institutional framework to assure that EU principles of the law are protected and corporate sustainability is effectively enforced. A better balance between shareholder interest, stakeholder interests and the general public interest appears to be required". See Autenne et al (2017), p. 10. Armour et al (2003) affirmed that UK corporate governance was in a state of flux towards stakeholders already then, p. 532.

398 Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions dated 27 October 2010, document number COM(2010) 608, proposals 16 and 38.

399 Möslein and Sorensen (2018) affirmed that, even for legislators, the concept of long-termism "is fuzzy in terms of its subjective scope (shareholders and investors vs. companies), its objective scope (economic and financial performance vs. more general persistence), and its temporal scope (medium term vs. long term). It is not always clear whether regulators are targeting a single company, markets, or society as a whole," p. 441.

400 Green Paper: The EU corporate governance framework dated 5 April 2011, document number COM(2011) 164.

401 Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions dated 25 October 2011, document number COM(2011) 681.

402 Parliament resolution on a corporate governance framework for European companies dated 29 March 2012, document number P7_TA(2012)0118.

“sustainable and long-term strategic approach to business,” “longer-term value creation” and “long-term oriented shareholders.”[403]

– In 2013, the European Parliament issued a resolution on corporate social responsibility that referred to “long-term investors” and “long-term investments.”

All these preparatory works, together with several consultations,[404] established the basis on which the Commission proposed the Shareholder Directive in April 2014. The document declared:

> the overarching objective of the current proposal to revise the Shareholder Rights Directive is to contribute to the long-term sustainability of EU companies.[405]

In the 2010s, European legislators have repeatedly used the phrase “long-term” in relation to corporate governance issues. This choice of phrase signals that the sea change mentioned above has occurred. This study espouses this decision and supports this ongoing cultural change. In this context, some clarification is called for: Union law does not define “long-termism” in the same way as this study. In fact, Union law does not provide any definition of “long-term.” Still, I argue that the objectives spelled out in legislation overlap with the three conditions of long-termism proposed in this study. Section IV.1.2 (*Existing framework*) describes this overlap.

The table below summarises the relevant documents chronologically:

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403 Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions dated 12 December 2012, document number COM(2012) 740.

404 The Commission held consultations in diverse forms: Public consultations; advice of the European Corporate Governance Forum and the London School of Economics; questionnaire to the Company Law Experts Group on each Member State’s framework on the relevant issues; technical discussions with experts from stakeholder groups (in particular pension funds, asset managers, issuer companies, retail investors, employees, proxy advisors, stock exchanges and regulators); and an academic conference on the Action Plan on Company Law and Corporate Governance, organised by the European Corporate Governance Institute.

405 Commission proposal for the Engagement Amendment dated 9 April 2014, document number COM(2014) 213 final.

Table IV.1.1 – Trajectory since 2010

Date | number | type	Subject	Relevant content
3 March 2010 | COM (2010)2020 Communication from the Commission	Europe 2020: A strategy for smart, sustainable and inclusive growth	Sets the three priorities for Europe until 2020: Smart, sustainable and inclusive growth.
27 October 2010 | COM(2010) 608 Communication from the Commission	Towards a Single Market Act: For a highly competitive social market economy: 50 proposals for improving our work, business and exchanges with one another	“European businesses demonstrate the utmost responsibility not only towards their employees and their shareholders but also towards society at large.” and “Their governance could be improved particularly as regards the composition and diversity of boards of directors, including the representation of women, long-term shareholder commitment and employee shareholding schemes.”
5 April 2011 | COM(2011) 164 Green Paper by the Commission	The EU corporate governance framework	Addresses three subjects at the heart of good corporate governance: The board of directors, shareholders, and the comply or explain approach.
13 April 2011 | COM(2011) 206 Communication from the Commission	Single Market Act: Twelve levers to boost growth and strengthen confidence: "Working together to create new growth"	Includes “social entrepreneurship” as one of the twelve levers.
25 October 2011 | COM(2011) 681 Communication from the Commission	A renewed EU strategy 2011–14 for Corporate Social Responsibility	“A strategic approach to CSR is increasingly important to the competitiveness of enterprises.”
29 March 2012 | P7_TA(2012)0118 Parliament resolution	Corporate governance framework for European companies	Highlights the importance of corporate governance to society at large.
12 December 2012 | COM(2012) 740 Communication from the Commission	Action Plan: Union company law and corporate governance: A modern legal framework for more engaged shareholders and sustainable companies	Sets three main lines of action: Enhancing transparency, engaging shareholders and supporting companies’ growth and their competitiveness.
6 February 2013 | P7_TA(2013)0049 Parliament resolution	Corporate social responsibility: Accountable, transparent and responsible business behaviour and sustainable growth	Supports transparency regarding ethical and responsible investment.
6 February 2013 | P7_TA(2013)0050 Parliament resolution	Corporate social responsibility: Promoting society's interests and a route to	Supports non-financial disclosure and long-term investment measures.

Date | number | type	Subject	Relevant content
	sustainable and inclusive recovery	
16 April 2013 | COM/2013/0207 Proposal by the Commission	Proposal for CSR Amendment	Imposes non-financial transparency as a key element of any CSR policy
11 July 2013 | 2013/C 327/10 Opinion of the European Economic and Social Committee	Proposal for CSR Amendment	Supports the proposal
9 April 2014 | COM/2014/0213 Proposal by the Commission	Proposal for Engagement Amendment	The directive's objective is to encourage long-term shareholder engagement
9 April 2014 | SWD/2014/0127 Impact assessment by the Commission Staff	Proposal for Engagement Amendment	The directive's overall goal is to contribute to the long-term sustainability of EU companies
16 December 2014 | 2014/C 451/14 Opinion of the European Economic and Social Committee	Proposal for Engagement Amendment	"The EESC believes that such long-term engagement should involve all stakeholders, including employees and suggests that the Commission should reflect on how better to involve employees in the building of long-term value." "The Commission's proposals to amend the Shareholder Rights Directive should be seen as part of a longer journey towards a more stable, sustainable corporate governance and investment environment in Europe. At the heart of these proposals is the view that if shareholders can be encouraged to take a more long-term perspective, then this will create a better operating environment for listed companies."
12 May 2015 | A8-0158/2015 Report by Committee on Legal Affairs	Proposal for Engagement Amendment	Reports the history of amendments to the directive
5 July 2017 | 2017/C 215/01 Communication from the Commission	Guidelines on non-financial reporting (methodology for reporting non-financial information)	Complements the CSR Amendment with specific recommendations on non-financial disclosure
8 March 2018 | COM/2018/097 Communication from the Commission	Action Plan: Financing Sustainable Growth	Supports long-termism

Date | number | type	Subject	Relevant content
20 June 2019 | 2019/C 209/01 Communication from the Commission	Guidelines on non-financial reporting: Supplement on reporting climate-related information	Complements the CSR Amendment with specific recommendations on climate related information

1.2 Existing framework

In Union law, the existing framework regulating corporate governance and long-termism in equity markets includes five directives: the Takeover Directive, the Merger Directive, the Shareholder Directive, the Reporting Directive and the Insolvency Directive (see description in section I.4.1.1: *Selected documents*).

As discussed, the Shareholder Directive is the European legal instrument that most expressly addresses long-termism and related issues as defined in this study. This directive speaks of "long-term shareholder engagement," "long-term financing," "long-term performance of the company," "long-term interests of the company" and "long-term sustainability of EU companies." The adjective "long-term" implies an extended time frame, which is the first condition stated in the definition of long-termism proposed in section III.2.1.1 (*Three conditions*).[406] However, the Shareholder Directive does not define these phrases and leaves considerable discretion to Member States when implementing the directive.[407]

Another significant feature of the Shareholder Directive is the establishment of a structure for shareholder engagement. Engaged ownership is a cornerstone of establishing Barton's long-term capitalism (see section I.3.3: *Long-term capitalism*). Disengaged ownership is one of the causes of short-termism (see section III.1.4: *Causes*) and the Shareholder Directive works to tackle this issue. I will review the details of shareholder engagement in chapter VI (*Shareholder Directive*).

The Reporting Directive highlights the importance of non-financial information in evaluating a company. Article 19a requires management to disclose various company data:

> ... the development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.

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[406] The three conditions are: (i) extended time frame, (ii) instrumentality of profits and (iii) fiduciary duty towards stakeholders.

[407] Member States must transpose directives into national for these instruments to become applicable towards Union nationals. Differently, regulations have direct applicability and do not need transposition into national law. See Table IV.2.2.2a (*Hard law*).

This motivates (or nudges) directors to consider these societal and environmental aspects *ex ante*, i.e. while making decisions and conducting daily business.[408] By prompting directors to think beyond the financial dimension, the Reporting Directive has the potential to encourage those responsible to consider value creation beyond price maximisation. Precisely this points to the overlap between the Reporting Directive's provisions and the second condition of long-termism.

The Takeover Directive, the Merger Directive and the Insolvency Directive create mechanisms for stakeholder protection. The Takeover Directive requires management to report on the effects of a takeover bid on both employment and the local community. It also ensures the rights of employees to opine on the bid.[409] The Merger Directive has very similar provisions, which apply to cross-border mergers.[410] The Insolvency Directive goes a step further and imposes on management the duty to consider stakeholder interests in the event of restructuring or insolvency. Their provisions for stakeholder protection link all three directives to the third condition of long-termism.

1.3 Upcoming developments

The Shareholder Directive was certainly a milestone in the path towards long-termism. Less than a year after the European Union had issued this directive, the Commission launched an even bolder initiative, the so-called Action Plan for Financing Sustainable Growth.[411] The plan had three aims, one of which was to foster "transparency and long-termism in financial and economic activity."[412] The plan included 10 actions, one of which focuses on addressing excessive short-termism, specifically "fostering sustainable corporate governance and attenuating short-termism in capital markets." This action included two non-legislative steps, which should have been completed by December 2019:

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408 Nudging is a non-coercive regulatory technique based on behavioural insights that always offers an opt-out alternative, as discussed in section IV.2.2.4 (*Nudging*).

409 Article 3(1)(b) and Article 9(5).

410 Article 5(d) and Article 7.

411 Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions entitled Action Plan: Financing Sustainable Growth, dated 8 March 2018.

412 This action plan is in line with the goals of the Action Plan on Building a Capital Markets Union, in the Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions dated 30 September 2015.

(a) Analytical and consultative work: The Commission engaged stakeholders to assess:

(i) the possible need to require corporate boards to develop and disclose a sustainability strategy, including appropriate due diligence throughout the supply chain, and measurable sustainability targets; and (ii) the possible need to clarify the rules according to which directors are expected to act in the company's long-term interest;

(b) Public consultation: The Commission invited the European Supervisory Authorities to collect evidence of undue short-termism.[413]

The results were had not been published in late January 2020. By then, it was not clear whether delegated acts relating to Action 9 (*Strengthening sustainability disclosure and accounting rule-making*) and Action 10 (*Fostering sustainable corporate governance and attenuating short-termism in capital markets*) of the Action Plan had been proposed.[414]

2 Proposed strategy

Having described the current status of long-termism regulation in Union company law, I now review the possible regulatory strategies for adapting it.

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413 Call for advice to the European Supervisory Authorities to collect evidence of undue short-term pressure from the financial sector on corporations. Available at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190201-call-for-advice-to-esas-short-term-pressure_en.pdf. Last accessed 11 September 2019.

414 See https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en#overview. Last accessed 24 January 2020. Action 10 expressly addresses the possibility of amending directors' duties: "Action 10: Fostering sustainable corporate governance and attenuating short-termism in capital markets 1.To promote corporate governance that is more conducive to sustainable investments, by Q2 2019, the Commission will carry out analytical and consultative work with relevant stakeholders to assess: (i) the possible need to require corporate boards to develop and disclose a sustainability strategy, including appropriate due diligence throughout the supply chain, and measurable sustainability targets; and (ii) the **possible need to clarify the rules according to which directors are expected to act in the company's long-term interest**. 2.The Commission invites the ESAs to collect evidence of undue short-term pressure from capital markets on corporations and consider, if necessary, further steps based on such evidence by Q1 2019. More specifically, the Commission invites ESMA to collect information on undue short-termism in capital markets, including: (i) portfolio turnover and equity holding periods by asset managers; (ii) whether there are any practices in capital markets that generate undue short-term pressure in the real economy." (emphasis added)

2.1 Why regulate?

Why should this study propose that the European Union ought to regulate long-termism in equity markets? Section IV.1.1 (*Trajectory*) has suggested one possible answer: Because the European Union has decided to become a part of a general "sea change" and has issued several preparatory works in pursuit of this goal. While this answer underpins this study, it is still useful to briefly understand the current discourse surrounding the question.

Cass Sunstein, after serving as head of the Office of Information and Regulatory Affairs during the first term of the Obama presidency, offered an interesting analysis of John Stuart Mill's view of state action and his own rationale for regulating (via nudging).[415] Regarding regulation, Mill's classical, late nineteenth century liberalism holds that:

> the only purpose for which power may be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. His own good, either physical or mental, is not a sufficient warrant.[416]

Under this principle, the state would be permitted to regulate cases in which a person may cause harm to others. Economists also agree with this principle in the event of market failures, where the action of market actors has harmful effects on third parties (externalities).[417] On the other hand, it would not be possible to regulate any behaviour that harms those persons themselves. In response to this approach, Sunstein quotes Mill's relativism:

> good reasons for remonstrating with him [*the citizen; my insertion*], or reasoning with him, or persuading him, but not for compelling him, or visiting him with any evil, in case he do otherwise.[418]

In Sunstein's view, this relativism would grant permission to use light-touch mechanisms (i.e. nudging) in order to persuade persons to prevent their own harm. In clear-cut situations such as the protection of human health and safety, and where human

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415 Sunstein (2014), pp. 4 et seq.
416 Mill (2011), p. 26.
417 Sunstein (2014), p. 16.
418 Mill (2011), p. 26.

bias is evident, nudging is allowed under Sustein and Thaler's libertarian paternalism.[419] Human biases lead to behavioural market failures, which led Sunstein to maintain that the state must act when such failures exist.[420]

In conclusion, the state may mandate persons to avoid harming others (e.g. externalities). It may also nudge them to prevent harming themselves in case of cognitive biases of limited information and timespans. Sunstein further argued that:

> A government that nudges people in directions that reduce their welfare is acting unethically. The same is true of a government that declines to create welfare-improving nudges.[421]

Indeed, Thaler and Sunstein's recommendations for state intervention via nudging[422] do not mention the regulation of corporate governance, the subject of this study. Nevertheless, I maintain that the state is entitled to regulate long-termism in equity markets based on three grounds. First, short-sightedness or intertemporal bias leads to excessive short-termism, as discussed in section III.1.4 (*Causes*). Second, market actors harm others when engaging in excessive short-termist behaviour (see section III.1.5: *Consequences*). Finally, long-termism is inherently a matter of societal welfare, which calls for protection and intervention by the state[423].

2.2 Regulatory techniques

One cannot irrefutably affirm that a given regulatory technique contributes directly to long-termism, or to achieving any other objective.[424] Many factors affect behaviour

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419 Sunstein (2014), pp. 18 et seq. Classical libertarians criticise nudging for influencing the freedom of individuals.

420 Sunstein (2014), pp. 20 et seq. See section IV.2.2.4 (*Nudging*) for biases in regulators.

421 Sunstein (2016), p. 201.

422 Thaler and Sunstein (2008).

423 There also seems to be a demand in the market for long-termist regulation. In a 2016 public consultation on long-term and sustainable investment, the Commission received 91 responses. For example, the results confirmed: "The majority of respondents, in particular institutional investors, considered that EU financial regulation did not always fit with the specificities of long-term investment". See Summary of the Responses to the Public Consultation on Long-term and Sustainable Investment, dated October 2016 (document number JUST/A3), p.3.

424 Nevertheless, some authors have found correlations between legal architectures and compliance with corporate social responsibility. For instance, Liang and Renneboog (2017) concluded from their empirical research: "CSR scores are higher in civil law countries than in common law countries, and on average companies with a Scandinavian legal origin have the highest CSR scores." Also "CSR

towards long-termism: Regulation may manipulate some of these factors, but not all of them. Moslein and Sorensen (2018) analysed the European Commission's legislative work on long-termism and concluded that it combined a "wide and diverse array of rather subtle regulatory instruments."[425] This section (*Regulatory techniques*) discusses different regulatory techniques and reviews their benefits and disadvantages.

2.2.1 European toolbox: Debriefing

In 2017, the European Commission issued the Better Regulation Guidelines[426] and the Better Regulation Toolbox.[427] Both documents provide information on drafting European regulation.[428] Three tools specifically mention regulatory techniques, yet not especially concisely.[429]

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reflects social preferences for good corporate behavior and a stakeholder orientation, and that such social preferences are more embedded in rule-based mechanisms that restrict firm behavior *ex ante*, mechanisms that are more prevalent in civil law countries. Such rule-based managerial constraints are less common in common law countries where *ex post* settling up mechanisms (i.e., judicial resolutions) are more important," p. 896. This is consistent with previous findings that the State plays a stronger role in civil law than in common law jurisdictions. Pargendler (2018), pp. 186 et seq.

425 Möslein and Sorensen (2018), p. 439.

426 Working Document entitled "Better Regulation Guidelines," written by the Commission Staff, dated 7 July 2017, document number SWD(2017) 350.

427 Better Regulation Toolbox, which complements the Better Regulation Guidelines presented in document SWD(2017) 350.

428 In addition to tools concerning regulatory techniques, these documents provide a very detailed roadmap for policy planning, impact assessment of regulation, stakeholder consultation, preparation of regulatory proposal, implementation and transposition of Union law, monitoring and evaluation/fitness checks of implemented acts. The Commission's staff has addressed all those steps that Baldwin (2010) listed as prerequisites for achieving better regulation, such as defined policy process and *ex post* measurement, pp. 260–274.

429 In October 2012, the Commission issued a report entitled "Science for Environment Policy. Future Brief: Green Behaviour," which cites four forms of policy for encouraging green behaviour: "Regulatory–this includes mandatory tools that ban or limit certain products or behaviour, and requirements, such as mandatory labelling; economic–market-based instruments that influence purchasing decisions through taxes, incentives, subsidies, penalties or grants for green enterprises; Information–such as product labels and information on energy bills; behavioural – tools or nudges aimed at influencing consumer behaviour by leading individuals to make choices that are better for the environment." This is yet another way in which the Commission has communicated with the public about policy options and regulatory instruments. It would be useful for the public if the Commission adopted a standardised nomenclature in addressing these topics.

Table IV.2.2.1 – The European toolbox

Tool #14	Tool #18	Tool #58
"less intense measures such as 'nudging' behaviour in the desired direction"	Four policy instruments: (i) 'hard,' legally binding rules; (ii) 'soft' regulation; (iii) education and information;[430] (iv) economic instruments.[431]	Five types of regulatory alternatives: (i) self-regulation; (ii) co-regulation; (iii) market-based instruments; (iv) performance-based standards; (iii) command-and-control.

The terminology is confusing in some respects. For instance, the phrases "economic instruments" and "market-based instruments" are used separately to mean the same set of measures. Also, economic instruments (such as taxes) are found in hard, legally binding rules. Performance-based standards are not further defined in the toolbox, but apparently relate to soft law technical standards.[432] Hence, they are not a separate category. Finally, many terms are not thoroughly defined in the documentation. And yet, on the whole, the three tools provide a tangible idea of which regulatory techniques are permitted under Union law.

So far, command-and-control and nudging measures have been applied mainly in equity market regulation affecting long-termism.[433] The European Union has also used comply-or-explain regulation, a sub-category of command-and-control. In their analysis of Union law on long-termism, Moslein and Sorensen (2018) classified corporate governance rules based on their nature:

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[430] Public policy may manifest in regulatory and non-regulatory measures. According to the Commission, education and information are policy instruments. However, they are not per se regulatory techniques, as their focus is not to create rights and obligations.

[431] In the European toolbox, economic instruments or market-based instruments are different terms that mean the same thing. Both include taxes, charges, fees, fines, penalties, liability and compensation schemes, subsidies and incentives, deposit-refund systems, labelling schemes and tradeable permit schemes.

[432] For instance, the European Aviation Safety Agency issued a report entitled "A Harmonised European Approach to a Performance-Based Environment (PBE)" on performance-based oversight of technical standards for safety. Executive Directorate document number FO.GEN.00400-003 dated 1 August 2014.

[433] Chapters V (*Takeover Directive, Merger Directive and Insolvency Directive*) through VII (*Reporting Directive*) discuss these rules.

Box IV.2.2.1 - Substantive, procedural and structural rules

- **Substantive rules** aim to motivate regulatees to adopt a certain behaviour or to refrain from it by either a carrot or a stick approach. [434] For instance, the Insolvency Directive requires directors to consider the interests of all stakeholders during restructuring or insolvency.
- **Procedural rules** do not define what the behaviour should be, but create a process that favours a certain behaviour or a certain type of decision-making.[435] One example is the obligation to disclose non-financial performance in the Reporting Directive, which indirectly nudges management to perform in non-financial aspects ex ante.
- **Structural rules** create the infrastructure of decision-making bodies (e.g. board of directors) in terms of function or person.[436] For instance, there are structural rules that attribute a specific function and corresponding duties to a board member. Some benefit corporation laws mandate a benefit director or employee representation. Other structural rules stipulate personal requirements for board members, such as specific skills and expertise, independence, gender, diversity.

2.2.2 Hard and soft law

The terms hard law and soft law stem from public international law. Originally, hard law referred to treaties in full force and effect, and which were legally binding after national ratification. They contrasted with soft law, which consisted of:

> Guidelines of behaviour, such as those provided by treaties not yet in force, resolutions of the United Nations, or international conferences, which are not binding in themselves, yet amount to more than mere statements of political aspiration (they fall into a legal-political limbo between these two states).[437]

The European Union uses the same rationale to distinguish hard and soft law. Toolbox #18 clearly defines each technique under soft and hard law (according to Article 288 of the Treaty on the Functioning of the European Union), as shown in the following tables.

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[434] Möslein and Sorensen (2018), p. 421.
[435] Möslein and Sorensen (2018), p. 443.
[436] Möslein and Sorensen (2018), p. 397.
[437] Law (2018), entry "soft law."

Table IV.2.2.2a – Hard law[438]

Regulations	Directives	Decisions
- Directly applicable in all Member States and binding in their entirety. - Used most commonly where it is important to uniformly implement a policy intervention.	- Binding on the Member States to which they are addressed in respect of the result to be achieved. - The specific form and methods are left to national authorities to decide.	- Binding in their entirety on those to whom the decision is addressed (e.g. individuals, companies or Member States).

Hard law is employed for three purposes: (i) to address serious risks of societal, environmental or economic impacts, which require legal certainty and enforcement backed by sanctions; (ii) where softer or self-regulatory actions have failed; or (iii) to establish essential requirements or framework, which are later complemented by soft law instruments.[439] While hard law is mandatory and has a stronger binding force on regulatees, it requires a complicated law-making process. For this reason, it often takes longer to come into force and adapts less flexibly to market changes.[440]

In the context of long-termism, hard law may be essential to ensuring that market behaviour places neither society nor the environment at serious risk. To date, soft law instruments, such as the Principles for Responsible Investment[441] and FCLT Global's tools,[442] have been unable to drive change swiftly enough.[443]

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438 Tool #18, p. 108. https://ec.europa.eu/info/files/better-regulation-toolbox-18_en. Last accessed 30 September 2019.

439 Tool #18, p. 107. Retrieved from: https://ec.europa.eu/info/files/better-regulation-toolbox-18_en. Last accessed 30 September 2019.

440 For instance, the Shareholder Directive took more than three years to pass.

441 Retrieved from: https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment. Last accessed 30 September 2019.

442 Such as the Contract Provisions for Long-term Model for Institutional Investment Mandates. Retrieved from: https://www.fcltglobal.org/research/tools. Last accessed 30 September 2019.

443 For example, there is scientific consensus that we have not been able to mitigate climate change so far, and that any improvement requires rapid changes. According to the latest report of the Intergovernmental Panel on Climate Change, "Human activities are estimated to have caused approximately 1.0°C of global warming above pre-industrial levels, with a likely range of 0.8°C to 1.2°C. Global warming is likely to reach 1.5°C between 2030 and 2052 if it continues to increase at the current rate. (high confidence)," p. 6. See also: "Pathways limiting global warming to 1.5°C with no or limited overshoot would require rapid and far-reaching transitions in energy, land, urban and infrastructure (including transport and buildings), and industrial systems (high confidence)," p. 17. IPCC (2018)

Table IV.2.2.2b – Soft law[444]

Recommendations	Technical standards	Self-regulation	Co-regulation
Used to encourage Members, individuals or companies to act in a particular way without being binding.	Private and voluntary documents that set out specifications and other technical information with regard to products, materials, services and processes.[445]	Business or industry sectors formulate (usually with facilitation by the Commission) codes of conduct or operating constraints on their own initiative for whose enforcement they are responsible.	The Union legislator entrusts the attainment of specific policy objectives to parties that are recognised in the field.

Recommendations and technical standards are specific European regulatory instruments (as regulations, directives and decisions). Recommendations are used in two situations: (i) when there is not sufficient evidence to support mandatory rules on a behaviour, but where the evidence is sufficient to encourage this behaviour; and (ii) in policy areas where the Union only has limited competence, and where Member States have regulatory autonomy. Technical standards serve: (i) to facilitate trade among Member States, by eliminating conflicting standards among them; and (ii) to provide a "common understanding among businesses, other stakeholders and public authorities on the commonly recognised state of the art."[446]

Self-regulation and co-regulation are more general regulatory strategies. Self-regulation can be very useful for sector-specific agreements (e.g. Equator Principles for project finance[447]), as well as when the interests of the market and of society coincide,

444 Toolbox #18, pp. 109-116. Retrieved from: https://ec.europa.eu/info/sites/info/files/file_import/better-regulation-toolbox-18_en_0.pdf. Last accessed 30 September 2019. See Kass and Klampf (2015) on the normative importance of recommendations in Union law, pp. 27-28.

445 The European standardisation organisations (ESOs) are the European Committee for Standardisation (CEN), the European Committee for Electrotechnical Standardisation (Cenelec), and the European Telecommunications Standards Institute (ETSI).

446 Toolbox #18, p. 112. Retrieved from: https://ec.europa.eu/info/sites/info/files/file_import/better-regulation-toolbox-18_en_0.pdf. Last accessed 30 September 2019.

447 The Equator Principles 2019: A financial industry benchmark for determining, assessing and managing environmental and social risk in projects. Retrieved from: https://equator-principles.com. Last accessed 19 November 2019.

yet the desired behaviour is still not standard practice.[448] As a general rule, self-regulation is not enforceable soft law. However, parties may adopt the content of self-regulation instruments in a contract, and the contract would then be enforceable. Co-regulation combines hard law from the state and soft law from private organisations. It works so that the state issues a rule that references rules drafted by a non-state organisation. One example is the applicability of the rules of the International Accounting Standards Board to listed companies in the European Union.[449] Co-regulation has the interesting advantage of achieving the benefits of binding and enforceable rules (hard law) by means of flexible and case-specific provisions (soft law).[450]

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[448] Toolbox #18, p. 109. Retrieved from: https://ec.europa.eu/info/sites/info/files/file_import/better-regulation-toolbox-18_en_0.pdf. Last accessed 30 September 2019.

[449] These are the international financial reporting standards (IFRS). See Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

[450] Toolbox #18, p. 110. Retrieved from: https://ec.europa.eu/info/sites/info/files/file_import/better-regulation-toolbox-18_en_0.pdf. Last accessed 30 September 2019. With respect to corporate governance regulation, many Member States have adopted corporate governance codes, which are defined as "non-binding set of principles, standards or best practices, issued by a collective body, and relating to the internal governance of corporations." See impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, p. 80.

Box IV.2.2.2 – Legal pluralism

Legal pluralism or regulatory diversity means the combination of different regulatory strategies, techniques and instruments within the same regulatory scope, e.g. corporate governance. It has several advantages compared to regulatory strategies focusing either on hard or only on soft law:

- **Safeguard against error**: Different instruments for achieving the same objective may reach different regulatees and encompass more contexts. If done well, diversity allows the regulator to learn what works best and provides a buffer against regulatory error.[451]
- **Resilience:** If the hard-law regulation allows for opt-out choices (e.g. by opting out of long-termism requirements in soft law), it increases variability, i.e. diverse models of corporate governance, among companies and among investors.[452] Clarke has argued that this variability leads to more resilience and stability of the market as a whole.[453]

Union company law and market dynamics have to some extent harmonised corporate governance rules by combining elements of civil and common law.[454] However, Union company law is diverse. It enables different national rules to co-exist given the specific tradition, history and culture of every Member State.[455] Johnston has observed that the European Union adopted a reflexive approach to corporate governance. This approach steers decision-making without directly influencing the substance of decisions (i.e. without requiring the regulator to choose a specific company-law tradition, such as civil versus common or shareholder- versus stakeholder-centred).[456]

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[451] Romano (2014), p. 1.

[452] For Gilson (2016), "there is a trade-off between a governance system that encourages long-term firm-specific investment and one that is mutable, quickly adapting to changes in the business environment," p. 26. He claims that the United States' business environment has a high rate of change. In turn, it becomes more important that a governance system has the capacity to adapt, and the less important that this system has the ability to support long-term investment, p. 6. Gilson affirms that the long-term-investment focus of the Japanese corporate governance system works in that environment, which is much more stable and less vibrant. The United States and Japan may be considered two extremes, while Europe stands somewhere in the middle.

[453] Clarke (2016), p. 47. For a general review, see Taleb (2012), who stresses that systems are "antifragile" when their parts are variable, flexible, versatile. Fragile systems break when shaken, robust systems remain intact and antifragile systems improve with stressors and disorder, p. 32.

[454] Hopt (2002) noted that the English one-tier boards and the German two-tier boards have become more and more similar over time, as have the rules on takeover bids, pp. 107–113.

[455] Hopt (2002) identified three examples, most commonly seen in British vs. continental European nations, labour co-determination vs. shareholder value, universal banks vs. capital markets, and laws on group of companies vs. piercing the corporate veil.

[456] Johnston (2009): "Reflexive approaches seek to establish communication processes which will inform and influence decision-making by feeding information about the context in which decisions

2.2.3 Command and control

The most widespread regulatory technique is so-called command and control. Traditionally, this consists of a behavioural requirement that is imposed by law and underpinned by the threat of a penalty in case of non-compliance.[457] The required behaviour may be to perform a specific action (e.g. to disclose certain information) or to abstain from a certain action (e.g. not causing damage to the environment). Command-and-control rules are usually present in hard law, i.e. binding law issued by the state. Such rules require state enforcement, i.e. control, to ensure compliance and, if necessary, to impose penalties.

The traditional way of regulating via command and control began to be criticised in the 1970s.[458] One of the disadvantages of this technique, especially when applied to corporate governance, is that it does not provide much flexibility. It implies "either-or" types of conduct. For example, a listed company may be required to disclose its sustainability policy in the annual report, but cannot do so because the policy was not approved in the previous meeting due to lack of quorum. In a typical command-and-control scenario, the company would probably receive a fine or another form of sanction. In reality, the company's management has endeavoured as best as possible to disclose its sustainability policy, yet was unable to do so in time. The traditional model of command-and-control regulation proved to be unworkable in daily business. Besides, the model also placed a superfluous administrative burden on the state (in this example, to punish behaviour of no significant harm to the system).

The criticism that arose in the 1970s led to useful adjustments to the command-and-control technique. The "comply-or-explain" model of drafting command-and-control rules emerged in the early 1990s.[459] In this model, the regulated company has two options: Either to follow the command or to explain its inability to comply (temporarily)[460]. In the above example, the company would explain to the state why it

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are implemented, and the ongoing effect of those decisions on that context, back into the decision-making process, thereby making decisions more appropriate for that context and seeking to encourage companies to take account of their external effects," p. 3.

457 See the entry on "command and control regulation" in Cane and Conaghan (2009).

458 Ibid. For an overview of the criticism in the 1990s, see Baldwin (1997).

459 See the entry on "corporate governance" in Cane and Conaghan (2009).

460 The impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, provides an overview of the equity market in the Union defined "comply or

could not disclose its sustainability policy. It would also provide information about the steps it was taking to approve the policy as soon as possible and would be undertaking to publish it within a reasonable time frame[461].

Other adjustments have also challenged using command and control. For instance, the "new governance" school meant that new regulatory techniques were introduced in the early 2000s.[462] Black (2012) explained four of these new techniques. First, principles-based regulation uses principles as the foundations and as the goals of interpreting and applying more detailed provisions[463] (e.g. regulations establishing "integrity" as a principle of corporate governance). Second, risk-based regulation focuses on setting objectives and identifying and addressing the risks of attaining such objectives[464] (e.g. most banking regulations issued after the 2008 financial crisis). Third, meta-regulation requires regulatees to develop their own set of rules and systems of compliance[465] (e.g. a company must draft its own sustainability policy). Fourth, enrolment extends regulatory capacity to other parties[466] (e.g. the European Union made the rules of the International Accounting Standards Board binding for its Members). The first and second techniques involve a different way of drafting contents, whereas the third and fourth new techniques relate to the process of creating regulations. After

explain" as "approach taken when a company choosing to depart from a corporate governance code has to explain which parts of the corporate governance code it has departed from and the reasons for doing so."

461 In Union company law, this was the preferred option for most stakeholders. The reflection group (2016) noted that they preferred disclosure of "the company's diversity policy in large listed companies on a comply-or-explain basis (…) over a compulsory diversity policy". Several authors criticise this approach because of the lack of detailed explanations for non-compliance. Sergakis (2013) recommended a "multi-layered" supervisory mechanism "to detect poor corporate governance strategies more efficiently". Here, institutional investors must disclose "more detailed information on their opinions on investee companies' compliance with corporate governance principles, as well as details of their interaction with companies to improve current corporate strategies", p. 431. Sergakis (2015) further recommended national review panels to be in charge of "soft monitoring" of the entire chain of disclosure on "Corporate Governance Codes, Stewardship Codes and the Best Practice Principles for Shareholder Voting Research".

462 Lobel (2004) and (2012). She listed eight clusters of approaches to law-making arising from the new governance school of thought: (1) increased participation of non-state actors; (2) public–private collaboration; (3) diversity and competition within the market; (4) decentralization; (5) integration of policy domains; (6) non-coerciveness ("soft law"); (7) adaptability and constant learning; and (8) coordination. All these approaches found their way into regulation in the late 2010s.

463 Black (2012), p. 1043. In European terminology, this could be seen as self-regulation.

464 Black (2012), p. 1052.

465 Black (2012), p. 1045.

466 Black (2012), p. 1051. In European terminology, this could be seen as co-regulation.

reviewing cases where each of these techniques were applied, Black concluded that they all have flaws, as does command and control.

The European Union, like other regulatory authorities across the globe, continues to use command and control. This regulatory technique has evolved from an inflexible model to a more dynamic form. This evolved model of command and control is what this study recommends. I deduce from Black's analysis that law-making should not be a competition to determine the "best" regulatory technique. Rather, it is an exercise of weighing the costs and benefits of each technique in terms of objective, context and types of regulatees.

2.2.4 Nudging

In the 2010s, psychology and other behavioural sciences began entering public policy development in the United States, United Kingdom, Europe and other OECD countries.[467] In terms of financial market regulation, behavioural insights did not reach the European Union until 2015.[468] In December 2016, the European Economic and Social Committee issued an opinion encouraging the use of nudge in public policies.[469] Several nudging provisions have since been enacted in Union company law (particularly in the Reporting Directive and the Shareholder Directive). While implemented by governments, nudging is generally positively received by the general public.[470]

Nudging is a non-coercive regulatory technique based on behavioural insights and that always offers an opt-out alternative. Sunstein defined it as:

> initiatives that maintain freedom of choice while also steering people's decisions in the right direction (as judged by people themselves).[471]

The behavioural sciences have evidenced a series of biases adopted by humans against their own interests. In order to solve the problem, Thaler and Sunstein proposed

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467 Jones et al. (2013), p. vii, and Sunstein (2014), p. 13 discussed the rise of the "psychological state."
468 Van Cleynenbreugel (2015), p. 255.
469 Own-initiative opinion entitled "Towards applying Nudge Thinking to EU Policies" by the European Economic and Social Committee dated 15 December 2016, document number NAT/685.
470 Sunstein et al. (2018) studied several countries (including Australia, Brazil, Canada, China, Japan, Russia, South Africa, South Korea, Denmark, France, Germany, Hungary, Italy, the United Kingdom, and the United States) and found that a vast majority of their populations support the use of nudges.
471 Sunstein (2014), p. 17.

that the state consider these errors when drafting policies.[472] Specifically, the state should set up the "choice architecture," i.e. the structure in which people make choices,[473] for its regulatees to make choices that are right for them.[474] Given that nudging helps Humans (with limited rationality) and grants Econs (rational beings) their freedom of choice, "the benefits of nudging seem to be very large and the costs very small."[475]

Box IV.2.2.4 – Types of nudges

States and other institutions have employed several forms of nudging. Sunstein mentions thirteen examples,[476] which are grouped here according to Baldwin's classification of first-, second- and third-degree nudges[477]:

First-degree nudges: Avoid existing bias, System 1 →2

- Disclosure of factual information (e.g. about the caloric content of foods)
- Simplification (e.g. of applications for job training or financial aid)
- Increases in ease and convenience (e.g. through website, airport or cafeteria design)
- Reminders (e.g. of bills that are about to become due or of the availability of benefits)
- Framing and timing (e.g. issuing clear statements that people are entitled to certain benefits or sending reminders and messages at a time when those concerned are likely to be paying attention)
- Increase in salience (e.g. by making potential benefits very clear to those who might enjoy them)
- Active choosing (e.g. by asking: which retirement plan do you want? Or do you want to become an organ donor?)

[472] Sunstein and Thaler (2008).

[473] Schlag (2010), p. 913.

[474] Sunstein (2016) affirmed that "The most minimal state creates choice architecture and influences people's choices even if it seeks not to do so," p. 199. If this occurs nevertheless, he suggests that the state apply behavioural insights to the process.

[475] Schlag (2010), p. 917.

[476] Sunstein (2016), p. 16.

[477] Baldwin (2014), p. 7. Taranu and Verbeeck (2016) synthesised Baldwin's classification in relation to bias: "First-degree nudges avoid an existing bias, second-degree nudges use an existing bias towards a predictable outcome, and third-degree nudges induces new biases," p. 4. With respect to how nudges work in the cerebral Systems 1 (heuristic) and 2 (rational), the authors explain that first-degree nudges operate from System 1 towards System 2, second-degree nudges operate in System 1, and third-degree nudges operate from System 2 towards System 1, p. 4.

Second-degree nudges: Use existing bias, System 1

- Default rules (e.g. opting for green energy)
- Pre-commitment strategies (e.g. through which people agree to a particular course of conduct)

Third-degree nudges: Induce new bias, System 2 →1

- Warnings, graphic or otherwise (e.g. cigarette packages)
- Use of social norms (e.g. disclosure of how one's energy use compares to that of one's neighbours)
- Personalisation (e.g. communication that focuses on the recipient's personal situation, that specifies a personal appointment time or that informs people of potential actions)

Non-monetary rewards (e.g. public recognition)

Nudging is not a bullet-proof technique and involves two challenges in particular according to the literature. The first challenge is epistemic. Sunstein held that randomised controlled trials[478] should be used far more extensively.[479] On the other hand, Juurikkala and several other scholars have disputed the accuracy of the behavioural sciences[480]:

> Behavioural economics is not a deep and holistic theory of real, flesh-and-blood human behaviour. Rather, just like all economics, it is a simplification based on experimental findings, observations, and the like. Likewise, in psychology, there are various theories related to these findings, and our understanding of their deeper causes is limited. The practical effect (and even the existence) of various

478 Include definition.

479 Sunstein (2014), p. 11.

480 Jones et al. (2013) highlighted that behavioural scientists exaggerate their predictions: "All the work that has been done in behavioural economics so far not only recognises the more-than-rational component of human decision-making, but also a hypothesis that irrationality is not random and can be studied, analysed, predicted," p. 163. In contrast, the authors proposed a critical evaluation of behavioural governance based on Foucault's social theory, which sees expertise as a convenient fiction, power relations (time, body, space, technology) as the objects of governance, space as a geo-historical epoch and the governed subjects as transgressive, as well as historically and geographically situated. Quigley and Stokes (2015) held that the European Union is "fixated" on evidence-based, behaviour-informed policy and warned: "Despite the enthusiasm from some quarters regarding the integration of empirical work from the behavioural sciences into regulation and policy-making, there are largely unanswered questions about how (potentially) effective and appropriate (both ethically-speaking and in regulatory terms) behaviourally-informed strategies might be," p. 62.

behavioural biases and anomalies depends on a host of factors, including the specific person in question and the context.[481]

The second challenge is institutional. The state as "nudger" also consists of biased humans. Thaler and Sunstein admitted that the success of nudging depends on "the ability of the nudgers to make good guesses about what is best for the nudgees."[482] There is always a risk of incompetence and self-dealing on the part of regulators[483]. Moreover, Cserne, discussing the gap between academia and the government, emphasised "there is likely to be a significant loss and distortion of information on the way from research labs and journal articles to policymakers and legislators, judges, and bureaucrats."[484]

This limited analysis of nudging suggests that it is an excellent regulatory technique, with advantages and disadvantages like all others. I take the view that the two challenges are true for nudging, just as they are for other regulatory techniques. The state will never possess all the necessary (behaviour-related, evidence-based or not) information before passing new rules into law. The same goes for the institutional challenge, which affects not only regulation, but every public policy. The regulator needs to bear in mind these challenges as regulatory risks and to pursue appropriate actions to mitigate such risks.[485]

An obvious outstanding choice facing regulators is when to command and control (heavy regulation) and when to nudge (light-touch regulation). Three criteria might guide this decision:

(a) Time frame: For circumstances requiring rapid transformation, for instance, climate change, Moslein and Sorensen posit that "nudging alone may not be

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481 Juurikkala (2012) established that it is difficult to isolate facts and behaviours leading to an event. For example, there were almost twenty different explanations for the 2008 financial crisis: "greed, short-sightedness, investor irrationality, imprudent monetary policy (long period of artificially low interest rates), flawed government policies favouring subprime loans, insufficient accounting principles, outdated principles of banking regulation, questionable bonus practices, problematic risk management, failed corporate governance, distorted credit rating practices," p. 47.

482 Thaler and Sunstein (2008), p. 247.

483 Sanger (2013) carefully studied how emotions play a role in law-making and how legislators carry out their work with affect, including how laws are sometimes passed to cause emotions in citizens.

484 Cserne (2015), p. 287.

485 Regarding nudging, Thaler and Sunstein (2008) drafted six principles for choice architecture in an attempt to address the challenges of the task. They consider incentives, understanding mappings, favouring defaults, giving feedback, expecting error and structuring complex choices, pp. 83–100.

sufficient or fast enough to facilitate changes"[486] and that more radical solutions will be required.

(b) Costs and benefits: When the benefits of commanding clearly outweigh the costs, commanding and controlling will probably prove more effective. The same holds true if the benefits of commanding are much higher than those of nudging.[487]

(c) Information availability: Moslein and Sorensen maintained that light-touch regulation, "which leaves more freedom to individuals, require[s] less information than more intensive regulatory instruments."[488]

2.2.5 European toolbox: Simplified

Based on the present analysis, table IV.2.2.5 (*Simplified*) helps to structure the regulatory strategies, techniques and instruments existing in Union law for the purposes of corporate governance and long-termism.

Table IV.2.2.5 – Simplified

Strategies	**Regulation**	**Co-regulation**	**Self-regulation**[489]
Techniques[490]	Command-and-control, including comply-or-explain and nudging, can be used as techniques for all three strategies.		
Instruments	Economic-based instruments, performance-based instruments and general rights and duties can be used as instruments for all three strategies.		

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[486] Möslein and Sorensen (2018), p. 451. In contrast, Heidbrink (2015) did not seem concerned about urgency and defended nudging for sustainability, p. 173.

[487] Sunstein (2014), p. 142.

[488] Möslein and Sorensen (2018), p. 443. Perhaps the will to enact hard rules for sustainability and long-termism is one of the reasons why the Union tried to obtain more evidence on short-termism and its detriments. See the discussion on public consultation in section IV.1.3 (*Upcoming developments*).

[489] As discussed, self-regulation if drafted contractually may become binding and enforceable. For instance, B Corporations certified with B Lab must amend their constitutional documents and sign a "Declaration of Interdependence." Based on these binding legal undertakings, B Lab is entitled to withdraw certification from companies in default.

[490] The toolbox does not mention principle-based or risk-based regulation, but the European Union has used these techniques for corporate governance of financial institutions. The bank recovery and resolution directive (BRRD) contains risk-based rules, e.g. requiring banks to carry out "stress tests" to check the resilience of their balance sheet. CRD IV applies principle-based rules and demands "proportionality" in the remuneration of bankers.

Legend:

	Hard law: Binding and enforceable
	Hard law coupled with soft law
	Soft law: Non-binding and enforceable unless transposed into binding and enforceable contracts

2.3 Better regulation and long-termism

The Better Regulation Guidelines and the Better Regulation Toolbox offer a remarkable set of instructions and resources for Union lawmakers. For the analysis in chapters V (*Takeover Directive, Merger Directive and Insolvency Directive*) through VII (*Reporting Directive*), two kinds of instructions are especially relevant. First, those instructions that concern the assessment of costs and benefits. These form the basis of company law regulation, as well as of most European regulation.[491] Second, those instructions that concern stakeholder consultation as key to any law-making process. Considering the objective of this study, to foster long-termism in equity markets (as defined in section III.2.1: *Definition*), involving stakeholders in the rule-making process is crucial.[492] The following paragraphs explicate and summarise the respective tools for achieving this goal.[493]

2.3.1 Costs and benefits

In Union law, cost-benefit analysis is the most used tool for assessing the costs and benefits of a piece of regulation, or of a system of regulations.[494] This analysis is performed *ex ante* and *ex post* enactment. Before passing a regulation, the European

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491 Tool #57, p. 451. Retrieved from: https://ec.europa.eu/info/files/better-regulation-toolbox-57_en. Last accessed 30 September 2019.

492 The Union has a long track record of stakeholder consultation, even before starting the Better Regulation agenda. Findlay (2013) elucidated that the Commission created the concept of smart regulation, which implies regulation that delivers results in the least burdensome way. The relevant conditions are (i) looking at the policy cycle in its entirety, (ii) the Union and Member States sharing responsibilities, and (iii) considering the view of those affected, p. 70.

493 In sum, one cannot address corporate governance regulation without minimum understanding of these two fundamental components of the law-making process. However, this study does not carry out a cost benefit analysis of its recommendations, as such analysis would entail the involvement of various affected stakeholders, as well as trained economists and policy-makers.

494 Other approaches are cost-effectiveness analysis, compliance cost analysis and multicriteria analysis. Better Regulation Guidelines, p. 28.

Commission conducts an impact assessment,[495] and thereafter evaluations and/or fitness checks.[496] In adopting this analytical approach, the European Union follows the predominant opinion in legal and economic scholarship about how the law-making process should occur.[497] Sánchez-Graells called this economically informed law-making, which does not mean that the aim should maximise economic efficiency. Rather, the law-making process shall consider the economic effects of the available decisions,[498] which is precisely what the Union does.[499]

The Better Regulation Toolbox defines cost-benefit analysis as follows:

> Cost-benefit analysis (CBA) entails the monetization of all (or the most important) costs and benefits related to existing public intervention or all viable alternatives at hand.[500]

Moreover, it sets out 10 steps for CBA and to be conducted by a multidisciplinary team.[501] The final step — i.e. considering distributional and cumulative impacts — includes a relevant component for analysing long-termism. It focuses on the impacts of

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495 For impact assessments, the cost-benefit analysis is part of a comprehensive procedure aimed at answering the following questions: "1. What is the problem and why is it a problem? 2. Why should the EU act? 3. What should be achieved? 4. What are the various options to achieve the objectives? 5. What are their economic, social and environmental impacts and who will be affected? 6. How do the different options compare (effectiveness, efficiency and coherence)? 7. How will monitoring and subsequent retrospective evaluation be organised?" Better Regulation Guidelines, p. 17. Retrieved from: https://ec.europa.eu/info/law/law-making-process/planning-and-proposing-law/better-regulation-why-and-how/better-regulation-guidelines-and-toolbox_en. Last accessed 30 September 2019.

496 Better Regulation Guidelines, p. 8.

497 Sánchez-Graells (2017) noted that some authors still maintain that the *homo economicus* should be the basic assumption of law-making: "The economic analysis of law assumes that we make decisions based on our assessment of the utility we can obtain from different options and that, rationally, we will choose the option that maximises out utility," p. 171.

498 Sánchez-Graells (2017), p. 173.

499 Sunstein (2014) synthesised this as follows: "The choice of [a policy] response depends on an analysis of the consequences for people's welfare, which requires a careful assessment of both costs and benefits," p. 18.

500 Tool #57, p. 451. Retrieved from: https://ec.europa.eu/info/files/better-regulation-toolbox-57_en. Last accessed 30 September 2019.

501 Appendix to Tool #57, pp. 457–458. The ten steps are: "Decide whether CBA is the most appropriate approach; identify the full range of costs and benefits; partial or general equilibrium analysis; monetise direct costs for the public intervention in question or for all policy alternatives and calculate total direct costs; monetise direct benefits; assess indirect impacts; determine when costs and benefits occur in the life of the initiative and apply social discounting to determine net present values; present impacts and formulate the judgement on the performance of existing public intervention or the comparison of the policy options; check the robustness of the results; and consider distributional and cumulative impacts.

a regulatory instrument on Member States, on future generations, on richer and poorer sections of society and on small and medium enterprises. Hence, the Union made considering "non-monetisable" impacts integral to CBA. This choice is further substantiated in the Toolbox:

> All regulations usually aim, as an ultimate impact, to achieve some advancement in social welfare, which can be described in terms of efficiency or in others terms. These ultimate impacts encompass well-being, happiness and life satisfaction, environmental quality, and more economic goals such as GDP growth and employment.[502]

The Toolbox classifies specific costs and benefits (Table IV.2.3.1: *Costs and benefits*):

Table IV.2.3.1 – Costs and benefits

Costs[503]	**Benefits**[504]
Direct costs: Regulatory charges (e.g. fees, levies, taxes), substantive compliance costs (of private persons to comply with regulation), administrative burdens (of public authorities and private persons to comply with regulation), and hassle costs (of private persons relating to delays, redundant rules, corruption, etc.) Enforcement costs: Implementation, monitoring, enforcement and adjudication. Indirect costs: Costs for private persons and public authorities not directly targeted by the regulation in question.	Direct benefits: Improving individual well-being (e.g. health, environmental and safety); efficiency improvements (cost savings, information availability and enhanced product and service variety and quality for consumers). Indirect benefits: Spill-over effects due to third-party compliance; wider macro-economic benefits (e.g. GDP, productivity, employment, job quality); other non-monetisable benefits (e.g. protection of fundamental rights, social cohesion, reduced gender discrimination, international and national stability).

[502] Tool #58, p. 465. Retrieved from: https://ec.europa.eu/info/files/better-regulation-toolbox-58_en. Last accessed 30 September 2019.
[503] Tool #58, pp. 460-463. Retrieved from: https://ec.europa.eu/info/files/better-regulation-toolbox-58_en. Last accessed 30 September 2019.
[504] Tool #58, p. 464. Retrieved from: https://ec.europa.eu/info/files/better-regulation-toolbox-58_en. Last accessed 30 September 2019.

The above classification extends beyond the pure *homo economicus*-type of CBA. In fact, it creates a space in which the risks and concerns surrounding a regulation-oriented CBA can be addressed honestly. In *The Cost-Benefit Revolution*, Sunstein highlighted three main concerns for CBAs:

(i) **Distribution:** A CBA may find that the regulation would hurt the well-off and help the worse-off. In this scenario, the regulation might be "justified on distributive grounds even if it decreases overall welfare."[505]

(ii) **Welfare:** Sunstein maintains that regulation-oriented CBAs may struggle to disconnect from their focus on welfare. In his view, welfare (which he calls the "master value") should be what matters most.[506]

My review suggests that the European Union's decision that the ultimate aim of all regulations is to increase welfare, "which can be described in terms of efficiency or in other terms," addresses distribution and welfare, at least indirectly. As a result, distribution may support a regulation with an unfavourable CBA, while welfare may guide drafting Union law (in spite of inefficiency).

(iii) **Knowledge:**[507] despite all available methodologies, researchers and practitioners are unable to precisely measure all costs and benefits. Regulation may have unintentional effects, for better or worse. Also, several factors resist being easily turned into monetary equivalents.[508] Moreover, the European Union recognises uncertainty in this respect:

> The uncertainty which is inherent in the various estimates of costs and benefits should be explicitly recognised and quantified as far as possible.[509]

Sunstein provided four methods for how the state might tackle this uncertainty. First, it should make public consultations and understand information provided by the public. Second, it should conduct retrospective analysis of existing regulation, which may offer useful insights into drafting new laws. Third, it should use randomised

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505 Sunstein (2018), p. xiii.
506 Sunstein (2018), p. 67.
507 This issue has partly been discussed as the "epistemic challenge" of nudging. See section IV.2.2.4 (*Nudging*).
508 Sunstein (2018), p. 24.
509 Tool #57, p. 455. It offers three statistical methods for tackling the issue: Worst/best case scenario analysis, partial sensitivity analysis and Monte Carlo sensitivity analysis. Retrieved from: https://ec.europa.eu/info/files/better-regulation-toolbox-57_en. Last accessed 30 September 2019.

controlled trials more often. Fourth, it should implement "measure and react" strategies, which involve real-time assessment of the effects of policies.[510] The first two methods are feasible for corporate governance, the third requires some adaptation and the fourth has very little applicability for corporate governance regulation, which seldom generates real-time effects.

2.3.2 Stakeholder involvement

As long-termism fosters stakeholder involvement, it is crucial that the rule-making process for long-termism includes stakeholders. For Union law, this is the case. The Better Regulation Guidelines require stakeholder consultation to take place for every policy initiative in the Union.[511] The consultation is a "formal process by which the Commission collects information and views from stakeholders about its policies."[512] The purpose of such consultations is threefold: (i) to gather input and views for the initial design, evaluation or revision of a policy; (ii) to improve the evidence behind an initiative; and (iii) to understand and avoid later problems and to promote acceptance for the implementation of an initiative.[513]

The Better Regulation Toolbox provides a very detailed process for addressing the potential challenges of a consultation (e.g. helping low-influence stakeholders to participate).[514] To ensure fair and effective consultations,[515] the Better Regulation and Guidelines set out corresponding principles and minimum standards:

There are four principles for stakeholder relations:

(1) Participation: Adopt an inclusive approach by consulting as widely as possible;

(2) Openness and Accountability: Make the consultation process and how it has

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510 Sunstein (2018), pp. 82–83.

511 Better Regulation Guidelines, p. 67. Legal scholarship has not paid specific attention to the European stakeholder consultation process, while literature in other fields has offered more content.

512 Better Regulation Guidelines, p. 68.

513 Better Regulation Guidelines, p. 68.

514 Bouwen (2002) noted that the European consultation process has suffered from bias in favour of insider groups. However, Bunea (2016)'s empirical research showed that the opposite is true at the moment of input collection. Still, "the challenge of processing inclusive stakeholder participation and its goal of processing stakeholders' feedback in a systematic, scientific manner consistent with the exigencies of evidence-based policy making" remains a challenge. See also Dür et al. (2015) and Dür (2016).

515 Renda (2016) emphasised how the Union law-making process has evolved since 2002. With stakeholders in particular, consultations must take place at all phases of the policy cycle and minimum criteria have been established, p. 1.

affected policymaking transparent to those involved and to the general public; (3) Effectiveness: Consult at a time where stakeholder views can still make a difference, respect proportionality and specific restraints; (4) Coherence: Ensure consistency of consultation processes across all services as well as evaluation, review and quality control.[516]

The minimum standards for all consultations are:

(A) Clear content of the consultation process ("clarity"): All communication and the consultation document itself should be clear, concise and include all necessary information to facilitate responses;

(B) Consultation of target groups ("targeting"): When defining the target group(s) in a consultation process, the Commission should ensure that all relevant parties have an opportunity to express their opinions;

(C) Publication: The Commission should ensure adequate awareness-raising publicity and adapt its communication channels to meet the needs of all target audiences. Without excluding other communication tools, (open public) consultations should be published on the internet and announced at the "single access point";

(D) Time limits for participation ("consultation period"): The Commission should provide sufficient time for planning and responses to invitations and written contributions;

(E) Acknowledgement of feedback ("Feedback"): Receipt of contributions should be acknowledged and contributions published.

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[516] Better Regulation Guidelines, p. 69. Quittkat and Kotzian (2011) alleged that lobbying may take place via consultation, because the more privileged groups often participate in forums and consultative groups (and these tend to participate more in a given initiative and in many initiatives), pp. 56 and 68. To tackle this, the Guidelines command: "Avoid regulatory capture: The same businesses/representative organisations should not always be exclusively consulted, as this increases the risk of listening to a narrow range of interests."

Publication of contributions on the single access point replaces a separate acknowledgment if published within 15 working days.

Results of (public) consultations should be published and displayed on websites linked to the single access point on the internet and adequate feedback given on how the results of the consultation have been taken into account.[517]

For the purposes of this study, three conclusions on the subject of stakeholder engagement suffice. First, consultations must take place within regulatory initiatives concerning long-termism. Second, the description of the European process above is useful for understanding how to avoid potential biases in such consultations. Finally, I maintain that societal engagement is currently necessary to counter-balance the large multinational corporations with enormous lobbying power[518] and the States who are failing to address societal needs[519].

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517 Better Regulation Guidelines, pp. 69-70.

518 Nowrot (2006) and (2011) evidenced the influence of multinational (or transnational) corporations in international law, and also reflected upon their power in national law-making. His 2006 *Habilitation* is an outstanding work with over 1000 pages about this subject.

519 The think tank the Fund for Peace together with the magazine Foreign Policy (2005-2018) and with the news agency The New Humanitarian (2019) have issued an annual index of fragile states. The 2018 and 2019 Fragile States Index revealed that countries like the United States and Brazil were among the most worsened countries, based on a set of twelve indicators: Security apparatus, factionalized elites, group grievance, economic decline, uneven development, human flight & brain drain, state legitimacy, public services, human rights & rule of law, demographic pressures, refugees & IDPs, and external intervention (Retrieved from https://fundforpeace.org/wp-content/uploads/2019/04/9511904-fragilestatesindex.pdf. Last accessed 30 September 2019).

Interim remarks

Chapters I (*Introduction*) through IV (*Regulatory strategy*) analysed and proposed a framework into which the recommendations for new regulation on long-termism can be incorporated. Chapter I (*Introduction*) stated both the main argument for and the various counter-arguments, as well as considered the scope and the normative foundations of this study. Chapter II (*Methodology*) presented the legal methods that were applied to data analysis, as well as the ontological orientation of this study. Chapter III (*Trend and counter-trend*) reviewed short-termism and long-termism as trends, including their possible causes and consequences. Chapter IV (*Regulatory strategy*) discussed the regulatory techniques that can be applied to regulating long-termism. The next chapters analyse current regulation and make recommendations.

As discussed (Section I.4: *Scope*), other authors have made regulatory recommendations relating to long-termism in equity markets. For instance, Dallas (2012) recommended measures for combating short-termism in the United States, yet excluded stakeholders from her scope.[520] Bowdren also recommended measures for fighting short-termism, especially concerning takeovers, shareholder activism and executive compensation in the United Kingdom.[521] Here, I recommend measures for fostering long-termism (inverted logic)[522] and consider Union law. Moslein and Sorensen (2018) also recommended measures for Union law. Contrary to this study, however, they focused more on the formal approach to regulation than on the substance thereof. Finally, Willey (2018) looked at regulation worldwide, including a superficial review of Union law. Like other authors, she also recommended a regulatory approach (so-called "light touch") to short-termism as against exploring substantive measures for fostering long-termism. This study builds on the previous work of all these authors.

Chapters V (*Takeover Directive, Merger Directive and Insolvency Directive*) to VII (*Reporting Directive*) recommend measures within the scope of Union law for

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520 Dallas (2012), pp. 362 et seq.

521 Bowdren (2016), pp. 308–311.

522 The inverted logic is a personal choice, a preference to promote positive behaviour rather than deterring negative behaviour. In her book *Cultivating Conscience*, Stout (2011) discussed the law's function to promote "conscience." She defined this term as unselfish prosocial behaviour. Based on sound neuroscience and behavioural economics research, she concluded that humans are mostly prone to unselfish prosocial behaviour when favourable conditions are given.

promoting long-termism in equity markets.[523] Rather than forecasting forthcoming regulatory developments,[524] these chapters articulate which measures might be adopted to achieve this goal.[525] Gilbert summarised the current mathematics of capital markets as to "externalise all the costs, concentrate all the earnings."[526] In part, the recommendations for long-termism made here concern changing this mathematics and tackling the question about how companies, shareholders, employees and other stakeholders could adjust their behaviour.[527]

This study aims to systemically incentivise the multiple groups of stakeholders and, in doing so, to avoid loose ends.[528] The combined incentives are intended to create a virtuous cycle, where groups "push" each other towards long-termism. Therefore, the analysis in chapters V (*Takeover Directive, Merger Directive and Insolvency Directive*) to VII (*Reporting Directive*) bundles the European directives in terms of their main focus (within the overarching issue of long-termism).[529] Chapter V (*Takeover Directive, Merger Directive and Insolvency Directive*) reviews the directives that have been formulated to tackle stakeholder-related issues in situations of changing control or financial difficulty. Chapter VI (*Shareholder Directive*) examines the shareholding

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523 The existing European directives and regulations already cover sufficient aspects of company law. Hence, my recommendations aim to amend existing law rather than to enact completely new legislation.

524 Porter recommended similar measures in the 1990s. These have still not been adopted, which may suggest they are still far away from becoming a reality.

525 As the British philosopher Read (1898) put "It is better to be vaguely right than exactly wrong", p. 351.

526 Gilbert (2019) affirmed "the capital markets are our greatest opportunity" when speaking at B Corp Summit held in Amsterdam in September 2019.

527 In this sense, this study contributes to the ongoing debate on the ability of businesses to co-create solutions to the various problems facing humankind and the planet (climate change, volatile fossil fuel markets, scarce material resources, water scarcity, overpopulation, hunger and food insecurity, deforestation, the lack of social, political and economic infrastructure to support aging populations, an expanding global middle class, automation transformation, growing urbanisation, etc). See Mayer in Section III.2.1.1 (*Three conditions*), footnote 289. Clarke (2015), pp. 486–487.

528 One exception is that certain sectors may need specific rules. For instance, the financial sector is regulated separately due to its particular characteristics (e.g. systemic risk, "too big to fail," etc.) and functions (e.g. settlement of payments). This study considers general corporate governance regulation and only cites sector-specific rules by way of illustration. Moreover, loose ends may come from the lack of regulation of other areas outside the scope of the principle directives discussed here (i.e. the Takeover Directive, the Merger Directive, the Insolvency Directive, the Shareholder Directive and the Reporting Directive). For instance, taxation structures and the regulation of credit rating agencies are not directly covered.

529 Using a different approach, Möslein and Sorensen (2018) classified provisions for long-termism by incentivised group, p. 395.

chain, the behaviour of its participants and their rights and obligations. Chapter VII (*Reporting Directive*) looks at non-financial reporting as an instrument for fostering long-term behaviour.

Chapter V: Takeover Directive, Merger Directive and Insolvency Directive

This chapter discusses to which extent three key directives — the Takeover Directive, the Merger Directive and the Insolvency Directive — protect the interests of employees during critical events in a company's lifetime. Section V.1 (*Critical events*) explains the nature of critical events and provides a general overview of the directives. Section V.2 (*Skin in the game*) lays out the structure of so-called skin in the game, as a theoretical approach to understanding the asymmetries of risks and rewards faced by employees and other stakeholders during critical events[530]. It also demonstrates how the three directives cover some of the asymmetries. Section V.3 (*State of play*) discusses those rights that are normally granted to employees.[531] Section V.4 (*Recommendations*) recommends various legal adjustments with a view to safeguarding the interests of employees and other stakeholders. This chapter works on steps 4 and 5 of the methodology introduced in section II.4.2 (*Five-step analysis*).

1 Critical events

Certain critical events in a company's lifetime create significant uncertainty for stakeholders, especially employees. Such events include takeovers[532], mergers[533] (with or without a change of control), financial difficulty or imminent insolvency.[534] These

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[530] Since this theoretical approach only applies to this chapter (*Takeover Directive, Merger Directive and Insolvency Directive*), it is presented here instead of in the introductory chapters of this study.

[531] The discussion of employee' rights in this chapter does not conflict with the company-law scope of this study. For an explanation, see Section I.4.2.2 (*Beyond company law*), Sjåfjell (2009), pp. 470–471 and Johnston (2009), p. 313.

[532] The Takeover Directive defines "takeover bid" as "a public offer (other than by the offeree company itself) made to the holders of the securities of a company to acquire all or some of those securities, whether mandatory or voluntary, which follows or has as its objective the acquisition of control of the offeree company in accordance with national law," Article 2(1)(a).

[533] The Merger Directive defines "merger" as operations whereby: (a) "one or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing company, the acquiring company"; or (b) "two or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to a company that they form, the new company"; or (c) "a company, on being dissolved without going into liquidation, transfers all its assets and liabilities to the company holding all the securities or shares representing its capital," Article 119(2).

[534] The Insolvency Directive uses the term "financial difficulties" without definition. With respect to insolvency, it refers to the definitions in national laws. In financial terms, Law (2018) defines

events directly involve company directors, who have access to information and decision power. Amid such critical junctures, the Takeover Directive, the Merger Directive and the Insolvency Directive ensure that shareholders are placed in a position equivalent to that of company directors. While employees and other stakeholders (as well as the environment) are affected, they are less involved. This asymmetry, between being affected and being involved, is the main source of uncertainty for these stakeholders.[535] On the one hand, employees lack information: They do not know how their working conditions and relations will change, nor whether they will be able to keep their jobs or maintain their business relations.[536] On the other, these critical events often entail cost reductions of all sorts and changes in the company's culture, affecting a myriad of stakeholders (e.g. suppliers and other creditors), the local community and the environment.[537] The greater the company's size and the more interconnected it is with other companies, the greater the impact of such critical events will be.[538] Like all critical

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insolvency as "the inability to pay one's debts when they fall due." At this point, it is useful to clarify that this study does not conduct a thorough analysis of insolvency law. Rather, it only addresses the aspects in the Insolvency Directive that touch upon company law matters and relate to the rights of the employees and other affected stakeholders.

535 Sjåfjell (2009) reviewed empirical studies on the effects of takeovers, concluding that "the only certain beneficiaries of takeovers are those target shareholders who sell and no longer have any relationship with the company," p. 120.

536 Johnston (2009), discussing mergers and takeovers, observed that employees "have to deal with different personnel who are less likely to feel bound by informal arrangements put in place by their predecessors," p. 321. Sjåfjell (2009) mentioned "the total (psychological) lack of control and predictability experienced by many of the involved parties" and "the possibility of abrupt changes." Boltanski and Chiapello (2007) referred to this "difficulty to project oneself in the future" as a general symptom of contemporary capitalism, and an indicator of Durkheim's anomie (i.e. the lack of any normative guidance to individuals), which leads to a "development of short-term commitments in private life," pp. 421–424.

537 Cross-border takeovers and mergers may have an even greater impact on the company's culture.

538 These critical events are moments of shock, in which the structure of the company is shaken. Either because this company is being absorbed completely by another, or because this company's existence is being mixed with (or watered down by) another company, or because the company is disappearing and losing its existence. All of these are situations of transformation and involve the death of something that has existed until then and the creation of something new. There is frequently an imbalance before balance can be restored. I have acted as a lawyer in such critical events on several occasions. The long-lasting effects may imprint themselves deeply on employees worldwide, regardless of how well-intended shareholders and directors had been in the process. Examples include the "Indian steel giant" taking over the "European steel company Arcelor based in Luxembourg"; for critical reflections, see Sjåfjell (2009), pp. 118–119; the acquisition of the world's second largest cellulose producer by the conglomerate held by the Indonesian tycoon Sukanto Tanoto; the fallout of the Lehman Brothers' bankruptcy; the rescue and restructuring of Hypo Real Estate, the only German bank to be bailed out during the financial crisis; and many others. In my view, an initial public offering — albeit in a different way — is also a critical event for a company

events, takeovers, mergers, restructurings and insolvencies require careful decision-making. As discussed (Section V.2: *Skin in the game*), shareholders and directors should assume higher responsibilities in such critical events.

Critical events are common to the Takeover Directive, the Merger Directive and the Insolvency Directive.[539] A second commonality of these directives is their aim to harmonise company law.[540] They serve the purpose of strengthening the internal market by preventing distortions of resource allocation when investors decide where to place capital, or when entrepreneurs decide where to establish their companies. These directives also facilitate handling cross-border takeovers, mergers, restructurings and insolvencies in the internal market.[541] Consequently, they ensure that distortions do not further aggravate critical events.

In addition to the mentioned commonalities, the three directives present a discrete evolution. In the 2000s, the preparatory works of the Takeover Directive[542] and the Old Merger Directive,[543] as well as their recitals, discussed employee information and

and its stakeholders. The Shareholder Directive and the Reporting Directive addresses their interests after shares have been listed, as discussed in Chapters VI (*Shareholder Directive*) and VII (*Reporting Directive*).

539 Restructuring and insolvencies are more drastic events for a company in the short-term than takeovers or mergers. Nevertheless, the lack of control and uncertainty, as well as the long-term effect on employees are present in these four events.

540 Enriques (2017) affirmed that although Union company law has not fully harmonised national laws, it certainly has enabled companies to function across Members States "without facing unreasonable company-law related transaction costs," p. 777. This also includes the Shareholder Directive and the Reporting Directive. See explanatory memorandum of the Commission proposal for the Engagement Amendment dated 9 April 2014, document number COM(2014) 213 final: "Without EU norms, rules and their application would be different from Member State to Member State, which could be detrimental to the EU level playing field. Without action at EU level the problems are likely to persist and only partial and fragmented remedies are likely to be proposed at national level. It therefore results that the objectives of this amendment are such that they cannot be fulfilled by unilateral action at the level of the Member States."

541 Johnston (2009), pp. 118-123, 266-267. Timmermanns (2003), pp. 628–629.

542 See explanatory memorandum of the Commission proposal for a Directive of the European Parliament and of the Council on takeover bids (2003/C 45 E/01) dated 2 October 2002; Opinion of the European Economic and Social Committee (COM(2002) 534 final —2002/0240 (COD)) dated 14 May 2003, paras. 1.6, 1.7, 2.5.3 and 2.8.1; and recitals 13 and 23 of the Takeover Directive.

543 The reference to the "Old Merger Directive" in this study means Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies. See explanatory memorandum of the Commission proposal for a Directive of the European Parliament and of the Council on cross-border mergers of limited liability companies (COM(2003) 703 final) dated 18 November 2003; Opinion of the European Economic and Social Committee dated 28 April 2004, paras. 1.2, 2.3.1 and 3.4.4.2; and recital 12 of the Old Merger Directive.

consultation, delegated participation rights to national law, and omitted other stakeholders.[544] In 2019, the legislators involved in the preparatory works and recitals of the Insolvency Directive[545] recognised the participation of employees and their right to vote, as well as the protection of other stakeholders. Even though employee rights are common in national insolvency laws, a general duty to protect the interests of stakeholders is less common. Therefore, the recognition of other stakeholder groups represents an achievement for long-termism.

Although the three directives address critical events, they affect different companies. The Takeover Directive applies to takeovers of companies listed in the internal market, regardless of whether the takeover is cross-border or not.[546] The Merger Directive applies to merger transactions involving companies in two or more Member States, regardless of whether these companies are listed or not.[547] The Insolvency Directive applies to restructuring frameworks and insolvencies of companies registered in the internal market, regardless of whether these companies are listed or not, with the exception of financial institutions and related entities.[548] As mentioned (Section I.4.3: *Equity markets*), this study considers listed companies, which are to some extent addressed by all three directives.

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544 Recitals play an important role in Union law. They often clarify the intentions behind the rules in a directive or a regulation, as are used as interpretative guidelines. See Robertson (2010), p. 155. Klimas and Vaiciukaité's (2008) research on ECJ's practice confirmed: "Where the recital is clear, it will control an ambiguous operative provision. This means that the operative provision will be interpreted in light of the recital," p. 92. See also Humphreys et al. (2015), p. 48.

545 See explanatory memorandum of the Commission proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (COM(2016) 723 final) dated 22 November 2016; Opinion of the European Central Bank of 7 June 2017, paras. 1.3 and 1.4; Opinion of the European Committee of the Regions (2017/C 342/07) dated 12 July 2017, paras. 4, 18 and 21; Opinion of the Economic and Social Committee (2017/C 209/04) dated 29 March 2017; and recitals 1, 3, 10, 11, 23, 29, 30, 33, 43, 44, 49, 60, 61, 62, 69, 71 and 93 of the Insolvency Directive.

546 Article 1(1) of the Takeover Directive.

547 Article 118 of the Merger Directive.

548 Article 1 of the Insolvency Directive.

2 Skin in the game

Taleb and Sandis recommended the creation of so-called "skin in the game heuristics" to achieve a safe and just society.[549] In their theory, having skin means bearing the risks and the consequences of one's actions.[550] Games are life events, such as the critical events mentioned above. In this context, some aspects of the game, e.g. environmental, legal, economic, social and political conditions, are given. Still, the game develops as the players (actors) make decisions and act. The actors' behaviour creates conditions that shape the path the game takes, as well as the game itself. Some actors have skin in the game and players' rights to be informed, to be consulted, to participate (have a voice), as well to decide and act. Some players have no rights, but a lot of skin in the game. Taleb and Sandis argue that this "asymmetry in taking risks without having skin in the game" is unethical and must be corrected.[551]

This section (*Skin in the game*) applies Taleb and Sandis's theory to equity markets, specifically with respect to protecting employee interests and those of other stakeholders. Equity markets exhibit several asymmetries during critical events, many of which are not covered by law. First, shareholders reap the rewards *and* bear the risks of their investment decisions. Their risks are capped by the limited liability applicable to all listed companies. The decisions of directors affect shareholders, but corporate governance rules ensure that this asymmetry is offset.[552] Shareholders' decisions entail risks for employees and other stakeholders that shareholders do not bear. This asymmetry is not covered by law.

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549 Taleb and Sandis (2016), p. 17. "Safe" in that sense that risks are well-managed and errors can be avoided. "Just" in the sense that decision-makers also bear the consequences of their decisions. Skin in the game is heuristic because it is practical and useful to achieving its stated goal. But it is not a perfect cognitive process (if there is such a thing).

550 Taleb and Sandis (2016) confirmed that this idea is not new, p. 24. For example, Talonis law of "eye for an eye, tooth for a tooth" somehow followed the same reasoning. In this context, Taleb (2018) cites the diatribe by Sextus Empiricus *Against the Professors*: "Those who talk should do and only those who do should talk," p. 43.

551 Sandis (2012), while admitting that humans are not capable of truly altruistic actions (which, moreover, do not make us happy), insisted that the ethical behaviour of bearing the costs for the benefit of someone else's skin is humanly possible, p. 70 et. seq.

552 The legal apparatus of corporate governance (based on agency theory) serves to protect the interests of majority and minority shareholders. Shareholders have the right to appoint and dismiss directors. In fact, the rationale for shareholders' voting rights stems from their capacity as "residual claimants" and "ultimate risk bearers" of the company. See Wymeersch (2010), p. 1573, and Roth (2010), p. 69.

Second, while directors benefit from their management decisions by way of reputation and bonuses, they only face limited risks. If something goes wrong, directors might not receive a bonus, yet will not be required to pay back the losses caused by their actions unless they are sued by the company or the shareholders. Further, they partly enjoy the rewards and bear the risks of their own actions symmetrically by loss of reputation. Shareholders have the right to decide on directors' skin, and the law safeguards directors against shareholder abuse. This asymmetry is covered by law.[553] Directors have decision power over the skin of employees and other stakeholders. This asymmetry is not covered by law.

Third, employees[554] reap very limited to no rewards in a critical event. The best-case scenario is that working conditions remain unchanged in the wake of a takeover or merger, or that salary and redundancy payments will continue to be effected in case of insolvency. On the downside, employees bear the risks of losing their jobs with very little (if any) relocation assistance. These rewards and risks follow from the decisions taken by directors and shareholders. While their skin is at stake in this game, employees have little to no decision power. This is certainly the largest asymmetry gap in the law.[555]

Fourth, other stakeholders (i.e. customers, suppliers and communities) also find themselves in an asymmetrical position.[556] However, assessing the position of these

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553 The protection of directors against shareholders is a fairly recent development in United States law. In the case of Ben&Jerry's takeover by Unilever in 2000, the minority shareholders threatened to sue the directors of Ben&Jerry's for not maximising their wealth if they tried to halt the takeover; see Page & Katz (2010). The new legal form of benefit corporations confers upon directors some protection in situations like these. In 2017, 3G Capital failed to acquire British-Dutch Unilever because of a strong board of directors; see Barber (2017).

554 A note on the wording: All three directives talk about employees, yet only the Insolvency Directive includes workers. An initial systematic interpretation would lead to the conclusion that former and future employees of companies are irrelevant for both the Takeover Directive and the Merger Directive.

555 Brink (2007) presented a diagram showing the firm-specific risks taken by shareholders (money) and by employees (time and labour), p. 9. He concluded that management should focus not only on shareholders, but also on other stakeholders.

556 See Table V.2 (*Asymmetries of skin in critical-event games*). As discussed in Section III.2.1.1 (*Three conditions*), this study sees stakeholders as team members. Johnston (2009) examined in detail the literature explaining the specificity of employees' investments, pp. 74-79. The firm-specific investments of other stakeholders are more difficult to evidence, as they mostly derive from implicit contracts. Hashimzade et al. (2017) defined implicit contract as "An understanding between parties on acceptable forms of behaviour that is not part of any formal agreement. Implicit contracts arise in many social situations and have been proposed as an explanation of labour market institutions. Implicit contracts usually develop over time and represent trust between parties. For example, it has been suggested that Coca-Cola has an implicit contract with its consumers not to alter the formulation of its standard cola product."

other stakeholders in the three directives is rather difficult. The first difficulty is the ambiguous wording of the directives. This results from (a) the lack of consistency in the use of terms within company law directives; and from (b) these terms not being defined in the directives, except for one.[557] Although the three directives cover different events, they should adopt a common terminology to address other stakeholders. As seen below (Box V.2a: *Rights of other stakeholders*), other stakeholders are left with almost no rights in the three directives.

Box V.2a – Rights of other stakeholders

Takeover Directive: "Locations of the company's places of business"

Since directors must include the impact on "locations" in their takeover report, there is a nudge effect for directors to consider such locations. The term "locations" could be interpreted to include the communities, suppliers, customers, and workers in the companies' place of business. This interpretation would be based on the overarching goals of the internal market,[558] yet not on the text of the Takeover Directive itself. However, even if "locations" encompassed other stakeholders affected by the takeover, the directive does not provide them with any rights (e.g. information and consultation).

Merger Directive: "Creditors of the merging companies"

Article 99(1) aims at "an adequate system of protection of the interests of creditors of the merging companies whose claims antedate the publication of the draft terms of merger and have not fallen due at the time of such publication". This language clearly denotes creditors, who hold direct financial claims against a merging company.

Nothing in the text of the directive leads one to understand that the term "creditors" should include other stakeholders, ones with indirect rights. For instance, these could be small businesses participating in the value chain of a merging company and that may be at risk of being substituted. They could also be the local communities in the places of business of a merging company that might be affected by unemployment caused by post-merger redundancies.

557 The Insolvency Directive defines "affected parties" as creditors whose claims or interests are directly affected by a restructuring plan. This seems to be a similar concept to that of "creditors" in the Merger Directive.

558 See section I.4.2.1 (*Principles of Union company law*).

The Merger Directive gives the financial creditors the right "to apply to the appropriate administrative or judicial authority for adequate safeguards." Regarding other stakeholders, no rights are granted.

Insolvency Directive: "Affected parties" and "stakeholders"

Article 4(6) requires that the rights of any affected parties and relevant stakeholders are safeguarded if the involvement of a judicial or administrative authority in a preventive restructuring is restricted. Still, no rights are granted to either parties.

Article 19 establishes the directors' duty of directors to "have due regard" for the interests of "creditors, equity holders and other stakeholders." It is neither clear which concrete actions must be taken to fulfil the "due regard" obligation, or who is meant by "other stakeholders." Two recitals may guide the interpretation of this obligation. First, recital 3 discusses the need to liquidate non-viable businesses as quickly as possible, if — inter alia — "restructuring efforts could result in the acceleration and accumulation of losses to the detriment of creditors, workers and other stakeholders, as well as the economy as a whole." In these cases, the prompt liquidation of the business could mean the fulfilment of the obligation to have due regard for other stakeholders. Second, recital 71 states that directors should neither derive any "personal gain at the expense of stakeholders" nor give "unfair preference" to one or more stakeholders. These might also be ways in which the "due regard" obligation is fulfilled.

Recital 10 states that restructurings should be based on a "dialogue with the stakeholders." However, the directive does not provide stakeholders (other than employees and creditors) with information, consultation or participation rights.

Taleb and Sandis' theory is useful for identifying the asymmetry gaps in the directives.[559] Table V.2 (*Asymmetries of skin in critical-event games*) summarises these gaps and presents the potential to relocate skin and rights during critical events. This chapter focuses on the asymmetries faced by employees.

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[559] Adopting Taleb's theory as an epistemological framework for this chapter complements the normative foundations of this study – the corporation as a team, Rawls's principles of justice and long-term capitalism, as discussed in section I.3 (*Normative foundations*). Taleb's theory functions as a normative guide for understanding the relationships between the company and the team members. Also useful is the analysis by Cheffins (2006) of the duration of contracting, anticipated return, risk of loss, controlling power, conflict of interest and bargaining through explicit contracts of each of the company's "key participants". He defines these as shareholders, creditors, employees, directors and management.

Examining the other legal systems shows that regulatory efforts have been aimed at correcting the asymmetries in table V.2 (*Asymmetries of skin in critical-event games*). The Equator Principles[560] are a good example of how (self-)regulation[561] may cover asymmetries of rewards and risks in large infra-structure and industrial projects. In these projects, the financing banks and constructing companies have a lot of decision power on consequences that will be borne by the workers, the affected communities and the environment. In this context, the Equator Principles lay out a set of voluntary rules aimed at higher levels of symmetry. To this end, the principles prescribe tools for conducting social and environmental impact and risk assessment.

While BankTrack sees the Equator Principles as a half-empty glass,[562] the financial industry and academic literature generally have praised the efforts and achievements ever since the principles were first adopted in 2003.[563] In 2019, over a hundred financial institutions in 38 countries had agreed on ten project finance principles. These require financial institutions to report yearly on their performance along the defined lines. Many of these principles (see box V.2b: *Equator Principles*) are useful for correcting asymmetries in other critical events, such as those within the scope of the Takeover Directive, the Merger Directive and the Insolvency Directive.

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560 Retrieved from: https://equator-principles.com. Last accessed 19 November 2019.

561 See section IV.2.2.2 (*Hard and soft law*) on self-regulation.

562 Meyerstein (2015) and the BankTrack blog post "'Equator Banks, Act!' campaign leads to decision to revise the Equator Principles" dated 3 November 2017; retrieved from: https://www.banktrack.org/article/equator_ banks_act_campaign_leads_to_decision_to_revise_the_equator_principles_v. Last accessed 19 November 2019.

563 Lazarus (2015), pp. 140–141. Wörsdörfer (2015), pp. 494–495.

Box V.2b – Equator Principles

Principle 1 (Review and Categorisation) requires banks to review planned projects and to categorise A, B and C depending on the likelihood and severity of the anticipated social and environmental impacts.

Principle 2 (Environmental and Social Assessment) requires the financed party to assess the risks for and the impacts on workers, the affected communities and the environment. The financed party must also plan how to minimise, mitigate or remedy (i.e. offset) such risks and impacts.

Principle 3 (Applicable Environmental and Social Standards) requires the financed party to comply with minimum environmental and social standards, such as IFC Performance Standards on Environmental and Social Sustainability and the World Bank Group Environmental, Health and Safety Guidelines.

Principle 4 (Environmental and Social Management System and Equator Principles Action Plan) requires the financed party to draw up a plan for environmental and social management, based on the assessment of Principle 2 and aimed at compliance with Principle 3.

Principle 5 (Stakeholder Engagement) requires effective and ongoing engagement "in a structured and culturally appropriate manner" with workers, affected communities and other stakeholders (including indigenous peoples). Engagement includes "external communication, environmental and social information disclosure, participation, informed consultation, and grievance mechanisms."

Principle 6 (Grievance mechanisms) requires the financed party to establish grievance mechanisms for workers and affected communities.

Principle 7 (Independent review) requires an independent consultant to review the assessment and management of environmental and social impacts.

Principle 8 (Covenants) requires that compliance with the plan and with the standards, as well as reporting, be covenants in the finance documents.

Principle 9 (Independent Monitoring and Reporting) requires independent monitoring and reporting during the lifetime of the loan.

Principle 10 (Reporting and Transparency) specifies the disclosure requirements for the financed party during the lifetime of the loan.

Table V.2 – Asymmetries of skin in critical-event games

Team member	Rights	Influence on others' skin	Own skin (risk)	Risk management tool	Outstanding asymmetry
Directors (board)	Information, consultation and participation	Yes: Shareholders, employees and other stakeholders	Job	The risk of executives losing their job is usually covered by insurance, and relocation is often paid for.	None
Shareholders	Same as directors	Yes: Directors, employees, and other stakeholders	Financial loss	Shareholders may sell their shares and buy "better" shares anytime.	None
Employees	**Information and consultation (limited participation in case of insolvency)**	**No**	**Job and change in working conditions**	**In the event of insolvency, the risk of financial loss is partly covered.**	**While others have a strong influence on their skin, they have very little influence on their own skin.**
Suppliers	No (limited information, consultation and participation in case of insolvency)	No	Loss of contractual relations, of quality in services and products, financial loss.	In the event of insolvency, the risk of financial loss is partly covered.	Some, yet this is mostly a normal business risk

Team member	**Rights**	**Influence on others' skin**	**Own skin (risk)**	**Risk management tool**	**Outstanding asymmetry**
Customers	No (limited information, consultation and participation in case of insolvency)	No	Financial loss (mainly business-to-business customers)	Some B2B customers are contractually protected, sometimes also in case of insolvency.	Some, yet (for B2B customers) this is mostly a normal business risk.
Affected communities	No	No	Loss of employment and chain effect on related businesses	Limited influence via street manifestations, social media and other digital activism.	While others have a strong influence on their skin, they have very little influence on their own skin.

3 State of play

This section (*State of play*) analyses the current level of employee protection[564] in the three main directives examined in this chapter (*Takeover Directive, Merger Directive and Insolvency Directive*). Protection comprises three dimensions: Involvement, director's duties, compliance and enforcement.

3.1 Involvement

One way to protect the interests of employees in critical events is to grant them rights to be involved in the decision-making process.[565] Laverty advanced that employee engagement leads to auspicious results not only in critical events, but also during the implementation of the company's overall strategy.[566] Union company law recognises three levels of employee involvement: Information, consultation and participation.[567] Figures V.3a (*Takeover Directive*) to V.3c (*Insolvency Directive*) explain the involvement rights of employees chronologically for each critical event.

3.1.1 Company law directives

Union company law has been criticised for creating complexity with respect to involvement rights:

> Union company law looks like an arbitrary patchwork, like an incomplete mosaic.

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[564] As discussed in section III.2.1.1 (*Three conditions*), the team members of the company include all affected stakeholders. However, the three directives in this chapter only grant rights to employees. Hence, the analysis in this chapter also focuses on employees.

[565] Some companies drive the discussion of employee involvement to stock option plans, in the attempt to substitute political involvement with financial return. This study sustains that financial participation in profit in the form of bonuses or stock opinion plans cannot substitute involvement. See also Johnston and Morrow (2015), p. 23.

[566] Laverty (2004), p. 959. "Top managers are responsible for articulating visions and strategic plans, which should articulate these opportunities and possibilities. (…) Top managers should help employees, see their roles in "the big picture", and this logically would lead to employees understanding – and being excited about helping to achieve – the future opportunities that are open to the firm. Moreover, understanding the richness of future opportunities encourages proactiveness and personal investment in long term projects."

[567] For instance, the Council Directive 2003/72/EC of 22 July 2003, supplementing the Statute for a European Cooperative Society with regard to the involvement of employees, defined involvement of employees as "any mechanism, including information, consultation and participation, through which employees' representatives may exercise an influence on decisions to be taken within the company," Article 2(h).

Information and consultation are individual fundamental rights permitting no thresholds, and at the same time there are collective rights for European works councils, works councils and worker representation in general.[568]

Information

Figures V.3a (*Takeover Directive*) to V.3c (*Insolvency Directive*) show that employees have guaranteed rights to obtain information.[569] These include the repercussions of a takeover or merger on employment, their participation rights after a takeover or merger, and the company's economic situation in the event of financial difficulty. In the latter case (financial difficulty), information becomes even more valuable. Employees have legitimate fears, as their future depends on the company's future, which is unknown in most cases.

Because the three directives entail critical events, a reasonable flow of information must take place. The duty to inform rests on the company directors and implies a duty to carefully plan internal communication. Managers often underestimate the importance of planning internal communication, which may lead to unnecessary internal resistance.[570] Moreover, the duty implies the right of employees to demand information if the information provided is insufficient. Hence, any information that is necessary for employees "to acquaint themselves with the subject matter and to examine it" should be conveyed.[571] Reasonable flow means that information that is justifiably confidential may be withheld from employees.[572] Likelihood scenarios should also be communicated.

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568 Kowalsky (2015), p. 209.

569 Articles 3(1)(b), 6, 8(1), and 9(5) of the Takeover Directive; Articles 121 and 123 of the Merger Directive; and Articles 3(3) and (5), 4(8), 8(g) and 13 of the Insolvency Directive.

570 Union law confers extreme importance upon workers' information and consultation rights, and guarantees these rights under Article 27 of the Charter of Fundamental Rights of the European Union. For a discussion, see Malmberg et al. (2013), pp. 139–140.

571 Article 2(f) of the Directive 2002/14/EC of the European Parliament and of the Council of 11 March 2002 establishes a general framework for informing and consulting employees in the European Community.

572 For instance, the Shareholder Directive grants shareholders the right to ask questions and mandates that companies respond, subject to the "protection of confidentiality and business interests of companies." In any case, the board of directors holds a high degree of discretion in deciding which information will be passed on to employees. Belgian law requires that the board decide collegially if it will answer questions from a specific shareholder or not. To guide the process, the Belgian Financial Services and Markets Authority has issued a document specifying examples of information that must be disclosed and others whose disclosure can be delayed. See Houben and Straetmans (2016), p. 627.

With respect to flow, the Takeover Directive requires that information be readily and promptly available[573] for employees or their representatives.[574] This requirement should extend to mergers and financial difficulty, because timing is also crucial in these events.

Consultation

As regards the right to consultation, employees may provide an opinion on the takeover or the merger.[575] If they do so "in good time," such opinion will be available to shareholders. Article 13(1) of the Insolvency Directive ensures that the employee consultation rights set forth in national law or in Union law remain unaffected.

Whereas employees enjoy very broad (yet abstract) information rights, consultation is not guaranteed by any of the three directives. Ideally, an "exchange of views and establishment of dialogue between the employees' representatives and the employer" [576] should take place in the event of a takeover, a cross-border merger or financial difficulty. Beyond the right to submit written opinion, employer-employee dialogue should include a meeting where both parties may present their views.[577] The Takeover Directive, the Merger Directive and the Insolvency Directive do not envisage such meetings. Rather, they refer to other Union laws that cover consultation.

Participation

Under the company law directives, employees have no right to vote on takeover bids or mergers. Nevertheless, their participation or co-determination rights in the company resulting from a takeover or merger shall be protected "if required under

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573 Article 6 of the Takeover Directive requires informing employees when a bid is made public. Hence, employees have no advantage at all in terms of the timing of information, as they receive this at the same time as the general public. Nonetheless, the directive requires that employers be informed directly by the company, which opens up the flow of communication between them.

574 Armour and Deakin (2002) noted the issue of employee representation where no union is present. Further, representatives are chosen on an ad hoc basis where the representative's independence "is in practice open to question," p. 461. This may compromise the information and consultation process, leaving employees without due protection. The authors argued that procedural rights of representation should be regulated in detail.

575 See Article 9(5) of the Takeover Directive and Article 123 of the Merger Directive.

576 Article 2(g) of the Directive 2002/14/EC of the European Parliament and of the Council of 11 March 2002 establishes a general framework for informing and consulting employees in the European Community.

577 Such open debates may more clearly reveal potentially heterogeneous views among employees, as well as employees' financial short-term interests, which may conflict with the company's long-term interests.

national law or Union law."[578] Moreover, national law might already grant employees of one or more of the involved companies the right of representation on the board. Hence, unless the involved companies are already under the obligation to ensure employee participation, the affected employees are omitted from decision-making.[579] In the event of company restructuring, if the corresponding plans imply changes in the work organisation or in contractual relations, workers or their representative have the right to approve such plans.[580] Moreover, subject to the discretion of Member States in their national laws, workers may have the right to participate and to request preventive restructuring to be put in place.[581]

Employees have limited rights of participation during the critical events mentioned in the directives. This asymmetry should be corrected, in order to avoid that others have excessive decision-making power over employees' skin.[582] For European cooperatives, the law defines participation as:

> The influence of the body representative of the employees and/or the employees' representatives in the affairs of a legal entity by way of: The right to elect or appoint some of the members of the legal entity's supervisory or administrative organ, or the right to recommend and/or oppose the appointment of some or all of the members of the legal entity's supervisory or administrative organ.[583]

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578 Article 14 of the Takeover Directive and Articles 121(2) and Article 133 of the Merger Directive. Article 133 embodies the solution proposed by the Davignon Group, which was responsible for reviewing the directive. In practice, if the merging companies fail to agree on employee participation, the provisions existing before the merger shall continue to apply. See Teichmann (2019), p. 11.

579 Employee participation and protection vary greatly among Member States. While Portugal and Spain provide little participation, Germany confers wide-ranging involvement rights to employees. Johnston (2009) attributed the German successful model to "the combination of board level co-determination with complementary institutions like works councils, corporatist industrial relations, long-term relational banking and a system of company law which emphasises the interests of the company in itself," p. 101.

580 Article 13(2) of the Insolvency Directive.

581 Article 4(8) of the Insolvency Directive.

582 Traditionally, labour law confers upon workers the right to strike. This may work as an attempt at participation in the decision-making processes. However, strikes have become less frequent in Europe. Retrieved from: https://www.independent.co.uk/news/world/europe/the-european-countries-that-strike-the-most-french-strikes-industrial-action-map-a7063926.html. Last accessed 18 December 2019.

583 Article 2(k) of the Council Directive 2003/72/EC of 22 July 2003 supplementing the Statute for a European Cooperative Society with regard to the involvement of employees.

This definition is useful to understand employees' potential level of involvement in a company.[584] Some national laws already include participation or co-determination in daily business.[585] Having a continuous mechanism of participation facilitates employee involvement during critical events.[586] Nevertheless, employee participation and boardroom representation are debated on both sides of the Atlantic. In Europe,[587] board-level employee representatives will serve not only the interests of this group, but also general social and environmental concerns.[588] In the United States, the heterogeneity resulting from constituency directors affects internal politics and bargaining power within boards. The issue is yet to be resolved.[589]

The three figures are coded as follows: The colour blue denotes events on the timeline of a bid, merger or financial difficulty, orange represents employees' rights, and green refers to the simultaneous events during a preventive restructuring framework. One asterisk (*) denotes mandatory rules, two asterisks (**) denote rules that make reference to rights in national law or in other Union law, while three asterisks (***)

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584 Porter (1992) recommended not only participation, but also ownership: "Directors, managers, employees and even customers and suppliers should all hold positions as important corporate owners," p. 77.

585 The Switzerland-based company Haufe-Umantis allows employees to elect the CEO and to vote on the company strategy annually. A 2017 newspaper article reported: "*Er lässt seine Mitarbeiter nicht nur mitentscheiden, wer sie führt, sondern auch einmal im Jahr über die Unternehmensstrategie abstimmen. 'So können wir die kollektive Intelligenz der gesamten Firma nutzen,' sagt Stoffel. Eine der wichtigsten strategischen Entscheidungen der vergangenen Jahre war die Beteiligung des Unternehmens Haufe an der einstigen Umantis AG. Die Mitarbeiter haben damals dafür gestimmt.*" Retrieved from: https://www.zeit.de/2017/44/marc-stoffel-umantis-softwareunternehmen-schweiz-demokratie/komplettansicht. Last accessed 17 November 2019.

586 Johnston (2006) maintained that "European initiatives such as the information and consultation Directive, which aims to deal with some of the consequences of breaches of implicit contract, do not fulfil the same function as governance mechanisms, such as co-determination, which aim to support ongoing relationships," p. 111.

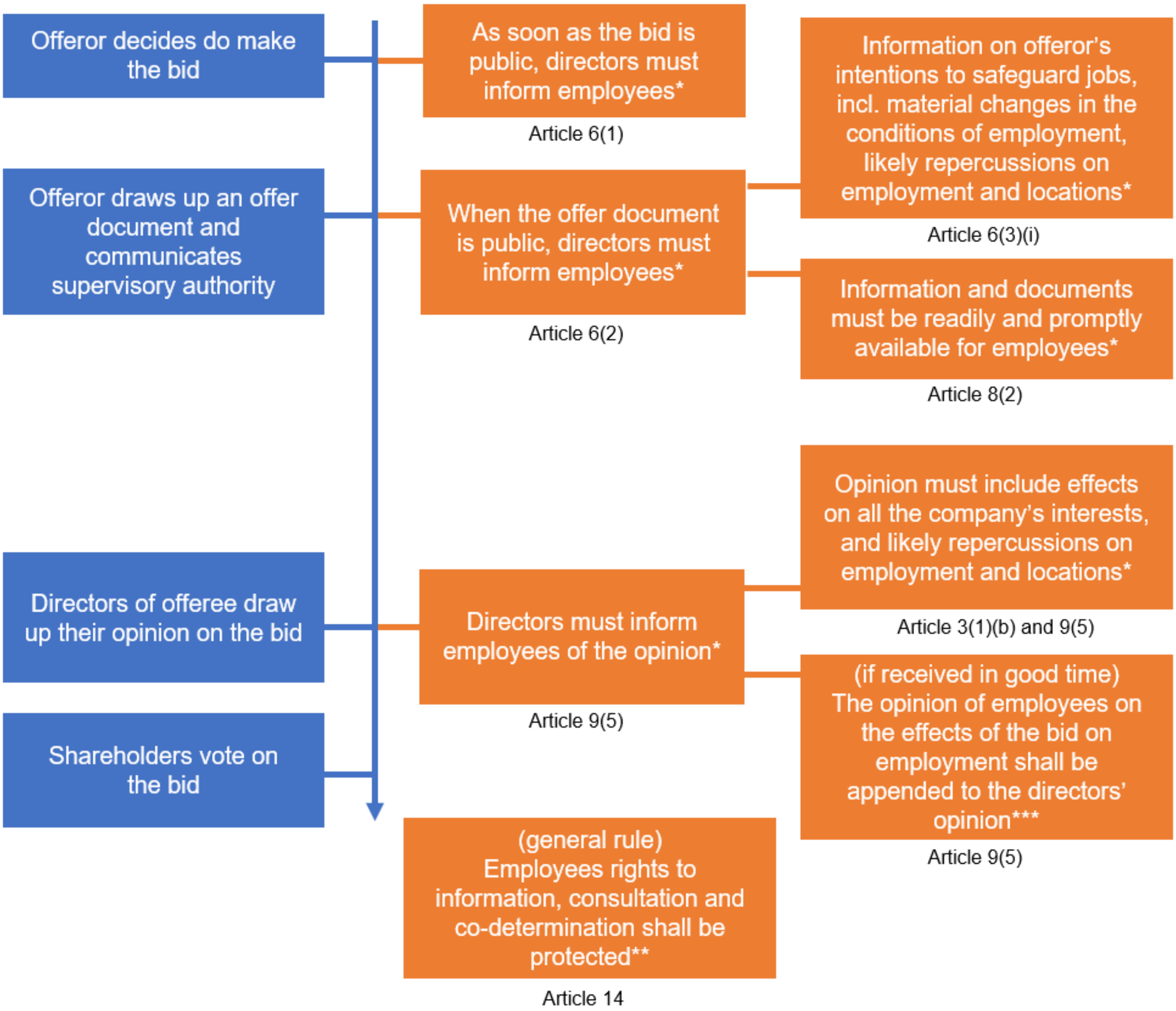
587 Gelter (2009) explained that "some legal systems endow employees with decision rights. The paradigmatic case is German codetermination, which assigns up to half of the seats on the (supervisory) board to employees (increasing in the number of the firm's employees) and thus gives limited but explicit influence to this group. A similarly intrusive system exists in the Netherlands, with more moderate employee participation systems in Austria, the Czech Republic, Slovenia, Slovakia, Hungary, Luxemburg, Denmark, Sweden, and Finland," p. 49. Sjåfjell (2009) added that France has an optional co-determination system, pp. 310 and 359.

588 Conchon and Waddington (2011), p. 107.

589 Gelter and Helleringer (2015), p. 1117. Sepe (2013) discussed constituency directors ("directors designated to the board by a particular constituency or sponsor"). These constituency directors are generally appointed to advocate for investors who are not common shareholders, such as preferred shareholders, creditors, unions, and even the federal government") as "intruders in the boardroom."

denote non-mandatory rights[590] (note that the provision contains terms such as "may," "where appropriate" or "if in good time").

Figure V.3a – Timeline of employees' rights
Takeover Directive



[590] Directives must be transposed into national law to enjoy direct applicability. Hence, provisions drafted as "options" afford Member States the discretion to adopt the provision in their own terms, or not to adopt them at all.

Figure V.3b – Timeline of employees' rights
Merger Directive

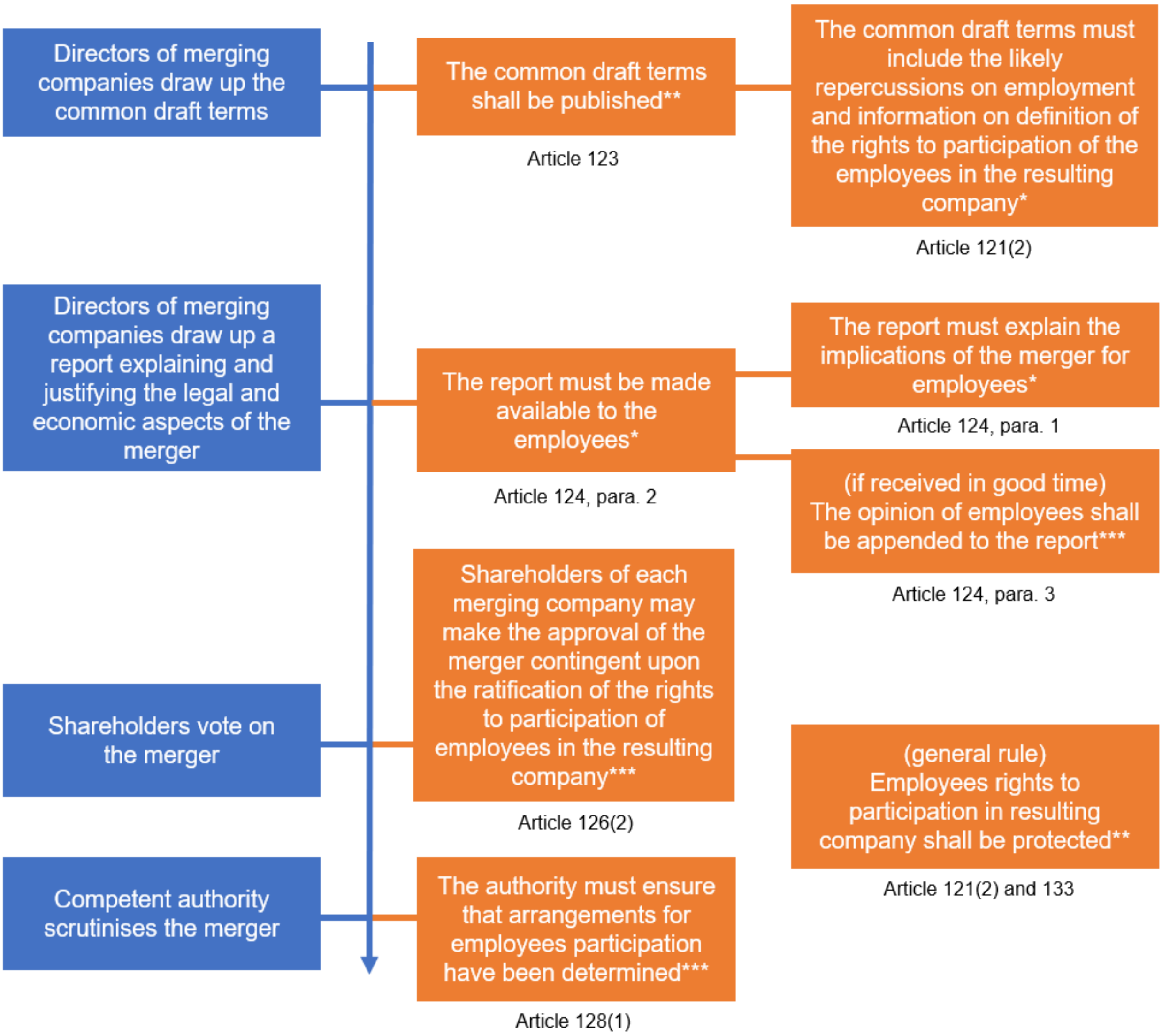
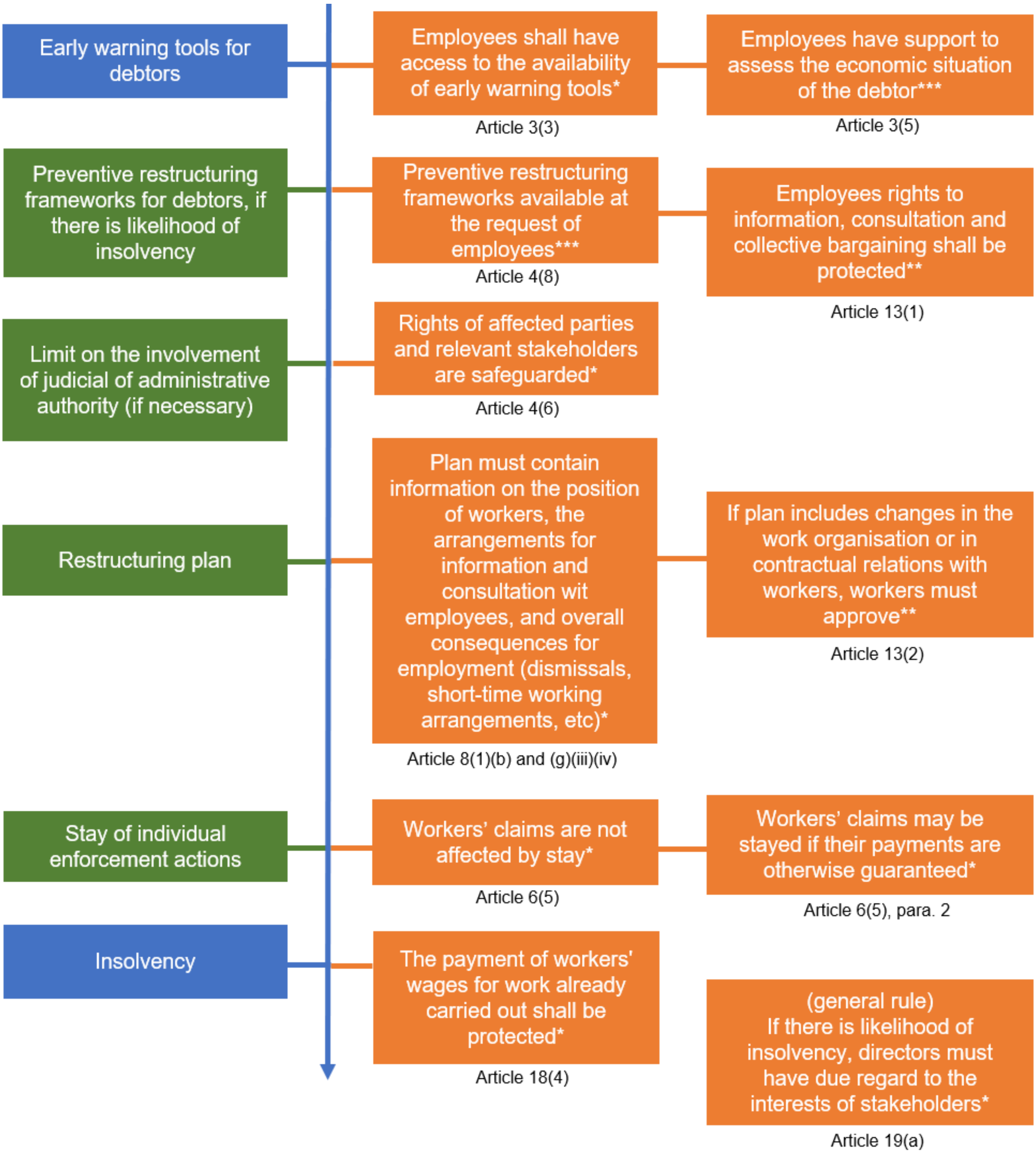


Figure V.3c – Timeline of employees' rights
Insolvency Directive



3.1.2 Labour law directives

As shown in figures V.3a (*Takeover Directive*) to V.3c (*Insolvency Directive*), all three directives guarantee the applicability of provisions in national laws and Union law regarding employees' rights of information, consultation and participation. Hence, the labour law directives supplement the involvement set forth in the three company law directives. These directives make reference to the following Union law documents:

Table V.3.1.2a – Labour law directives

Referenced directives	Takeover Directive	Merger Directive	Insolvency Directive
SE Employee Involvement Directive	✓	✓	
Works Council Directive[591]	✓		✓
Collective Redundancies Directive	✓		✓
Information and Consultation Directive	✓		✓
Acquired Rights Directive			✓
Employer Insolvency Directive			✓

The SE Employee Involvement Directive covers co-determination and participation rights in the post-takeover or post-merger company. These rights are irrelevant for the present analysis because they do not interfere with employee protection during critical events.[592] While the Employer Insolvency Directive addresses involvement rights, it guarantees employees' outstanding claims of their employment contracts.

With respect to the other directives, the following involvement rights are guaranteed:

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[591] Former Directive 94/45/EC.

[592] As of 2018, there were approximately 3000 companies registered as a *Societas Europeae*. Retrieved from: https://www.worker-participation.eu/European-Company-SE/Facts-Figures. Last accessed 17 November 2019.

Table V.3.1.2b – Guaranteed rights

Directives	Rights
Works Council Directive	Article 1(3): Information and consultation of employees and representation (for transnational issues) at the relevant level of management, if the employer is required to establish a European Works Council.[593]
Collective Redundancies Directive	Article 2(1): Information and consultation rights, if the employer is contemplating collective redundancies.[594]
Information and Consultation Directive	Article 4: Detailed procedures to ensure information and consultation rights for employees of a company or business unit with at least fifty or twenty employees, respectively.[595]
Acquired Rights Directive	Article 7: Information and consultation rights, if the employer is planning a transfer of undertaking or business.[596]

593 As per Articles 1(2) n European Works Council (with the purpose of informing or consulting employees) or a procedure for informing and consulting employees must be in place for all companies or group of companies that: (a) have at least 1 000 employees within the Member States; and (b) at least 150 employees in each of at least two Member States.

594 This directive brings the concept of "exceptional circumstances," during which involvement rights arise. The directive's annex provides that in "exceptional circumstances or decisions affecting the employees' interests to a considerable extent, particularly in the event of relocations, the closure of establishments or undertakings or collective redundancies," the works council shall have the right to meet the central management, "so as to be informed and consulted."

595 "Article 4 (…) 2. Information and consultation shall cover: (a) information on the recent and probable development of the undertaking's or the establishment's activities and economic situation; (b) information and consultation on the situation, structure and probable development of employment within the undertaking or establishment and on any anticipatory measures envisaged, in particular where there is a threat to employment; (c) information and consultation on decisions likely to lead to substantial changes in work organisation or in contractual relations, including those covered by the Community provisions referred to in [the Collective Redundancies Directive and the Acquired Rights Directive].
3. Information shall be given at such time, in such fashion and with such content as are appropriate to enable, in particular, employees' representatives to conduct an adequate study and, where necessary, prepare for consultation.
4. Consultation shall take place: (a) while ensuring that the timing, method and content thereof are appropriate; (b) at the relevant level of management and representation, depending on the subject under discussion; (c) on the basis of information supplied by the employer (…) and of the opinion which the employees' representatives are entitled to formulate; (d) in such a way as to enable employees' representatives to meet the employer and obtain a response, and the reasons for that response, to any opinion they might formulate; (e) with a view to reaching an agreement on decisions within the scope of the employer's powers (…)."

596 This directive mainly protects employees' rights that were acquired before a transfer of an undertaking or business, by ensuring that the obligations of the initial employer towards employees are transferred to the resulting employer.

3.2 Directors' fiduciary duties

Providing rights is one way in which the law can protect workers and employees. Another form of protection, and of correcting skin-in-the-game asymmetry, is via fiduciary duties. Fiduciary duty is mainly owed when one person acts on behalf of another, for instance, when directors act on behalf of the company.[597] While the legal background of this duty varies in each country, European national laws largely recognise that directors owe fiduciary duties to the company.[598] These duties include the duty to act with care, skill, diligence and loyalty, as well as to act in good faith and in the company's best interest.[599]

Company's interest

Both common and civil law countries include fiduciary duties to act in good faith and in the company's best interest.[600] One question that follows from this assumption is: What constitutes the company's interest?[601] In response, Gerner-Beuerle and Schillig (2019) recently observed:

> The company would represent the interests of the ultimate beneficiaries (shareholders or, following a pluralistic approach, also other stakeholders), who

[597] Cane and Conaghan (2009) explained that "Fiduciary duties are owed by trustees to beneficiaries, and by the executor of the estate of a deceased person to the beneficiaries of the estate. They are owed by corporate directors and officers to their corporation. They are also owed by agents to principals, and by partners in a partnership to one another. They are owed by solicitors to their clients. In some jurisdictions, it has been held that fiduciary duties exist between parent and child, doctor and patient, and in other relationships that involve decision-making power."

[598] In England, fiduciary duty derives from the trust relationship between directors and shareholders. In France, this duty comes from the contractual (mandate and employment) relationship between the company and the director. Blair (2015) argued that duties arise from the directors' position as mediating hierarchs. See Gerner-Beuerle and Schillig (2019), pp. 467–468. They concluded that "not only the common law, but also many civil law jurisdictions qualify directors as fiduciaries who are required to act in good faith for the benefit of another person and exercise a high standard of care and loyalty in managing the other person's financial interests."

[599] Gerner-Beuerle and Schuster (2014), p. 199. In the United States, the duty to act in the company's best interest derives from the business judgement rule. See Frazão (2011), pp. 391 et seq.

[600] This is an obligation of means, not of result. Gerner-Beuerle and Schuster (2014), pp. 198 and 203.

[601] Another related question is: To whom is this duty owed? Miller and Gold (2015) argued that fiduciary duties may entail loyalty to a person (e.g. a company) or to a purpose (e.g. the company purpose as stated in the articles of association), p. 556 et seq. Ideally, the object of loyalty should be explicit in law or in contract.

would not stand in a direct legal relationship with the director.[602]

Mayer (2016) also defended the pluralistic view of directors' duties:

> The directors can and should balance the interests of different parties in pursuit of the prosperity of the corporation. And the owners should ensure that the corporation pursues its long-term not just its immediate prosperity, which may [...] involve forgoing short-term for long-term shareholder returns.[603]

Union company law does not expressly regulate fiduciary duties. Moreover, it has yet to clarify the scope of the company's interest. It is important to clarify the company's interest, so that directors are able to identify what their duties are.[604] Sjåfjell (2009) discussed the use of "the interests of the company as a whole" in the Takeover Directive. She concluded that the issue is unresolved: The expression may be interpreted to include all shareholders, employees and communities, or that Member States have discretion to determine its meaning. European national laws are not harmonised as to whom duties are directed.[605] In England, duties are owed to the company. While directors must consider other stakeholders, only shareholders have a right of action.[606] In France,

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[602] Gerner-Beuerle and Schillig (2019), p. 468. Frazão (2011) explained that the view that the directors' duties are owed ultimately to shareholders stems from contractualism and from the theory of the firm of the Chicago school of economics. On the other hand, institutionalism encompasses all affected stakeholders in the firm's interests, p. 128. Also Salomão Filho (2011), p. 31. Gelter (2011) affirmed that institutional theories had not managed effectively to include stakeholders in the firm's interests. He argued that the then-current financial crisis could change this tide, pp. 729–730.

[603] Mayer (2016), p. 9. Clarke (2016) supported the widening of the scope of directors' duties in face of the urgency of climate change and based on Global Compact's definition of corporate sustainability as "a company's delivery of long-term value in financial, social, environmental and ethical terms," p. 578.

[604] Nesteruk (1991, p. 725) explained that role morality is relevant to inform the decision-making of directors, i.e. the ends guiding the decisions of directors shape their role in the company.

[605] Sjåfjell (2009), pp. 346–352. In the United States, directors may consider stakeholders' interests in three ways. First, with the business judgement rule, according to which directors may justify decisions taken for the public good as also indirectly benefiting the company (e.g. reputation) and hence shareholders. Second, the articles of association may determine as much (e.g. certified B Corporations). Third, constituency statutes allow for considering interests other than those of shareholders. See Stout (2012), pp. 24 et seq.

[606] Tomasic (2012) reviewed the concept of "enlightened shareholder value" in Section 172(1) of the UK Companies Act. He concluded that the practical effect of this provisions has several limitations. One of which is the lack of accountability to stakeholders: "The idea of 'having regard to' might be seen as taking account of various matters and does not mean that the matters must be given priority; it presumably at least requires serious consideration to be given to these other interests. It should thus be noted that there is a distinction between taking account of a number of interests when making decision and being accountable to these interests," p. 31. Also Clarke (2015), pp. 465 et seq.

directors are responsible “towards the company and third parties.”[607] Germany and The Netherlands also adopt a pluralistic view.[608] This study supports the view that the company’s long-term interests must encompass the interests of all team members.[609] This pluralistic view is based on the interpretation of company law in light of the principles of the TEU.[610] Box V.3.2 (*Sustainable development guidelines*) shows how Sjåfjell links company activity (through its directors) to the principle of sustainable development in the TEU.

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607 Gerner-Beuerle and Schillig (2019), p. 472.

608 Dotevall (2016) analysed directors’ duties in European national laws in order to identify discrepancies in how these duties function in practice. See also Hopt (2016) on Union law, Rott (2017) on German law and Barker (2018) on English law. For Heuschmid (2013), in German and other continental European countries, “the interests of the company may be regarded as the sum of the various forces coincident within the company,” p. 127.

609 Italy has been the only European country to adopt a law that establishes the legal form of the benefit corporation or *società benefit* (see section I.4.2.3: *New company law*). Under benefit corporation laws, directors have the duty to consider the interests of all stakeholders. Academia and some market participants have criticised this duty because the legal provisions are broad and do not explain how this duty should work in practice. They fear that such laws may protect directors against unprofitable decisions.

610 Sjåfjell (2009), p. 451. See section I.4.2.1 (*Principles of Union company law*).

Box V.3.2 – Sustainable development guidelines

It is widely accepted that the company's interest limits the scope of directors' duties.[611] Sjåfjell claimed that, besides the company's interest, the principle of sustainable development also has a normative function and guides the responsibilities of all actors in the global community, including companies.[612] She lists three guidelines for companies (naturally acting through directors) in this respect:

First guideline
"If a company can pursue one of two equally interesting paths, and both are in line with the company interest, but one will make a greater contribution to sustainable development, the latter should be chosen."
Second guideline
A company may have to "change its methods of production, even though such changes will, within the foreseeable future, lead to fewer bonuses for the employees and lower profits for the shareholders", if such changes would be required in order to contribute to sustainable development.

Third guideline
A company may have to "close down its business, if it is not possible to find alternatives that do not cause damage to the interests of the global community."

Sjåfjell (2009) hypothesised a European company targeted by a takeover bid, and a board that "justified their defences by referring to their duty to consider environmental protection requirements in line with the directive as interpreted in the context of the aim of the Treaty principle of sustainable development." She conjectured which position the European Court of Justice ("**ECJ**") might take on the matter.[613] The ECJ has not yet seen such a case. However, the Unilever takeover attempt illustrates Sjåfjell's hypothesis. In early 2017, The Kraft Heinz Company and 3G Capital made an offer to acquire Unilever. Paul Polman, Unilever's CEO, together with board chairman Marijn Dekkers, rejected the offer because the takeover "would be the end of Unilever's 147-year existence, along with its commitment to sustainability and a multi-stakeholder model."[614] The Kraft Heinz Company and 3G Capital are known for their aggressive cost reduction and mass

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611 Gerner-Beuerle and Schuster (2014), p. 205. Cahn and Donald (2010), pp. 332 et seq.
612 Sjåfjell (2009): All citations in box V.3.2 (*Sustainable development and directors' duties*) are from pp. 108–110.
613 Sjåfjell (2009), p. 452.
614 George and Migdal (2017a), p. 7.

redundancy policy. The offerors then quickly withdrew the offer on a Sunday afternoon.[615] The market reacted positively to the board's decision, valuing Unilever shares at an increased 13% immediately after the decision to reject the offer. Unilever has since continued its commitment to both its long-term value strategy and its stakeholders alongside achieving sound financial results.[616]

The Merger Directive does not include a directors' duty to act in the interest of the company as a whole.

Article 19 of the Insolvency Directive states the duty of directors to have due regard "of the interests of creditors, equity holders and other stakeholders" if there is a likelihood of insolvency. The directive does not specify who the other stakeholders are, but it is clear that employees' financial interests should be included. Moreover, some doubt exists that local communities and the environment lie within the scope of the directive.[617] However, if Article 19 is interpreted in light of the TEU, it could be understood to include the triple bottom line interests of both employees and other stakeholders.[618] Again, the ambiguity in the legal text leaves room for Member States to determine the scope of the directive.

Nudging for consideration

As observed, none of the three directives imposes on directors a clear-cut duty to act in the interests of employees and other stakeholders. Nevertheless, each directive includes implicit incentives for directors to consider these interests (see figures V.3a: *Takeover Directive* to V.3c: *Insolvency Directive*).[619] The Takeover Directive requires directors to opine on the effects of a takeover bid on the employment and locations of

[615] George and Migdal (2017b) noted "'You're dealing with different kinds of cultures,' Berkshire Hathaway's Warren Buffett said. 'It became very apparent that Unilever did not want this offer,'" p. 1. Berkshire Hathaway is a shareholder of The Kraft Heinz Company.

[616] In 2019, Paul Polman retired as CEO of Unilever. His strategy and work culture embodied the normative role of the board, as Sjåfjell (2009) maintained: "To balance and promote the interests of the company and ensure that the company fulfils its societal purpose."

[617] Linna (2019), p. 218. She further stated: "In sum, the primary task of the bankruptcy administrator is to maximise creditor satisfaction and minimise all obstacles preventing this from happening. The administrator has to balance the requirements of the market and the interests of the creditors and search for the optimal way to proceed. Thus, green bankruptcy is not preferred or intrinsically valued in liquidation proceedings. Only when it is in the interest of the general body of creditors does the administrator have to consider sustainability."

[618] Social, environmental and financial interests.

[619] See discussion on this regulatory strategy in section IV.2.2.4 (*Nudging*).

the company. The obligation to give an opinion and to disclose this opinion to employees and shareholders may nudge directors to consider employees and the locations of the company *ex ante*[620].

The Merger Directive requires directors to explain "the implications of the cross-border merger for members, creditors and employees". As in the Takeover Directive, there may be a nudge effect that pushes directors to consider the interests of employees *ex ante*. Similarly, the Insolvency Directive requires that the restructuring plan contain information on the position of workers as well as the overall consequences for employment. This may nudge directors to consider these factors (and possibly to protect workers and employees) when drafting the plan.

Furthermore, the nudging provisions of the three directives also impact shareholders. Moslein and Sorensen (2018) affirmed that provisions that nudge directors, also nudge shareholders. This is because providing shareholders with information on workers, employees, employment and business locations may nudge shareholders to consider the interests of these affected parties when voting.[621]

Finally, while nudging is a step in the right direction, it may not be enough to incentivise long-termist behaviour. Clear director duties are particularly necessary for companies that do not include social and environmental purposes in company object of their constitutional documents.[622] As discussed, clarity with respect to the company's interest is crucial for clarity on director duties.[623] For this reason, this study recommends clearer director duties for listed companies in section V.4 (*Recommendations*).

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[620] In Germany, where the two-tier board system prevails, the role of the supervisory board already encompasses "soft" fiduciary duties towards stakeholders — not only in critical events, but always. Hopt and Leyens (2004) confirmed this view: "Networking with stakeholders and business partners and the balancing of interests within the corporation have been rated as indispensably valuable, particularly for resolving desperate situations," p. 141.

[621] Möslein and Sorensen (2018), p. 420.

[622] Sorensen and Neville (2014), p. 290. The Commission has issued a recommendation on the role of non-executive directors (Commission Recommendation of 15 February 2005, document number 2005/162/EC. However, this soft-law document only addresses matters like transparency, qualification, commitment and independence.

[623] Sjåfjell (2018), *Beyond Climate Risk*, advanced the Sustainable Governance Model, created by the 'Sustainable Market Actors for Responsible Trade' research group, as a tool for directors under sustainability fiduciary duties. Sjåfjell (2018), *Redefining the Corporation for a Sustainable New Economy*, further argued the need for reforms on the purpose of the company and the duties of directors.

3.3 Enforcement

As observed, employees (as well as other stakeholders) may be protected in two ways: By granting them involvement rights, and by imposing fiduciary duties on directors. Yet whereas regulation and policy in these respects have become more sophisticated in recent years, implementation remains low.[624] Hence, another relevant form of protection is to ensure compliance with regulation or, in case of default, to enforce it. Compliance mechanisms are mainly internal company policies.[625] Enforcement is mostly a state monopoly, while a few self-regulatory initiatives exist.[626]

With respect to long-termism, the Takeover Directive, the Merger Directive and the Insolvency Directive do not create specific enforcement rights.[627] One example of such a right would be the creation of a right of action for local community representatives, in case the board's report on the bid did not disclose the effects on the local community. None of the three directives deals with such an aspect, nor do they refer to other directives that grant employees and other stakeholders special rights of action in critical events.[628]

Some Member States have adopted alternative mechanisms for enforcing the rights of employees and other stakeholders within the general scope of company law and within the responsibility of multinational enterprises.[629] In England, for instance, the

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624 Clarke (2014), p. 487. A survey has shown that, in practice, Australian directors rank shareholders first. The priority list starts with shareholders and continues with the company, employees, customers, suppliers, lenders and creditors, the community, the environment, and the country. See Marshall and Ramsay (2012), p. 37.

625 A legal incentive for compliance in long-termism is the Reporting Directive, which requires companies to publish their policies on environmental protection, social responsibility and treatment of employees, respect for human rights, anti-corruption and bribery and diversity on company boards. Kaeb (2015) in Walker-Said and Kelly, 198. See chapter VII (*Reporting Directive*).

626 Self-regulatory initiatives, for their lack of state intervention are soft law instruments, as discussed in section IV.2.2.2 (*Hard vs. soft law*).

627 Such enforcement provisions would consist of another regulatory approach, namely command and control – as discussed in section IV.2.2.3 (*Command and control*).

628 Gerner-Beuerle et al. (2013) found out that Member States' national laws have very different approaches as to which actors have a standing to sue against a violation of directors' duties. They concluded that there is no common agreement on the most effective approach, pp. 185–192. Study on Directors' Duties and Liability prepared for the European Commission DG Markt by: Carsten Gerner-Beuerle, Philipp Paech and Edmund Philipp Schuster (Department of Law, London School of Economics). Retrieved from: http://eprints.lse.ac.uk/50438/. Last accessed 30 December 2019.

629 Mandatory grievance mechanisms are crucial for compliance. The Indian Companies Act, as amended in 2013, adopts a more stakeholder-centric approach. Its Section 166(2) states: "A director of a company shall act in good faith in order to promote the objects of the company for the benefit

Office of the Regulator of Community Interest Companies has the duty to monitor such companies and has the power to investigate stakeholder complaints.[630] This enforcement mechanism is only available for community interest companies.[631] Another mechanism that exists in most Member States is the OECD National Contact Points for Responsible Business Conduct ("**NCPs**"). The NCPs offer a grievance mechanism in case of violations of the OECD Guidelines for Multinational Enterprises. Any stakeholder who can demonstrate an "interest" in the case may lodge a complaint.[632]

4 Recommendations

Based on the previous discussion, especially on the principles of Article 3(3) of the TEU, and aiming to correct skin-in-the-game asymmetries in order to achieve long-term behaviour in European capital markets, this study recommends that the following rights and obligations be included in Union company law concerning listed companies. The recommendations in this section V.4 (*Recommendations*) as well as in sections VI.4 (*Recommendations*) and VII.3 (*Recommendation*) are subject to the normative finding that the purpose of the company is, in the exercise of its economic activity, to contribute to the long-term economic, environmental and societal value creation for all its stakeholders and society at large.[633]

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of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment." Nevertheless, a lack of effective penalty and of a monitoring mechanism are still major problems for compliance with this provision. See Prasad (2018), pp. 299 et seq.

630 Processable complaints may relate to fraud, mismanagement, conduct involving deliberately misleading or deceiving customers or creditors, and breach of directors' duties to the company or its creditors. See Office of the Regulator of Community Interest Companies, document entitled "Complaints about community interest companies" dated May 2016, p. 4. Retrieved from: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/605438/cic-14-1090-complaint-about-community-interest-companies.pdf. Last accessed 2 December 2019.

631 "CICs are a new type of limited company for people wishing to establish businesses which trade with a social purpose (social enterprises), or to carry on other activities for the benefit of the community." See Office of the Regulator of Community Interest Companies, document entitled "Chapter 1: Introduction" dated May 2016, p. 4. Retrieved from: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/626088/cic-12-1333-community-interest-companies-guidance-chapter-1-introduction.pdf. Last accessed 2 December 2019.

632 See detailed procedure in OECD Watch. Retrieved from: https://www.oecdwatch.org/how-to-file-a-complaint/. Last accessed 2 December 2019.

633 See sections I.3 (*Normative foundations*) and III.2.1 (*Definition*).

Involvement[634]

R1. Employees and other affected stakeholders[635] have the right to receive and request information about decisions affecting their short- and long-term interests prior to a decision being taken. This right shall be exercised on an ongoing basis, including yet not limited to critical events.

R2. The board of directors has a duty to inform shareholders, employees and other affected stakeholders about decisions affecting their short- and long-term interests prior to a decision being taken. The information shall include (i) the long-term effects of the decision on shareholders, employees and other affected stakeholders; and (ii) in case of negative effects, the measures to minimise such effects and to indemnify affected stakeholders. This duty shall be exercised on an ongoing basis, including yet not limited to critical events.

R3. Employees and other affected stakeholders have the right to consultation (including the right to provide an opinion that will be published) about decisions affecting their short- and long-term interests prior to a decision being taken. [636] This right shall be exercised on an ongoing basis, including yet not limited to critical events.

R4. In critical events, including takeovers, cross-border mergers and financial difficulty, employees and other affected stakeholders have the right to request an independent opinion about decisions affecting their short- and long-term interests prior to a decision being taken.

R5. The board of directors of companies with at least fifty (50) employees shall include a director who is a member of the workforce and is responsible for representing the interests of workers. [637]

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634 Recommendations R1 to R6 involve a judgement of materiality, i.e. which information is relevant enough because it materially affects stakeholders' interests. In this context, directors have the discretion and the responsibility (liability) to decide which information is material enough to be disclosed. This point is addressed in the 2017 Commission guidelines on non-financial reporting. See Communication from the European Commission dated 5 July 2017, entitled Guidelines on non-financial reporting (methodology for reporting non-financial information), document number 2017/C 215/01.

635 Stakeholders also make company-specific investments and are often intrinsically linked to a company's success. They should have rights equivalent to those of employees, in proportion to their relationship with the company. Hoskisson et al. (2018) showed the managerial trend that incentivises stakeholders to make firm-specific investments. They explained that the "inability of stakeholders to transfer the value of their investments in factor markets may subject the stakeholder to firm holdup and an inability to appropriate value *ex post*." Lipton (2019) affirmed: "While it recognizes a pivotal role for boards of directors in harmonizing the interests of shareholders and other stakeholders, it also assumes that shareholders and other stakeholders have more shared objectives than differences—namely, they have the same basic interest in facilitating sustainable, long-term value creation."

636 Executive remuneration would be an example, as recommended in the Cofferati Report. Porter (1992) recommended similar reforms for long-termism, including: "Encourage board representation by significant customers, suppliers, financial advisers, employees, and community representatives" and even "nominate significant owners, customers, suppliers, employees, and community representatives to the board of directors." In his view, such constituencies are more likely to have long-term interests and push management towards long-term investments, p. 81.

637 This would allow for employees to have an indirect say on pay, as recommended by Johnston and Morrow (2014).

R6. The board of directors of companies with at least fifty (50) employees shall have a non-executive director who is designated as a long-term director. This director shall have the duty to issue an annual statement on the company's compliance with its obligations towards its stakeholders. This director must fulfil independence requirements.[638] This director shall communicate with affected stakeholders on a semi-annual basis with respect to any decisions taken by the company that affect the interests of such stakeholders.

Directors' fiduciary duties

R7. All members of the board of directors owe to the company a duty to act in good in faith and in the best interest of the company.[639] In case of violation of this duty, the company (upon the initiative of the general assembly of shareholders) shall have the right of action against the director. [640]

R8. All members of the board of directors owe to the company a duty to consider, balance and protect the long-term interests of all stakeholders affected by a given decision.[641] If the interests of one or more stakeholder groups cannot be protected in a given decision-making process, the board of directors shall state a clear and reasoned explanation for this decision.[642]

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638 See discussion on benefit director by Alexander (2017), p. 82. In the Model Benefit Corporation Legislation, §102 defines "independent" so that the director candidate or any immediate family member cannot have any material relationship with the company or its subsidiaries in the previous three years, including employment or management relationship, beneficial or record ownership, either directly or via an intermediary entity.

639 Additionally, Jeffwitz (2018) envisaged"

640 A series of documents have been prophesying this development. Most recently, Klaus Schwab launched the 2020 Davos Manifesto in the 50th edition of the World Economic Forum meeting in Davos. The document starts with the following statement "The purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders, but all its stakeholders – employees, customers, suppliers, local communities and society at large. The best way to understand and harmonize the divergent interests of all stakeholders is through a shared commitment to policies and decisions that strengthen the long-term prosperity of a company." Retrieved from: https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/ Last accessed 24 January 2020.

641 Jeffwitz (2018) suggested how this might be achieved: "We recommend that directors are explicitly required to identify and mitigate all of the economic, social, and environmental risks to the company's interests and the attainment of its specific social goals. We recommend that this analysis and mitigation should be reported on in a suitable integrated reporting format. We also recommend that the legislation specifies salient material risks for key industries." Further, she proposed "a duty to act within the planetary boundaries and social foundations, supported by a legal requirement for directors to carry out ongoing human rights and environmental due diligence in relation to a company's operations (including its supply chains) and to develop a strategy to mitigate any such impacts" and "that companies can adopt a social purpose that either expressly takes precedence over their commercial purpose, or is to be balanced with that commercial purpose by the directors in the exercise of their discretion".

642 The exercise of the duties in paragraphs R6 and R7 above must not endanger neither the company's financial viability nor its long-term continuation.

Verification

R9. The national supervisory authority(ies) responsible for approving the terms of a takeover, cross-border merger or restructuring plan shall verify the takeover, cross-border merger or restructuring plan with respect to the adequate treatment of the short- and long-term interests of all affected stakeholders, including the measures to minimise negative effects and to indemnify affected stakeholders.

Other

R10. The interest of the company includes the short- and long-term interests of its shareholders, employees and other affected stakeholders.

R11. Companies shall retain a certain amount of capital, in order to indemnify employees and other stakeholders affected by decisions in critical events, including takeovers, cross-border mergers and financial difficulty. The amount shall be proportionate to the size and risk profile of the company vis-à-vis its stakeholders.[643]

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[643] CRD IV includes a "conservation buffer" of 2.5% with a similar logic, i.e. to protect taxpayers by "preventing the situation in which taxpayers' money would have to be injected for recovery and resolution of banks." See Sappideen (2011), pp. 430–431.

Chapter VI: Shareholder Directive

This chapter reviews the Shareholder Directive and its potential implications in three steps. First, section VI.1 (*The equity investment chain*) analyses the actors involved in the ownership of a company's shares. Section VI.2 (*Issues in the directive*) discusses the existing provisions in the Shareholder Directive, which aim to enhance long-term behaviour. Section VI.3 (*Beyond the directive*) looks at issues related to the shareholding chain, but which are not yet covered in the directive. Section VI.4 (*Recommendations*) recommends implementing various legal adjustments, in order to incentivise shareholders and directors to embrace long-termism. This chapter works on steps 4 and 5 of the methodology introduced in section II.4.2 (*Five-step analysis*).

1 The equity investment chain

The Shareholder Directive addresses certain relevant team members of the listed company. It makes sense to draft special legislation on the rights and obligations of shareholders, considering that their general meeting has the power to amend the articles of association and to influence the direction to which the company is heading.[644] Member States have conferred upon directors the power to manage companies, and upon shareholders the power to elect and dismiss directors. In equity markets, a vast array of shareholders with different (and sometimes conflicting) interests are active. Some prefer short-term gains and speculate to this end while others seek long-term value creation. Hence, shareholder regulation is crucial for attaining long-termism.

Moslein and Sorensen identified two strategies "to promote a move towards more long-term and sustainable corporate performance": (a) insulating the directors and (b) incentivising shareholders to use their influence over directors for the long-term interests and sustainability of the company[645]. Strategy (a) has been widely criticised in the literature. This study also supports the view that shareholders should maintain their right

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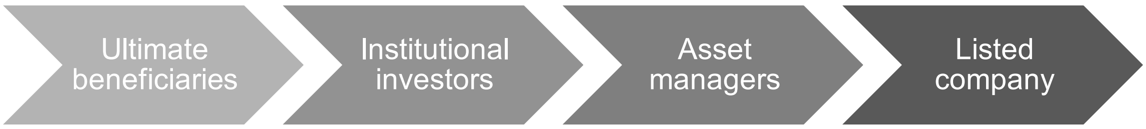
[644] In Spanish law, Articles 159 and 161 of the Companies Act 2010 establish the sovereignty of the general meeting. Many national laws used to state that the general meeting is "sovereign" and "supreme." However, nowadays the majority academic view no longer sees the general meeting as the "highest body" of the company. See Siems (2008), p. 151 and Martínez-Echevarría (2016), p. 40.

[645] Möslein and Sorensen (2018), pp. 418–419.

to influence management, subject to limitations.[646] Strategy (b) was the choice of the European Commission and is the course of action discussed in this chapter (*Shareholder Directive*). This strategy is aimed at all levels in the equity investment chain: Ultimate beneficiaries, institutional investors (or asset owners), asset managers and the company.[647] The directive also looks at the role of proxy advisors, who provide services to institutional investors and asset managers as well as to companies.



In 2013, OEE and IODS published a study on the main types of shareholders of listed companies in the internal market by the percentage of market capitalisation:[648]

– Investment funds and other financial intermediaries held 25% of shares;
– Non-European investors held 22% of shares;
– Non-financial corporations held 18% of shares;
– Households and non-profit organisations held 13% of shares;
– Insurance corporations and pension funds held 12% of shares; and
– Banks held 2% of shares.[649]

Three findings may be derived from this data. First, asset managers — investment funds, banks and other financial intermediaries — held the largest chunk of the equity market (27%). Institutional investors — insurance companies and pension funds — held 12% of shares. Second, assuming that the majority of foreign investors are institutional investors and asset managers, their aggregate holdings amounted to 61% of the market.

[646] See discussion on board insulation in section I.2.1 (*Criticism as of 2013*).

[647] Impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, p. 12.

[648] The Observatoire de l'Epargne Europeene — OEE and INSEAD OEE Data Services (IODS) — prepared a study for the European Commission and the Financial Services User Group under the tender "Who owns the European economy? Evolution of the ownership of EU-listed companies between 1970 and 2012," August 2013, p. 7. Retrieved from https://ec.europa.eu/info/file/46812/download_en?token=v7XSX55A. Last accessed 30 December 2019.

[649] Approximately 5% of shares were held by general governments. Since these actors invest in equity markets as part of their national economic policies, which differs from the strategy of private investors, they lie beyond the scope of this study.

Third, households, non-profit organisations and non-financial corporations mostly held shares for their own benefit as ultimate beneficiaries and represented the second-largest group with 31%. The next paragraphs review each type of shareholder.

Ultimate beneficiaries

Ultimate beneficiaries currently form a smaller part of equity markets and normally have long-term interests (e.g. retirement plans, university education of children, provision for next generations, etc.). In general, ultimate beneficiaries such as households and foundations have low technical knowledge about investments and are rarely direct holders of equity. They often invest via specific investment channels (e.g. pension funds) and are highly influenced by their advisors and managers. The latter may shift the long-term interests of ultimate beneficiaries towards short-term behaviour and thus affect equity markets negatively.[650] Ultimate beneficiaries are protected in the Shareholder Directive as the "clients" of institutional investors and asset managers.

Institutional investors

For the purpose of the Shareholder Directive, institutional investors[651] and asset owners[652] are treated as synonyms. The Impact Assessment defined asset owners:

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650 Hirst (2018), p. 238.

651 Article 2(e): "'Institutional investor' means: (i) an undertaking carrying out activities of life assurance within the meaning of points (a), (b) and (c) of Article 2(3) of Directive 2009/138/EC of the European Parliament and of the Council, and of reinsurance as defined in point (7) of Article 13 of that Directive provided that those activities cover life-insurance obligations, and which is not excluded pursuant to that Directive; (ii) an institution for occupational retirement provision falling within the scope of Directive (EU) 2016/2341 of the European Parliament and of the Council in accordance with Article 2 thereof, unless a Member State has chosen not to apply that Directive in whole or in parts to that institution in accordance with Article 5 of that Directive." Basically, these are insurance companies and pension funds.

652 Article 2(f): "'Asset manager' means an investment firm as defined in point (1) of Article 4(1) of Directive 2014/65/EU that provides portfolio management services to investors, an AIFM (alternative investment fund manager) as defined in point (b) of Article 4(1) of Directive 2011/61/EU that does not fulfil the conditions for an exemption in accordance with Article 3 of that Directive or a management company as defined in point (b) of Article 2(1) of Directive 2009/65/EC, or an investment company that is authorised in accordance with Directive 2009/65/EC provided that it has not designated a management company authorised under that Directive for its management." Basically, these are:
– investment firms [any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis];
– managers of alternative investment funds [Alternative investment funds are funds that are not regulated at EU level by the UCITS Directive. They include hedge funds, private equity funds, real

> Asset owners hold assets on behalf of ultimate investors who bear the economic risks of the investment. The most typical of these are pension funds, insurance companies, banks and sovereign wealth funds.[653]

Academic and governmental research has identified the upsides and downsides of financial intermediation. The upsides are that institutional ownership boosts innovation[654] and is associated with higher investment in R&D.[655] Moreover, institutional investors, as financial intermediaries, may work to redistribute savings from households and industrial companies into the real economy.[656] However, the prevalence of intermediation in the entire financial sector (including institutional investors and assets managers) has led to downsides.[657] For instance, Mazzucato reported that in the United Kingdom only 10% of the earnings of the financial industry flow into the real economy, while 90% go back to financial institutions, insurance companies and real estate. Recital 15 of the directive amending the Shareholder Directive in 2017 recognised the importance of institutional investors and asset managers, while emphasising the downsides of their activity:

> Institutional investors and asset managers are often important shareholders of

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estate funds and a wide range of other types of institutional funds. See https://ec.europa.eu/info/business-economy-euro/growth-and-investment/investment-funds_en. Last accessed 6 January 2020.];

– management companies [“management company” means a company, whose regular business is the management of undertakings for collective investment in transferable securities in the form of common funds or of investment companies (collective portfolio management of UCITS)]; and

– undertakings for collective investment in transferable securities constituted in accordance with statute as investment companies (without external management).

653 Impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, p. 10. The document defined institutional investors as “any institution of considerable size which professionally invests (also) on behalf of clients and beneficiaries, e.g. pension funds or insurance companies.”

654 Aghion et al. (2013), p. 277.

655 Brossard et al. (2013), pp. 1058–1059. Roe (2013) mentions several other studies that reached the same conclusion, p. 994.

656 Morck (2014), p. 189. “Schumpeter views the social purpose of the finance sector as channelling the savings of capitalists (people with wealth but neither the time nor inclination to run businesses) into firms run by creative entrepreneurs (people with sound ideas about introducing new and profitable products or production processes). Successful entrepreneurs pay solid returns to capitalists, who then have even more wealth to invest. Each cycle of the circular flow increases the total wealth of the economy.”

657 Mazzucato (2019) at the St. Gallen Symposium. She further referred to Andrew Haldane’s research showing how the growth of the financial intermediation industry has drastically outpaced the growth of the real economy since the 1990s. Haldane et al. (2010), p. 109.

> listed companies in the Union and can therefore play an important role in the corporate governance of those companies, but also more generally with regard to their strategy and long-term performance. However, the experience of the last years has shown that **institutional investors and asset managers often do not engage with companies in which they hold shares** and evidence shows that capital markets often **exert pressure on companies to perform in the short term**, which may **jeopardise the long-term financial and non-financial performance of companies** and may, among other negative consequences, lead to a **suboptimal level of investments**, for example in research and development, to the **detriment of the long-term performance of both the companies and the investors**.(emphases added)

The Shareholder Directive aims to correct such downsides.

Asset managers

According to the Impact Assessment, an asset manager means a "person managing the assets of institutional investors and households either through investment funds, or through discretionary mandates."[658] Further:

> Asset managers manage the assets of asset owners and households. They can do so either through investment funds (the most important being Undertakings for Collective Investment in Transferable Securities (UCITS)), or through discretionary mandates.[659]

The *Kay Review* affirmed that asset managers had become "the dominant players in the investment chain."[660] As discussed in section III.1.4 (*Causes*), contractual arrangements have made asset managers more powerful than final beneficiaries. The excessive power of asset managers is seen to make directors avoid R&D investments

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[658] Impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, p. 80. The document defined discretionary mandates as "mandates giving asset managers the authority to manage the assets on behalf of an asset owner in compliance with a predefined set of rules and principles, on a segregated basis and separate from other investors' assets."

[659] Impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, p. 11. "Managing almost €6 trillion in assets, UCITS account for around 75% of all collective investments by small investors in Europe," in Commission Statement entitled *Greater protection for retail investors: Commission welcomes European Parliament adoption of strengthened European rules on UCITS*, dated 15 April 2014.

[660] Kay (2012), p. 11.

and new hirings, and instead to dismiss employees, reduce R&D spending and deploy financial engineering to temporarily raise the share price.[661] In many cases, the fees of asset managers are based on short-term performance. The mismatch between the time horizon of client interests and the compensation incentives of asset managers is often seen as the root cause of the problem.[662] The Shareholder Directive aims to tackle this mismatch.

Proxy advisors

The Impact Assessment defined proxy advisors as "firms providing voting services to investors including voting advice."[663] Such advisors work mainly for institutional investors and asset managers, but also for companies.[664] There are two leading proxy advisors globally, Institutional Shareholder Services and Glass Lewis. Together, they hold practically the entire proxy advisory services market.[665] Hitz and Lehmann found empirical evidence that proxy advisors play a meaningful role in European markets as information intermediaries, and that their voting recommendations have a large impact on shareholder voting at annual general meetings and on the evolution of general governance mechanisms.[666]

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661 Stout (2012), p. 72.

662 Bowdren (2016), p. 293. Explanatory memorandum of the Commission proposal for the Engagement Amendment dated 9 April 2014, document number COM(2014) 213 final, p. 4.

663 Impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, p. 80. The document also clarified their importance: "Proxy advisors are important advisors to institutional investors and asset managers, since they provide voting advice to shareholders, which is particularly important for institutional investors and asset managers that hold shares in hundreds or thousands of companies," p. 12. The Shareholder Directive defines a proxy advisor as a "legal person that analyses, on a professional and commercial basis, the corporate disclosure and, where relevant, other information of listed companies with a view to informing investors' voting decisions by providing research, advice or voting recommendations that relate to the exercise of voting rights."

664 Proxy advisors have a satellite function in the investment chain as they do not directly or indirectly hold shares themselves. Credit rating agencies and other investment analysts are in a similar satellite position. Authors like Fox and Kenagy (2012) have expressed views that such actors should also be part of the long-termist regulatory framework. Krehmeyer (2006) proposed that analysts be prohibited from providing short-term forecasts (e.g. three months) and be required to explain how their forecasts relate to the company's long-term story (including non-financial metrics). They should also be required to have a policy on how they take into account the long-term effects of their forecasts in the market, pp. 6 and 14. B Analytics is a tool which allows for long-term analysis. Some investments research companies provide ESG analysis, including ISS-Oekom, Sustainalytics and MSCI.

665 Hitz and Lehmann (2018) collected evidence from fourteen European countries from 2008–2010: ISS covered 61% and GL covered 34% of the listed companies in the Union, p. 714.

666 Hitz and Lehmann (2018), p. 740. On the other hand, empirical studies have found that institutional

Proxy advisors have been under increasing public scrutiny since the early 2010s. For instance, in 2012, the European Securities and Markets Authority issued a discussion paper highlighting the lack of transparency about "the methodology applied by proxy advisors to provide reliable and independent voting recommendations; the dialogue with issuers when drafting voting recommendations; and the standards of skill and experience among proxy advisor staff."[667] Moreover, the authority emphasised that it was not clear to what extent proxy advisors considered local market conditions when recommending votes and called for a sectoral code of conduct. In 2014, the Commission noted that proxy advisors were not subject to any binding regulation on either the Union or the national level.[668] The major proxy advisors reacted to this call by drafting Best Practice Principles for Shareholder Voting Research.[669] In 2015, the authority confirmed that the principles largely covered the issues raised.[670] Two main issues have raised public awareness over proxy advisors in the past decade, and the lack of clarity in their methodology was one of them.

The second issue was the conflict of interests of proxy advisors working simultaneously for listed companies and shareholders, as well as for shareholders with conflicting interests, etc. In November 2019, the United States Securities and Exchange Commission proposed new regulation requiring proxy advisors (i) to disclose "material conflicts of interest in their proxy voting advice"; (ii) to give clients "the opportunity to review and provide feedback on proxy voting advice before it is issued"; and (iii) to publish the client's "views on the proxy voting advice" for the benefit of other clients, on request of the opining client.[671]

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investors use proxy advisors only to complement their decision-making, instead of relying completely on their advice. See Copland et al. (2018), p. 4.

667 ESMA (2012), p. 26. The document calls this lack "the black box issue."

668 Impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, p. 32.

669 According to their website (https://bppgrp.info), the drafters of the principles were proxy advisors themselves. They have an Independent Oversight Committee which is composed of large institutional investors and asset managers. Hence, other stakeholder groups were not represented in law-making.

670 ESMA (2015), p. 1. In parallel, the European Commission worked on the amendment to the Shareholder Directive to address these matters.

671 Proxy advisors do not disclose historical recommendation data, so researchers are still unable to measure the impact of recommendations on long-term value creation, for example. For a general discussion, see Copland et al. (2018), p. 3.

Whereas other legislators have not linked proxy advisors to short-termism, the Union has addressed the issues relating to proxy advisors within the scope of long-term shareholder engagement. The rationale is that more reliable voting recommendations will help institutional investors and asset managers "to more prudently manage investments for the long-term."[672] The Shareholder Directive addresses the conduct of proxy advisors as service providers relevant for shareholders.

Box VI.1 – Concentrated ownership and long-termism

Research has associated concentrated ownership with long-term investment and positive R&D spending. Listed companies with concentrated ownership are seen to behave similarly to privately held firms. They also invest more in their operations than publicly held firms. [673]

In his article on long-termism, Barton recommends a mixed ownership structure, based on McKinsey's study of successful family-owned companies. This structure would combine "some exposure in the public markets (for the discipline and capital access that exposure helps provide) with a significant, committed, long-term owner."[674] Barton further called on executive and non-executive directors to dedicate more time and attention to their roles. As board members, they have the potential of filling the gap of a committed owner in the case of listed companies with dispersed ownership.[675]

In the Union equity markets, companies in the United Kingdom, Ireland and The Netherlands have more dispersed ownership. In continental Europe, concentrated ownership is the rule. However, the German and Spanish equity markets are pending towards dispersion.[676] The Union legislator has not linked long-termism to concentrated ownership and regulation has remained neutral in this respect.[677]

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672 Willey (2018), p. 114.
673 Asker (2011) and (2013).
674 Barton (2011), p. 90.
675 Barton (2011), p. 91. He cited research findings that only 43% of the non-executive directors of public companies believe they significantly influence strategy.
676 Ibid.
677 The impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, only dedicates one paragraph to the topic: "In the dispersed ownership system, there is a 'separation of ownership and control' with share ownership being dispersed among many institutional and retail shareholders and no shareholders typically holding significant blocks. In the concentrated ownership system, a shareholder, a family group, or a small number of shareholders hold a significant block of shares and often have the power to appoint representatives on the companies' boards, thus obtaining a certain level of control over its management," p. 9.

2 Issues in the directive

The European Commission's proposal for the Engagement Amendment laid out the objectives for the amendment:

> The overarching objective of the current proposal to revise the Shareholder Rights Directive is to contribute to the **long-term sustainability of EU companies**, to create an **attractive environment for shareholders** and to enhance **cross-border voting** by improving the **efficiency of the equity investment chain** in order to contribute to **growth, jobs creation and EU competitiveness**.
> It also delivers on the commitment of the renewed strategy on the long-term financing of the European economy: It contributes to a more long-term perspective of shareholders which ensures better operating conditions for listed companies.[678]

In order to achieve these overarching objectives, the Engagement Amendment specified five specific areas of action. Other than related party transactions, all of these areas are directly related to long-termism and are discussed in this section (*Issues in the directive*).

> 1) Increase the level and quality of **engagement of asset owners and asset managers** with their investee companies; 2) Create a better **link between pay and performance** of company directors; 3) Enhance transparency and shareholder oversight on **related party transactions**; 4) Ensure reliability and quality of advice of **proxy advisors**; 5) Facilitate transmission of **cross-border information (including voting)** across the investment chain in particular through shareholder identification.[679]

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678 All of these objectives are repeated recitals of the enacted amendment; my emphases.

679 Both extracts are from the explanatory memorandum of the Commission proposal for the Engagement Amendment dated 9 April 2014, document number COM(2014) 213 final; my emphases.

2.1 Shareholder engagement

In 2011, the European Commission recognised that most shareholders were "passive and often only focused on short-term profits."[680] It believed that corporate governance would be better off with a checks-and-balances system in which shareholders are more active.[681] However, the framework in place prior to the Engagement Amendment was "built on the assumption that shareholders engage with companies and hold the management to account for its performance."[682] Therefore, the Commission pushed for more shareholder engagement. In the United Kingdom, soft law has tried to encourage institutional investors to engage and exercise stewardship since 2002 — without any tangible success towards long-termism.[683] The Impact Assessment defined shareholder engagement as

> The active monitoring of companies, engaging in a dialogue with the company's board, and using shareholder rights, including voting and cooperation with other shareholders, if need be to improve the governance of the investee company in the interests of long-term value creation.[684]

Recital 2 of the Engagement Amendment clearly confirms that shareholders often support managers' excessive short-term risk taking and urges a more adequate level of monitoring investee companies as well as increased shareholder engagement.[685] The

680 Green Paper by the European Commission, dated 5 April 2011, document number COM(2011) 164. p. 3. For instance, high frequency trading accounted for 35% of all Union equity market trading in 2010. This revealed a preference of profits and trading activity over long-term engagement. See the discussion in the *Kay Review*, p. 9, and the Larosière Report, p. 30.

681 The literature review conducted as part of this study revealed that shareholder engagement is mostly correlated positively with the company's long-term performance. Bebchuk et al. (2015) found that even interventions by activist hedge funds are not correlated with a decline in the operating performance of companies, p. 76.

682 Green Paper by the European Commission, dated 5 April 2011, document number COM(2011) 164. p. 4.

683 Johnston and Morrow (2015), pp. 29–30. The authors explained the regulators' belief that increased engagement leads to less pressure to sell shares.

684 Impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, p. 81. This definition clearly excludes the detrimental activism of shareholders aimed at increasing the risk profile of the invested company.

685 "The financial crisis has revealed that shareholders in many cases supported managers' excessive short-term risk taking. Moreover, there is clear evidence that the current level of 'monitoring' of investee companies and engagement by institutional investors and asset managers is often inadequate and focuses too much on short-term returns, which may lead to suboptimal corporate governance and performance."

Engagement Amendment focuses on three key documents of institutional investors and asset managers:

(a) **Engagement policy**: Article 3g requires — on a comply or explain basis — institutional investors and asset managers to disclose publicly their engagement policy (i.e. how they integrate shareholder engagement in their investment strategy) and its implementation on an annual basis.

(b) **Investment strategy**: Article 3h(1) requires institutional investors to disclose publicly how their investment strategy contributes to the long-term performance of their assets. Article 3i(1) requires asset managers to disclose to institutional investors how their investment strategy and implementation thereof complies with the arrangements between both parties and contributes to the long-term performance of their assets.

(c) **Arrangement with asset managers**: Article 3h(2) requires institutional investors to disclose publicly their arrangements with asset managers. The institutional investor must also disclose how it monitors the portfolio turnover by the asset manager and the duration of the arrangement.

All three articles include procedural rules which nudge a substantive effect. By requiring institutional investors and asset managers to disclose their engagement policies, investment strategies and arrangements with asset managers, the Shareholder Directive nudges these actors to more highly regard the content of the engagement policy, investment strategy and arrangement with asset managers. The procedural rules flow into the substance of the regulated conduct because they impose specific content on each of the three documents (see table VI.2.1: *Content*).[686] These documents are relevant because they are supposed to guide the relationship of institutional investors and asset managers with their clients. Further, the documents define the obligations of

[686] The Pension Fund Directive includes a similar mechanism, i.e. it imposes content to be included by pension funds in their investment strategy. Article 41(1) thereof states "Member States shall require IORPs to ensure that prospective members who are not automatically enrolled in a pension scheme are informed, before they join that pension scheme, about: (…) (c) information on whether and how environmental, climate, social and corporate governance factors are considered in the investment approach". IORPs are institutions for occupational retirement provision.

the directors of such institutional investors or asset managers towards their clients.[687] By establishing the content of such documents, the Shareholder Directive creates minimum standards of conduct for institutional investors and asset managers.

Table VI.2.1 – Content

Engagement policy	**Investment strategy**	**Asset manager arrangements**
How institutional investors and asset managers: • monitor companies on strategy, financial and **non-financial** performance and risk, capital structure, **social and environmental impact** and corporate governance; • conduct dialogues with companies; • exercise voting and other rights; • cooperate with other shareholders; • communicate with relevant company stakeholders; and • manage conflicts of interest.	How the strategy: • is consistent with the **long-term liabilities** of the investor; and • contributes to the medium to **long-term performance** of their assets. Additional content for asset manager disclosure: • material long-term risks; • portfolio composition and turnover; • use of proxy advisors; • policy on securities lending;[688] • decisions based on long-term company performance including non-financial performance; and • conflicts of interest.	How the arrangement incentivises the manager: • to align its strategy and decisions with the profile and **long-term liabilities** of the institutional investor (including via the remuneration structure); • to make decisions considering the company's medium to **long-term financial and non-financial performance**; and • to engage with companies to improve their medium to **long-term performance.**

[687] As Möslein and Sorensen (2018) put, the directors of institutional investors and asset managers are incentivised here: "Management decisions immediately translate in corporate behaviour. (…) Every single decision has a potential impact on workers, customers, or the environment. As a consequence of their control over a company's business, managers seem to be the ideal target group for regulatory interventions designed to encourage responsible corporate conduct.", p. 396.

[688] This addresses empty voting, discussed in section VI.3.1 (*Long-term holding*). Article 3i(1) requires asset managers to disclose their "policy on securities lending and how it is applied to fulfil its engagement activities if applicable, particularly at the time of the general meeting of the investee companies."

The Shareholder Directive requires institutional investors and asset managers to report on the implementation of these documents. Moreover, Article 3g(1)(b) requires institutional investors and asset managers to annually disclose their voting behaviour to the public, explaining their most significant votes and their use of proxy advisors. This procedural rule might also nudge an effect on substance. Knowing that they will have to explain their votes publicly in the future gives shareholders a reputational incentive to think *ex ante*. Evidently, the effectiveness of such a nudging tool depends greatly on the market oversight of such disclosures. If other stakeholders do not react to "bad" votes (e.g. excessively short-termist votes), shareholders are unlikely to adjust their behaviour.[689]

The Shareholder Directive does not expressly demand compliance with the engagement policy, investment strategy, or asset manager remuneration arrangements. Nor does it establish any enforcement mechanism in case of default of these documents. The Union legislator has left compliance and enforcement to the discretion of Member States, or the investors and companies' cross-policing (i.e. the market will punish itself).[690]

In my view, this choice has little chance of succeeding: The overall goal of the Engagement Amendment is "long-term sustainability of EU companies."[691] Further, the internal market shall achieve "sustainable development," "social justice and protection" and "solidarity between generations."[692] However, the Union only imposes procedural obligations on shareholders and listed companies potentially able to indirectly — if the nudge really works — contribute to these goals. If shareholders and listed companies fail to adopt the procedures, they are supposed to penalise each other in the market. Given the market's track record, it is naïve to expect investors and companies to oversee each other with regard to such procedures.[693] This is even more true because currently

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689 Johnston and Morrow (2015) emphasised the risk that more shareholder power may exacerbate short-termism, p. 26.

690 Article 14b of the Shareholder Directive: "Member States shall lay down the rules on measures and penalties applicable to infringements of national provisions adopted pursuant to this Directive and shall take all measures necessary to ensure that they are implemented. The measures and penalties provided for shall be effective, proportionate and dissuasive."

691 See section IV.1.1 (*Trajectory*).

692 See section I.4.2.1 (*Principles of Union company law*).

693 Section III.1 (*The trend towards short-termism*) discussed how shareholders and listed companies have focused mainly on the single bottom line, leaving social and environmental concerns for the state.

substantive rules do not recognise the primary obligation of shareholders and of listed companies to contribute to "sustainable development," "social justice and protection" and "solidarity between generations." Hence, substantive rules in this direction are urgent at Union level.

So far, the Union legislator has created substantive rules with very limited scope. For instance, the regulation on European long-term investment funds addresses investments in long-term assets, as explained in box VI.2.1 (*European long-term investment funds*). The SEF Regulation creates substantive rules on positive social impact, as described in box VI.3.2 (*European social entrepreneurship funds*). Given their limited scope, these directives rely on the promise of regulatory dualism.[694] Gilson et al. explained that regulatory dualism provides

> protection to entrenched owners and managers for the sake of reducing their opposition to the reforms needed to develop an efficient system for financing and managing at least a portion of the corporate sector.

Research on regulatory dualism reveals that a booming economy is a relevant factor for the necessary reforms to succeed. This was the case in Germany, Brazil and the United States. However, the Union faced difficult economic, social and political challenges during the 2010s, and gloomy prospects are forecasted for the 2020s. Hence, European long-term investment funds and European social entrepreneurship funds have little tail wind to carry them forward. In this scenario, it takes more than dual regulation or "light-touch" regulation to scale up long-termism.[695] Current regulation needs to evolve further into hard-law substantive rules applicable to a wider group of companies and shareholders.

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694 Gilson et al. (2011): "The evolution of corporate law reflects a struggle between allocation and distribution—the conflict presented by reforms that increase production [*or sustainable development*] at the expense of making the existing economic and political elites worse off," p. 536; my insertion. The authors claim that the reforms will become standard once the critical mass adopting the reforms becomes substantial enough.

695 Willey (2018) maintained that the light touch approach is "the most effective method of 'nudging' capital markets away from their current short-term focus," pp. 216–219.

Box VI.2.1 – European long-term investment funds

Before amending the Shareholder Directive, the Union had already created an optimal framework for shareholders aiming at long-term engagement and long-term performance. This framework is set out in LTIF Regulation. The main characteristics of such funds are:

- At least 70% of their capital must be invested in “eligible investment assets.” These are non-financial privately-held companies or non-financial listed companies with a capitalisation below EUR 500 million, including other European long-term investment funds, European venture capital funds and European social entrepreneurship funds.
- As a general rule, engaging more than 5% of their capital in short selling, securities lending, securities borrowing, repurchase transactions, derivative transactions and commodities is prohibited.
- Such funds are subject to diversification rules, such as a maximum of 10% of their capital invested in a single company or real assets,[696] other than under the exceptional conditions described in Article 13.
- With regard to concentration, such funds shall not hold more than 25% of shares in a single European long-term investment fund, European venture capital funds and European social entrepreneurship fund.
- Such funds are subject to leverage limits and may not borrow cash representing more than 30% of their capital.
- The shares of such funds are non-redeemable before their end of life.

Some of these features may of course be adopted by any shareholder focusing on long-term investments. The regulation, however, does not address the non-financial aspects of investments, such as environmental, social and governance issues.

2.2 Pay and performance

Article 9a(1) of the Shareholder Directive ensures that shareholders have a say on pay, i.e. the right to vote on the remuneration policy of the directors of listed companies.[697] Paragraph 6 of this article includes three substantive requirements. First,

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[696] Article 2(6) of the LTIF Regulation defines: “‘real asset’ means an asset that has value due to its substance and properties and may provide returns, including infrastructure and other assets that give rise to economic or social benefit, such as education, counselling, research and development, and including commercial property or housing only where they are integral to, or an ancillary element of, a long-term investment project that contributes to the Union objective of smart, sustainable and inclusive growth.”

[697] The impact assessment by the Commission Staff dated 9 April 2014, document number SWD/2014/0127, includes relevant definitions, pp. 80–81. Remuneration: “Salary plus additional

the policy shall "contribute to the company's business strategy and long-term interests and sustainability." Second, it shall be based on "financial and non-financial performance criteria" and on "criteria relating to corporate social responsibility."[698] Third, the document shall explain how the policy as a whole and its performance evaluation criteria contribute to the long-term interests and sustainability of the company.[699]

In addition to substantive requirements, Article 9b(1)(a) imposes various procedural aspects, among others, that the company shall annually report on the remuneration paid or due.[700] This report, moreover, must explain how the paid remuneration contributes to the long-term interests and sustainability of the company.[701] Reporting *ex post* remuneration allows shareholders and other stakeholders to verify whether the *ex ante* policy produced fair *ex post* results.[702] For instance, stock options plans may entail long-term as well as short-term behaviour in management, depending on the overall design of the mechanism and of contextual factors.[703]

amounts of benefits and bonuses"; Remuneration policy: "Policy defining all forms of compensation, including fixed remuneration, performance-related remuneration schemes, pension arrangements, and termination payments"; Individual remuneration: "Remuneration to be attributed, individually, to directors"; Additional remuneration: "Any participation in a share option or any other performance-related pay scheme; it does not cover the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the company (provided that such compensation is not contingent in any way on continued service)"; and Variable components of remuneration: "The components of directors' remuneration entitlement which are awarded on the basis of performance criteria, including bonuses."

698 There is no one-size-fits-all formula for tying compensation to long-term sustainability. Burchman and Jones (2019) provide a step-by-step roadmap for companies aiming to design such a compensation policy.

699 The original proposal for the Engagement Amendment required the policy to disclose and explain the ratio between remuneration of directors and that of other full-time employees. The idea dates back to Plato's Athens and was defended by Peter Drucker in an article published in the *Wall Street Journal* in 1977. He argued that there should be a cap for the ratio between the CEO's salary and the lowest full-time employee salary, suggesting 25:1 as a fair ratio. In 2013, the Swiss electorate voted against a popular initiative proposing to cap the ratio at 12:1.

700 Some commentators have argued that disclosure may have the side-effect of inflating salaries in the market. See Johnston and Morrow (2015), p. 36.

701 The United Kingdom has adopted similar rules and remuneration practices have not changed since. See Johnston and Morrow (2015), p. 35

702 Bolton et al. (2005) observed that "what looks like an outrageous reward *ex post* may be seen as perfectly reasonable from an *ex ante* perspective," p. 738.

703 Chakhovich et al. (2010), p. 311. See Main et al. (2011) for a thorough analysis of the effects of career shares — i.e. "an annual award of unvested shares which cannot be cashed in until, variously, the end of the CEO's career or some 12, 24, or 48 months after that termination."

Indeed, compensation can work as a reward for directors that pursue long-termism, by working as an extrinsic motivation.[704] However, scholars pointed out three issues that make it difficult to design such a reward. Firstly, if the regulation set out too many details, it will excessively interfere in the private autonomy of company and directors. Secondly, defining long-termist targets may be challenging for the lack of precision of the term. Thirdly, these goals have long-term nature and cannot be assessed annually.[705] In my view, the three issues have been addressed by the law, academic literature or market initiative. Private autonomy may be limited in order to pursue other objectives (see sections I.3.2: *Principles of justice* and I.4.2.1: *Principles of Union company law*). While this study lays out the general definition for long-termism as an academic contribution (section III.2.1.1: *Three conditions*), other self-regulatory entities have created metrics to measure societal and environmental performance.[706] With respect to the longer timeframe, deferred payments may do the trick.

If transposed precisely, Articles 9a and 9b may potentially incentivise executive directors to behave longer-term when making daily business decisions.[707] I argue, however, that the Engagement Amendment falls short with respect to deferred payments.[708] In the aftermath of the 2008 crisis, Union law adopted the deferred

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704 In terms of incentives for directors, scholars have suggested other mechanisms beyond remuneration. Fox and Kenagy (2012) found a positive correlation between manager turnover and short-term behaviour. They noted that CEOs average tenure declined from 10 years in 1995 to 6 years in 2010, and recommended longer C-suite mandates as well as more industry knowledge. With respect to non-executive directors, Laverty (2004) proposed that an increase in time dedicated to the company, p. 959. He quoted a government-commissioned review of the governance of British banks, which revealed that bank non-executive directors spend between 12 and 20 days annually dedicated to the bank. In contrast, non-executive directors of companies owned by private equity firms dedicate in average 54 days.

705 Möslein and Sorensen (2018), p. 405.

706 The B Impact Assessment may serve as inspiration for setting environmental, societal and governance targets for executives. It is a free tool available at https://bimpactassessment.net/. Last accessed 21 January 2020. On the other hand, Fox and Kenagy (2012) indicated that expenses on R&D, marketing, training and re-skilling, as well as sales and profit margin, market share and market position are long-term financial indicators. In 2020, Royal Dutch Shell became the first energy company to tie executive remuneration with targets of carbon emission reduction.

707 Johnston and Sjåfjell (2020) explained that the United Kingdom introduced similar rules before the Union, without much success towards long-term sustainability. They present examples of British companies paying executives "enormous sums of money" and leaving society with nothing after bankruptcy.

708 There are other aspects outstanding in this design for incentives. Remuneration should not be the only incentive. As Gordon et al. (2018) put, research revealed that "financial incentives have a significant relationship to the quantity of work delivered, but not with the quality of the work" and

payments strategy of the Basel Committee for financial institutions.[709] The rules in the Capital Requirement Directive, as described in box VI.2.2 (*Remuneration in the Capital Requirement Directive*) would certainly also benefit non-financial listed companies.

Box VI.2.2 – Remuneration in the Capital Requirement Directive

In this Directive, the key provisions concerning remuneration and long-termism are[710]:
Article 92(2)(a) and (b) – The remuneration policy must be consistent with the long-term interests of the institution and does not encourage excessive risk-taking. (similar to 9a(6) of the Shareholder Directive)
Article 94(1)(a) – Remuneration must be based on combining the assessment of the performance of (i) the individual, (ii) the business unit concerned and (iii) the overall results of the institution.[711] When assessing individual performance, financial and non-financial criteria must apply.
Article 94(1)(b) – Performance be assessed within a multi-year framework based on longer-term performance. Remuneration payments are spread over time.
Article 94(1)(m) – At least 40% of the variable remuneration component must be deferred over three to five years.

Sappideen observed that, historically, most compensation schemes incentivised short-term share price increase. Hence, executive directors were "encouraged to pursue short-term speculative projects even at the expense of long-term fundamental value."[712] Bebchuk and Fried noted that the insulation of boards, combined with inflated pension plans, life insurance contracts and golden parachutes, led to excessively high executive compensation.[713] The Engagement Amendment works to tweak the incentives for

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"large financial incentives are not helping them [executives] to make better decisions, but rather the opposite", p. 179.

709 This is part of so-called Basel III, namely, "an internationally agreed set of measures developed by the Basel Committee on Banking Supervision in response to the financial crisis of 2007-09. The measures aim to strengthen the regulation, supervision and risk management of banks." Retrieved from https://www.bis.org/bcbs/basel3.htm?m=3%7C14%7C572. Last accessed 24 January 20. Coca-Cola Co. adopted deferred payments in 2006, in a compensation scheme that became known as the "all-or-nothing pay." See Fox and Kenagy (2012).

710 The UCITS Directive requires management companies working for undertakings for collective investment in transferable securities to issue internal remuneration policies under similar prerequisites. See Articles 14a and 14b.

711 This ensures that C-suite executives bear some downside risk and have skin in the game of the company as a whole.

712 Sappideen (2011), p. 428.

713 Bebchuk and Fried (2004), p. ix.

directors. In addition to shareholders' say on pay, it imposes relevant content on compensation policies.

Sullivan & Cromwell LLP provided a global overview of executive compensation and employee benefits during 2017 and found five main trends:

(i) A global trend emerged for pay-for-performance compensation structures, basically consisting of a fixed salary amount and a variable long-term incentive that increases with seniority. In Europe, the fixed salary and long-term incentive parts of compensation were rather balanced, whereas variable incentives made the larger part of compensation in the United States and the smaller part in Asian countries;

(ii) Many jurisdictions exempted executives from general labour laws, which allowed for more contractual flexibility;

(iii) Some national laws aimed to address the excesses in executive compensation perceived by society, with little practical success;

(iv) Some countries started to regulate the compensation of non-executive directors; and

(v) Clawback rules requiring executives to return compensation because of misconduct became increasingly present.

Mayer & Brown LLP repeated the analysis in 2019, highlighting four main global trends:

(a) There was an increasing focus on disclosure of compensation and compensation policies, requiring long-term value creation. However, shareholder returns still mattered;

(b) Non-compete undertakings became increasingly more difficult to enforce globally, especially if executives are not compensated for this obligation;

(c) The #metoo movement had an impact on the appraisal of executive performance globally. Executives are required to participate in training and to implement company policies against harassment; and

(d) Awareness of the gender pay gap grew in capital markets. In some jurisdictions, employers must disclose differences in salaries and bonuses paid to female and male employees. More and more activist shareholders were paying increased attention to diversity and inclusion issued.

While important issues such as excessive payments and diversity and inclusion appear to be addressed, none of the identified trends represent a direct incentive for long-termism. Since not all Member States have transposed the Engagement Amendment yet (e.g. Germany only did so in December 2019), academic literature has been unable to empirically review whether Articles 9a and 9b have changed remuneration structures in Union listed companies.[714]

At the very least, the Shareholder Directive contributes to changes in the general societal and managerial discourse around remuneration. Specifically, environmental, social and governance metrics will play a more prominent role in appraisals and variable remuneration, instead of the narrow focus on financial metrics.[715] In conclusion, scholars agree that short-term orientation may be required to address very specific circumstances with limited scope (particularly in middle management). However, executive directors should be incentivised towards strategic long-term orientation.[716]

2.3 Proxy advisors

Article 3j of the Shareholder Directive addresses both issues discussed in section VI.1 (*The equity investment chain*): The lack of transparency in the methodology of proxy advisors and in relation to conflicts of interest. In sum, this article requires that proxy advisors:

(i) Adopt a code of conduct and report annually on their application of this code (comply-or-explain)

(ii) Disclose their (a) methodologies and models; (b) main information sources; (c) procedures to ensure quality of research, advice, and voting recommendations and staff qualifications; (d) how and whether they consider national market, legal and company-related factors; (e) voting

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714 Two Commission Recommendations (2004/913/EC of 14 December 2004 and 2009/385/EC of 30 April 2009) have been issued on the remuneration of directors of listed companies. Neither makes a significant contribution in terms of long-termism.

715 For instance, the Global Reporting Initiative is a pioneer in environmental, social and governance standards with worldwide recognition.

716 Chakhovich et al. (2010), p. 314.

policies for each market; (f) dialogues with companies and their stakeholders; and (g) policy on the prevention and management of conflicts of interests; and

(iii) Identify and disclose potential conflicts of interests to clients.

Provision (i) ensures a minimum deontological standard for proxy advisors as well as a level playing field for the sector. Provision (ii) is a procedural rule that imposes content on the internal policies of proxy advisors. It has the potential to improve the quality of their methodology and voting advice, if due attention is paid to each criterion. Provision (iii) is a substantive rule that tackles the existing obscurity over conflicts of interests.

With respect to long-termism, the directive does not include the obligation of proxy advisors to consider the sustainability and long-term interests of the company when making voting recommendations. Consequently, shareholders are left with the responsibility of demanding this consideration from proxy voters. It is doubtful whether shareholders will carry out this policing activity, since the current discourse fails to indicate that shareholders are willing to pressure proxy advisors. I argue that, given these advisors' prominence in the equity investment chain, they should also be (at least) obliged to explain how they contribute to the "long-term sustainability of EU companies."[717]

2.4 Cross-border facilitation

Three articles of the Shareholder Directive focus on cross-border facilitation:[718]
Article 3a – Companies have the right to identify shareholders holding more than 0,5% of shares or voting rights. On the flipside, this imposes on intermediaries[719] the obligation to disclose the ultimate beneficiary on the company's request.

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717 This claim is consistent with Article 1 of the Shareholder Directive: "This Directive […] also establishes specific requirements in order to encourage shareholder engagement, in particular in the long term. Those specific requirements apply in relation to […] transparency of institutional investors, asset managers and proxy advisors."

718 The European Data Protection Supervisor approved these provisions in its opinion dated 21 November 2014, document number 2014/C 417/06.

719 The Shareholder Directive defines an intermediary as a person (e.g. an investment firm, a credit institution or a central securities), "which provides services of safekeeping of shares, administration of shares or maintenance of securities accounts on behalf of shareholders or other persons."

Article 3b (1) and (4) – Intermediaries shall transmit from the company to shareholders any information that the company must provide so that shareholders can exercise their rights. Intermediaries shall transmit information to the company according to the instructions of shareholders.
Article 3c – Intermediaries shall facilitate the exercise of shareholder rights by making the "necessary arrangements" as well as by confirming that votes have been made, recorded and counted, electronically or otherwise.

With these provisions, the Shareholder Directive aims to open up a communication channel between companies and their shareholders, especially to facilitate communication among those in different countries. This channel is expected to ensure that information flows smoothly and that voting becomes easier, thus making (cross-border) investments more cost-efficient. Consequently, there would be more long-term engagement between shareholders and companies.[720] Some scholars, however, are sceptical about this potential consequence. For instance, Johnston and Morrow argued that direct communication between institutional investors and companies is unlikely due to time pressures on the former. Nevertheless, these authors urge companies to use this direct communication channel to inform shareholders about the views of other stakeholders.[721] The 2020s might reveal whether the cross-border facilitation provisions in the Shareholder Directive will contribute effectively to long-term engagement. So far, this study makes no recommendations in this respect.

3 Beyond the directive

In terms of incentives for long-termism, the Shareholder Directive falls short of what is required to change current market behaviour in the Union.[722] Two topics relating

[720] Forthcoming Union company law is expected to take a further step and foster direct holding of securities by asset owners. Article 3(1) of the Depositaries Directive shall require direct holding in 2023 for new securities and in 2025 for all: "Any issuer established in the Union that issues or has issued transferable securities which are admitted to trading or traded on trading venues, shall arrange for such securities to be represented in book-entry form as immobilisation or subsequent to a direct issuance in dematerialised form."
[721] Johnston and Morrow (2015), p. 29. There must have been high agency costs in pre-Engagement Amendment arrangements between intermediaries and shareholders if such arrangements really did not confer upon asset owners the right to receive information from intermediaries.
[722] Johnston and Morrow (2014), p. 1.

to shareholder long-term engagement were omitted from the Engagement Amendment: Long-term shareholding and shareholders' fiduciary duties. These are discussed below.

3.1 Long-term shareholding

While some Member States have laws favouring long-term (loyal) shareholders, the Union has not taken any decisive step in this direction. In 2011, the Reflection Group on the future of EU company law recommended incentives for long-term shareholding to the Commission.[723] The Committee on Legal Affairs issued a report with similar recommendations in 2015.[724] According to this report, the incentives could take the form of voting rights, tax incentives[725], loyalty dividends or loyalty shares. However, these incentives never entered the final text of the Engagement Amendment. Hence, Union company law may potentially incentivise longer holding periods and loyal engagement.[726]

As Warren Buffett maintained, longer holding periods are a condition for true engagement. In contrast, the shorter the holding period, the more "beliefs" about the market influence investment decisions.[727]

> In fact, when we own portions of outstanding businesses with outstanding managements, our favourite holding period is forever. We are just the opposite of those who hurry to sell and book profits when companies perform well but who tenaciously hang on to businesses that disappoint.[728]

Most existing laws and scholars consider two to three years to be the minimum holding period that qualifies as "long-term."[729] In addition, markets feel the need to

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723 Antunes et al. (2011), pp. 46–47.

724 In their report adopted on 12 May 2015 regarding the Engagement Amendment. See Recital 9a and Article 3ea.

725 Tax law falls outside of the scope of this study. However, several authors have debated using tax incentives for long-termism. For instance, Fox and Kenagy (2012) recommended flexible tax rates on capital gains according to the duration of the holding. See also Dallas (2012), p. 348, and Quimby (2013), p. 413.

726 Long-term shareholding may mitigate the risk that the directive engages activist short-term shareholders and has a negative effect on long-termism.

727 Rappaport (2005), p. 66.

728 This is an excerpt from Warren Buffett's 1988 letter to the shareholders of Berkshire Hathaway Inc. Retrieved from https://www.berkshirehathaway.com/letters/1988.html. Last accessed 15 January 2020. The tycoon maintains this approach to investments until today.

729 French law requires a two-year minimum. Industry reports recommend at least three years, e.g.

combat shareholders absenteeism at general meetings. Companies are interested in engaged shareholders, who participate sustainably in important decisions (e.g. a contested election of board members, approving a major acquisition or sale, employee equity programmes and remuneration policies).[730] Hence, shareholders who hold their shares for a longer time and who participate in meetings could be entitled to positive political and economic incentives.[731] Examples of positive and negative incentives are:

Incentives concerning political rights

- Additional number of votes for long-term (loyal) shareholders;[732]
- Minimum holding period for the right to include matters for the agenda of an annual meeting and to ask questions to directors and auditors during this meeting;[733]
- Minimum holding period for the right to vote on certain matters (e.g. approval of a major acquisition or sale or of CEO pay);
- Right to more frequent communication with management;
- Majority at two subsequent general meetings for the approval of certain matters; and[734]
- After failing to attend a general meeting, prohibition to vote at the next one.[735]

Generation Foundation (2012), p. 20 and Mercer et al. (2013), p. 9. Some companies like Pernod Ricard require ten years.

730 Copland et al. (2018), p. 1.

731 Even if long-term shareholding may occur due to "laziness" and not because of engagement, it is still the best available proxy for an incentive towards long-termism. Möslein and Sorensen (2018), p. 450.

732 Fox and Kenagy (2012). Mayer (2013) proposed that shareholders register their intended holding period and receive corresponding votes at the time of purchase, p. 208.

733 See Strine (2010) and Houben and Straetmans (2016), pp. 625–626.

734 Bebchuk (2005), pp. 872–873. As short-term shareholders may not expect to stay on for the second meeting, mainly long-term shareholders will be able to vote on such decisions. He therefore proposed: "Alternatively, the suggested regime could stipulate that a proposal approved in an annual meeting would come into effect after the subsequent annual meeting, but only if no decision to reverse the earlier decision is approved in that meeting."

735 Under Article 28b of the Transparency Directive (Directive 2013/50/EU), shareholders who have committed a breach may have their voting rights revoked.

Incentives concerning economic rights

- More dividends for long-term (loyal) shareholders;[736]
- "Attendance bonus" for shareholders actively participating in general meetings; and[737]
- Reduced dividends after not attending or voting at a meeting.

Granting additional political or economic rights may also have negative consequences.[738] The outcome depends on how the incentive is structured. For instance, dual class shares in Silicon Valley have been largely criticised.[739] For instance, Mark Zuckerberg has been accused of violating the one share, one vote rule to maintain his control over the company.[740] Therefore, any incentive for long-term shareholding must be designed to ensure that no abuse of control occurs.[741] One important feature of such incentives is that the benefit — e.g. additional voting rights or dividends — be attached to the shareholder, based on his or her behaviour. As soon as the shares are transferred to another party (even by way of inheritance or succession), the benefit ceases to exist. This is the case in France, where loyalty shares are mainly held by retail investors.[742]

Some authors propose restricting shareholder rights to avoid short-termism, thus indirectly fostering long-termism. One example is restricting the use of voting rights for empty voting, which happens when shareholders exercise voting rights without bearing the economic risk. For example, share borrowers sometimes obtain shares prior to a general meeting to influence its outcome and repay the shares immediately after the

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736 French law allows companies to adapt their articles to give long-term shareholders up to 10% more in dividends. Bolton and Samama (2012), p. 12.

737 German and Spanish companies. Delvoie and Clottens (2015), p. 22.

738 Fried (2015), p. 1627.

739 Bebchuk and Kastiel (2017), p. 611. See further ICGN Viewpoint: Differential share ownership structures: Mitigating private benefits of control at the expense of minority shareholders, dated February 2017.

740 Facebook, Inc. has issued class A shares which confer one vote per share, whereas Zuckerberg's class B shares bear ten votes per share. See Murphy, "Protest vote highlights concern over Mark Zuckerberg's power," Financial Times, 4 June 2019. Retrieved from https://www.ft.com/content/49bd5ed8-865a-11e9-a028-86cea8523dc2. Last accessed 21 January 2020.

741 For instance, Dutch law sustains the general principle of equal treatment of shareholders but allows for a loyalty dividend scheme if it is justified by the "legitimate objective" of long-term value creation. Delvoie and Clottens (2015), p. 21.

742 Delvoie and Clottens (2015), p. 20.

meeting. For instance, Article 22(7) of the UCITS Directive restricts the loaning of shares to avoid them being used for short-term speculation.[743] Hu et al. suggested that voting rights should be suspended for those shareholders occupying a pure short economic position.[744]

In conclusion, the Shareholder Directive does not include direct incentives for shareholders to engage with the company in the long-term. To address this gap, section VI.4 (*Recommendations*) proposes rules that foster more long-termist behaviour by shareholders.

3.2 Shareholders' fiduciary duties

The second point omitted from the Shareholder Directive are the fiduciary duties of institutional investors and asset managers. As described in section V.3.2 (*Directors' fiduciary duties*), the directors of listed companies should have fiduciary duties towards the company's stakeholders. This study proposes that shareholders also have fiduciary duties towards their stakeholders.

In Union company law, the Financial Instruments Directive is a starting point. It establishes the duties of "traditional" investment firms towards their clients. According to Article 24 of the directive, these firms shall "act honestly, fairly and professionally" as well as "in accordance with the best interests of [their] clients." Grundmann noted that this rule implies a duty of diligence or care, and a duty of loyalty towards clients.[745] These duties are well-known in both common and civil law jurisdictions, and their existence is no longer controversial. The next step, however, is to extend such duties to stakeholders other than the clients of institutional investors and asset managers. In 2018, the High-Level Expert Group on Sustainable Finance recommended that the Commission proposes regulation to clarify the fiduciary duties of investors to include

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[743] In Union law, such restrictions must be clearly justified in Article 3(3), as well as in the general interest and proportionality. Only thus may it be a legitimate restriction to the free movement of capital.

[744] Hu et al. (2006), p. 888.

[745] Grundmann (2012), pp. 531–533.

environmental, social and governance considerations in their decision-making.[746] However, no regulation has come so far.[747]

Box VI.3.2 – European social entrepreneurship funds

European social entrepreneurship funds basically are funds that invest in undertakings which, inter alia: (a) have the achievement of measurable, positive social impacts as their primary objective, (b) provide services or goods which generate a social return or employ a method of production of goods or services that embodies their social objective, (c) use their profits to achieve their primary social objective, and (d) are managed in a transparent way involving workers, customers and other stakeholders (Article 3(1)(d)).

The SEF Regulation governs these funds and fund managers, who could serve as inspiration for "traditional" shareholders, with respect to their duties. For instance, the regulation stipulates that:

- Fund managers have a duty to promote the positive social impact of the qualifying portfolio undertakings in which they have invested and to monitor such impact (Article 7(c) and (d)). Remarkably, Article 7 includes duties that should be evident for the director of any fund. These are: To act honestly, fairly and with due skill, care and diligence; to apply procedures preventing malpractices; to possess adequate knowledge of the investees; to treat their investors fairly; and to ensure that no investor obtains preferential treatment.
- Fund managers have a duty to employ procedures to measure the extent to which the positive social impact in undertakings is achieved (Article 10).
- Fund managers have a duty to report the social outcomes of their investment policy and a description of how environmental and climate-related risks are taken into account in the investment approach (Article 13(2)(f)). This reporting obligation may nudge managers to consider these aspects ex ante and may induce a de facto fiduciary duty.

Funds complying with this regulation have the right to use the designation "EuSEF."

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[746] Final Report by the High-Level Expert Group on Sustainable Finance, Secretariat provided by the European Commission, dated 31 January 2018, p. 20-21.

[747] This is envisaged in the Action Plan: Financing Sustainable Growth: "Action 7: Clarifying institutional investors' and asset managers' duties. Subject to the outcome of its impact assessment, the Commission will table a legislative proposal to clarify institutional investors' and asset managers' duties in relation to sustainability considerations by Q2 2018. The proposal will aim to (i) explicitly require institutional investors and asset managers to integrate sustainability considerations in the investment decision-making process and (ii) increase transparency towards end-investors on how they integrate such sustainability factors in their investment decisions, in particular as concerns their exposure to sustainability risks."

The SEF Regulation creates additional duties for the managers of European social entrepreneurship funds, but does not address a duty towards the stakeholders at shareholder level.

Möslein and Sorensen summarised several soft law instruments applicable to listed companies that allow shareholders to make investment decisions based on non-financial factors.[748] Nevertheless, nothing in Union company law imposes on shareholders fiduciary duties to the company or its stakeholders.[749] Consequently, the law creates a scenario in which shareholders' interests are self-centred and thus perpetuates a misalignment of shareholder, company and societal interests.[750] This legal position of shareholders is inconsistent not only with Article 3(3) of the TEU (see section I.4.2.1: *Principles of Union company law*), but also with the company's purpose proposed in section I.3 (*Normative foundations*). Moreover, this legal position is also inconsistent with the skin-in-the-game rationale discussed in section V.2 (*Skin in the game*), as shareholders have decision-making power over other stakeholders' skin, yet without a corresponding duty.[751]

In general terms, three major regulatory trends have impacted corporate governance since the 1990s. The first trend (still ongoing) aimed to coordinate the directors, the company and shareholders by reducing agency costs.[752] Scandals like Enron and WorldCom helped to initiate the second trend: The reporting revolution and the rights of minority shareholders. The enactment of the Sarbanes-Oxley Act of 2002 marked this moment. This second trend coordinated the relationship of the company, its shareholders and the market as a whole. Since the aftermath of the 2008 financial crisis, a third trend has emerged. Today's corporate governance is concerned with the relationship of the company, the market and society. On the one hand, the regulation of financial institutions targeted inter alia the protection of taxpayers. On the other, climate change is shedding more light on the environmental and societal dimensions of

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748 Ibid, pp. 433–434.

749 Möslein and Sorensen (2018) noted that in some jurisdictions like the United Kingdom, under specific circumstances, courts may recognise a duty towards the company for controlling shareholders acting as a de facto director, pp. 431–432. See also Mevorach (2013).

750 Houben and Straetmans (2016), pp. 616 and 618.

751 In the realm of corporate social responsibility, Houben and Straetmans (2016) proposed that shareholders' liability is limited to the company's debts. However, shareholders' responsibility entails the duty to further the long-term interests of the company and its stakeholders, p. 628.

752 Cheffins (2011), p. 9.

investments. In 2015, the European Commission issued a report on "Resource Efficiency and Fiduciary Duties of Investors." This document recommended that shareholders take environmental and social aspects into account in their investment decisions.[753] In the context of the third trend, section VI.4 (*Recommendations*) proposed modifications to the current rules on shareholders.

4 Recommendations

Based on the previous discussion, especially on the principles of Article 3(3) of the TEU, and aiming to further long-term shareholder engagement, this study recommends that the following rights and obligations be included in Union company law concerning listed companies.

Long-term shareholder engagement

R12. Companies shall implement mechanisms to foster long-term shareholder engagement, including yet not limited to the incentives concerning political and economic rights discussed in section VI.3.1 (*Long-term shareholding*). The incentives contingent upon a minimum holding period shall apply to shareholders holding shares for at least three years.[754]

R13. Shareholders have the right to receive and request information about how the matters discussed in a general meeting affect the short- and long-term interests of affected stakeholders prior to that general meeting.

Pay and performance

R14. The remuneration policy shall explain (a) how the multi-year performance of the individual, as well as the overall results of the company and the group and (b) how the directors' performance of their fiduciary duties as set out in recommendations R1 to R8 (section V.4: *Recommendations*) are taken into account by variable remuneration.

R15. Variable remuneration shall be spread over time and at least 40% of variable remuneration must be deferred over a period of three to five years.

R16. The remuneration policy shall detail the non-financial appraisal metrics and how they affect the career plan of employees.

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[753] European Commission, DG Environment, Study on resource efficiency and fiduciary duties of investors, produced by Ernst & Young Cleantech and Sustainability Services (France), document number ENV.F.1/ETU/2014/0002, dated 9 December 2015, Retrieved from https://ec.europa.eu/environment/enveco/resource_efficiency/pdf/FiduciaryDuties.pdf. Last accessed 21 January 2020.

[754] Some authors have argued that systemic companies, e.g. listed companies with more than 500 employees, should have a minimum holding period of two years applicable for all shares.

Proxy advisors

R17. Proxy advisors shall publicly disclose on an annual basis how the long-term interests of the companies and the stakeholders affected by voting recommendations were taken into account.

R18. Proxy advisors owe to their clients a duty to consider, balance and protect the long-term interests of the stakeholders affected by voting recommendations. If the interest of one or more stakeholder groups cannot be protected in a given decision-making process, shareholders shall state a clear and reasoned explanation for this decision.

Shareholders' fiduciary duties

R19. Shareholders owe to the invested company and to their clients a duty to consider, balance and protect the long-term interests of the stakeholders affected by their decisions. If the interest of one or more stakeholder groups cannot be protected in a given decision-making process, shareholders shall state a clear and reasoned explanation for this decision.

Chapter VII: Reporting Directive

This chapter looks at the Reporting Directive, particularly with respect to non-financial information, and its contribution to long-termism. It first closely examines non-financial disclosure in the directive (section VII.1: *Non-financial disclosure*).[755] Section VII.2 (*Weaknesses and potential*) discusses the weaknesses of the Reporting Directive and advances a potential expansion of its contribution to long-termism. Section VII.3 (*Recommendations*) proposes one legal adjustment with a view to augmenting the positive effects of the Reporting Directive. This chapter works on steps 4 and 5 of the methodology introduced in section II.4.2 (*Five-step analysis*).

Before considering non-financial disclosure, a brief note on financial disclosure is required. To further long-termist behaviour, many authors propose better reporting of financial information.[756] The most debated topic regarding financial reporting is frequency. Quarterly earnings guidance has been seen as a cause of short-termism (section III.1.4: *Causes*). While quarterly earnings guidance used to be a rule, several jurisdictions have removed this requirement since the latest financial crisis. The Union solved the matter with the Transparency Directive, which abolished the obligation of quarterly reporting in the internal market.[757] However, other issues remain. For instance,

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[755] La Torre et al. (2018) clarified terminology as follows: "Although the terms 'reporting' and 'disclosure' are usually used synonymously, these refer to different phenomena (Dumay, 2016). Reporting is a process that results in the production of a report according to a reporting model. Instead, corporate disclosure has a broader meaning that goes beyond the boundaries of reporting. Corporate disclosure concerns the 'interaction and learning' between a firm and its markets. It encompasses the 'disclosure channel,' the 'private information agenda' 'and many other elements' that deal with information asymmetry (Holland, 2005, pp. 249; 264). Therefore, corporate information can flow through various channels, some of which are more dynamic and timely for users than annual reports", pp. 603-604.

[756] See Black (2002), Krehmeyer (2006), the McKinsey Quarterly (March 2006), Barrot (2017) and Schumsky (2018). Samuelson and Stout (2009) affirmed that shareholders look at short-term financial accounts because they lack the knowledge to distinguish losses from long-term expenditures and losses from managerial incompetence, consequently incorrectly evaluating the performance of executives and paying them misguidedly.

[757] Recitals 4 and 5 of the Transparency Directive provide the background reasoning: "In order to encourage sustainable value creation and long-term oriented investment strategy, it is essential to reduce short-term pressure on issuers and give investors an incentive to adopt a longer term vision. The requirement to publish interim management statements should therefore be abolished." Further, "Member States should not be allowed to impose in their national legislation the requirement to publish periodic financial information on a more frequent basis than annual financial reports and half-yearly financial reports."

some executives still manipulate accounting information to meet financial targets.[758] Hence, financial reporting and long-termism still need further work. For instance, McKinsey has designed a corporate horizon index, which suggests five financial indicators to measure whether companies show long-term behaviour.[759] After reviewing several authors, Dallas recommended that companies report more thoroughly on long-term financial value (e.g. unexecuted obligations and contractual arrangements with suppliers and other business partners, intangible assets and risk exposure).[760] Rappaport suggested that, among other changes to financial performance reporting, the assumptions for discounted cash flow earnings forecasts be more clearly disclosed.[761] While further improvements in financial reporting are required, they do not feature very high on the Union agenda for long-termism.

1 Non-financial disclosure

This section (*Non-financial disclosure*) discusses non-financial disclosure in the Reporting Directive. It considers the purpose of this new type of disclosure, as introduced by the CSR Amendment (why), describes the process of nudging via disclosure (how) and addresses the reporting content (what).[762]

1.1 Why: Corporate social responsibility

In Union law, non-financial disclosure is closely linked with corporate social responsibility ("**CSR**").[763] In 2011, the European Commission published an agenda for

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[758] Bushee (1998), Roychowdhury (2006), Cohen (2008) and McKinsey (2017).

[759] McKinsey (2017), p. 3. The indicators are ratio of capital expenditure to depreciation, accruals as share of revenue, difference between revenue growth vs. earnings growth, how often companies meet earnings per share target, and the difference between earnings per share growth vs. true earnings growth. Legislators could demand that companies always disclose the rationale behind share buybacks.

[760] Dallas (2012), pp. 324 et seq.

[761] Rappaport (2005), p. 70.

[762] This resembles the structure of Sinek's (2017) use of the golden circle for marketing products. Nevertheless, the structure is also useful for organising and understanding other concepts.

[763] As discussed in section IV.1.1 (*Trajectory*), the Commission sought to ensure the long-term sustainability of listed companies, corporate social responsibility, non-financial disclosure and long-term shareholder engagement in parallel. Despite this fact and the thematic overlap, the Commission did not clearly state how these efforts related to each other. The proposal for the Engagement Amendment does not mention CSR at all, but only the 2011 Green Paper on the EU corporate governance framework.

CSR action. The agenda included the goal of "improving company disclosure of social and environmental information," in order to "facilitate engagement with stakeholders and the identification of material sustainability risks."[764] Two years later, the Commission launched a proposal to amend the directive on the disclosure of non-financial and diversity information by certain large undertakings and groups. The proposal declared non-financial transparency as a "key element of CSR policy."[765] Also in 2013, the European Parliament issued two resolutions on corporate social responsibility, both of which stressed the importance of companies sharing social and environmental information.[766]

In 2014, the European Parliament and the Council approved the proposed CSR Amendment. Its first three recitals mention corporate social responsibility. The Commission defines CSR as the responsibility of companies for their impacts on society[767], which is closely related to the concept of skin in the game (section V.2: *Skin in the game*). In this context, companies shall:

> have in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders, with the aim of: Maximising the creation of shared value for their owners/shareholders and for their other stakeholders and society at large; [and] identifying, preventing and mitigating their possible adverse impacts.[768]

Recital 21 of the CSR Amendment lays out the objective of this document: "To increase the relevance, consistency and comparability of information disclosed by certain large undertakings and groups across the Union." This objective is inserted in

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764 Communication from the European Commission dated 25 October 2011, A renewed EU strategy 2011-14 for Corporate Social Responsibility, document number COM(2011) 681 final, p. 11.

765 Explanatory memorandum of the Commission proposal for the CSR Amendment dated 16 April 2013, document number COM(2013) 207 final, p. 2.

766 Parliament resolutions dated 6 February 2013, entitled Corporate social responsibility: Accountable, transparent and responsible business behaviour and sustainable growth (document number P7_TA(2013)0049) and Corporate social responsibility: Promoting society's interests and a route to sustainable and inclusive recovery (document number P7_TA(2013)0050.)

767 Impact assessment by the Commission Staff dated 16 April 2013, document number SWD/2013/127, p. 4.

768 Ibid. This idea relates to the interest of the company discussed in chapter I.3 (*Normative foundations*).

the overall concept of the company's social responsibility. It relates directly to recommendation R10 in chapter V (*Takeover Directive, Merger Directive and Insolvency Directive*). Ultimately, non-financial disclosure is part of the company's responsibility for its impacts on society, and of its subsidiary obligation to maximise shared value creation for all its stakeholders and society at large.

This definition of CSR is closely related to the long-termism defined in this study. Both concepts entail an obligation to create shared value for all the company's stakeholders and also for society. The only difference is that long-termism refers to an extended timeframe, while the Commission's definition of CSR does not. Nevertheless, the Commission's recommendation on the quality of corporate governance reporting linked high-quality disclosure as part of good corporate governance and "well run-companies," which are "more likely to be **sustainable in the long term.**"[769] Dorfleitner et al. found that companies with best CSR practices outperform their peers.[770]

1.2 How: Nudging via disclosure

As seen in the directives discussed in chapters V (*Takeover Directive, Merger Directive and Insolvency Directive*) and VI (*Shareholder Directive*), as well as in the Reporting Directive, the Union often uses disclosure as a tool to regulate corporate governance. As procedural rules (see box IV.2.2.1: *Substantive, procedural and structural rules*), they create the infrastructure for corporate decision-making.[771] They influence both the recipients of information (shareholders) and the disclosing persons (directors).

Recipients

There are two main groups of recipients of non-financial information: First, shareholders, who are the primary recipients targeted by the directive; second, employees, consumers, suppliers and society, who have an interest in the provided information. The principal effects of these disclosure rules on recipients are:

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769 Recitals 1, 2 and 5 of the Commission Recommendation of 9 April 2014 on the quality of corporate governance reporting ("comply or explain") (2014/208/EU); my emphasis.

770 Dorfleitner (2018).

771 Möslein and Sorensen (2018), p. 397.

(a) Increased market efficiency: The idea behind sharing information is that if all recipients receive the necessary information, markets may become more efficient;[772]

(b) Educational effect: Information may raise awareness of a subject, thus increasing the attention given to it.[773] Kahneman maintained that presenting detailed information to recipients makes them think "slowly" about topics, i.e. process them more analytically;[774]

(c) Increased transparency: The overall quantity and quality of information about social and environmental aspects available in the market increases;[775] and

(d) Better investments: Under the mantra "only what gets measured gets managed," the Impact Assessment of the CSR Amendment states that better non-financial information may lead to better risk management. The document claimed the business case that "front-running companies on sustainability issues tend to outperform their competitors in financial terms."[776]

(e) Stakeholder engagement: With sufficient information at hand, stakeholders might feel empowered to connect with companies and discuss the impacts of such companies on themselves.

Disclosers

Non-financial disclosure also aims to impact disclosers, i.e. company directors with the duty to disclose and report. The relevant effects of disclosure rules on disclosers are:

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[772] This is because transaction costs are reduced when information asymmetries are corrected. Winter et al. (2002), p. 25.

[773] Möslein and Sorensen (2018), p. 409. See box IV.2.2.2 (*Legal pluralism*).

[774] See Kahneman (2011).

[775] Impact assessment by the Commission Staff dated 16 April 2013, document number SWD/2013/127, p. 37.

[776] The document also stated: "Overall, evidence suggests therefore that limited non-financial transparency may contribute to negatively affect the performance of companies." Ibid, pp. 18 and 37–38.

(f) Responsible decision-making: Disclosure nudges directors to perform well and in accordance with the expectations of addressees. It makes managers consider stakeholders and society ex ante in their decision-making (and think “slowly” about non-financial information). This is because they know that the non-financial outcomes of that decision will be subject to future reporting.

(g) Strategic guidance: Möslein and Sorensen claimed that the Reporting Directive implicitly requires companies to elaborate CSR policies. In their view, the wording "a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented" may influence strategic orientation.[777]

(h) Increased accountability: Article 33 of the Reporting Directive imposes collective responsibility and liability on directors over the disclosed information, which may increase the accountability of these persons. Article 34(3) exempts non-financial reports from the requirement of external auditing.

(i) Chain effect: Some of the listed companies within the scope of the Reporting Directive are shareholders, who must disclose information on their non-financial performance. Consequently, such shareholders may start looking at the behaviour or their invested companies and demand that these become more socially responsible.

1.3 What: Information on non-financial matters

In terms of content, the Reporting Directive requires listed companies to include a non-financial statement in their financial report containing information necessary to understand the company’s “development, performance, position and impact of its activity” with regard to, inter alia “environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.” As per Article 19a, the report shall include:

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[777] Möslein and Sorensen (2018), p. 414.

(a) a brief description of the undertaking's business model;

(b) a description of the policies pursued by the undertaking in relation to those matters, including the implemented due diligence processes;

(c) the outcome of those policies;

(d) the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;

(e) non-financial key performance indicators relevant to the particular business.

The wording is quite comprehensive and covers the various processes in which social and environmental aspects play a role: In the business model, in internal policies and their outcomes, internal due diligence and its implementation, risk management and key performance indicators. For guidance on how and what information should be published, listed companies have two sets of resources:

- International standards: The Reporting Directive refers to existing standards such as "the Eco-Management and Audit Scheme (EMAS), or international frameworks such as the United Nations (UN) Global Compact, the Guiding Principles on Business and Human Rights implementing the UN's "Protect, Respect and Remedy" Framework,[778] the Organisation for Economic Co-operation and Development's (OECD) Guidelines for Multinational Enterprises, the International Organisation for Standardisation's ISO 26000, the International Labour Organisation's Tripartite Declaration of principles concerning multinational enterprises and social policy, the Global Reporting Initiative." This list is not exhaustive and companies may thus opt for other standards.
- Guidelines: The Commission issued two guidelines in 2017 and 2019.[779] These are soft-law instruments aimed at improving the overall quality of non-financial reporting. On the one hand, the 2017 guidelines establish principles for

[778] Principles 11 to 24 address the responsibility of companies to respect human rights. They are accessible at https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf. Last accessed 13 January 2020.

[779] Communication from the Commission: Guidelines on non-financial reporting: Methodology for reporting non-financial information, dated 5 July 2017, document number 2017/C 215/01. Communication from the Commission: Guidelines on non-financial reporting: Supplement on reporting climate-related information, dated 20 June 2019, document number 2019/C 209/01.

disclosure, such as materiality of information, stakeholder orientation and "fair, balanced and understandable" reporting[780]. On the other, they give several examples of key performance indicators which companies may employ. In 2019, the Commission consulted with stakeholders about supplement guidelines. The 2019 guidelines have a narrower scope and focus solely on climate-related information. Both sets of guidelines refer to an extended timeframe and have a strong potential of contributing to transparency about he long-term impacts of companies.[781]

In addition to the non-financial information described above, the CSR Amendment made diversity a factor in the Reporting Directive. Article 20(1)(g) requires companies to publish a description of the diversity policy in their corporate governance. Diversity here means age, gender, or educational and professional backgrounds. This provision nudges companies to implement a diversity policy and to consider diversity when deciding on the composition of their administrative, management and supervisory bodies. Various studies have pointed out that diversity (especially gender diversity) may contribute to long-termism. For instance, Niessen-Ruenzi noted that women pursue less risky investments than men: "Their portfolios are less volatile and they tend to trade less"; moreover, "women tend to follow their investment styles more closely and deviate less from announced investment styles." [782]

In practice, these reporting obligations impose a new administrative burden on directors, who are not used to collecting, processing and publishing this type of information. In light of this fact, only large companies with more than 500 employees are required to disclose non-financial information. Larger companies have more administrative resources and a higher impact on society and the environment.[783] Article

780 Fox and Kenagy (2012) discussed the sensitivity of addressing "understandable" disclosure. They adverted for the unintended effect of reducing overall quality of disclosure to the public. Hence, the use of plain language shall not be used as an excuse for lack of transparency or precision.

781 E.g. "long-term risks and opportunities," "transparent business management is also consistent with longer-term investment," "long-term strategy," "long-term implications," "long-term objectives," "a company's business model describes how it generates and preserves value through its products or services over the longer term," "long-term principal risks" and "longer-term risks and opportunities" in the 2017 guidelines; and "strategic long-term vision," "long-termism in financial and economic activity," "longer-term time horizon," "longer-term changes in climate" and "longer-term perspective" in the 2019 guidelines.

782 Niessen-Ruenzi (2015), p. 440.

783 Indeed, small and medium enterprises (SMEs) have an aggregated large impact. However, the

19a(1), second paragraph, establishes that if a listed company has no policies in relation to environmental, social and employee issues, respect for human rights, anti-corruption and bribery, then it must provide a clear and reasoned explanation for this omission.[784]

With respect to the financial services sector specifically, the Union issued a regulation on sustainability-related disclosures in November 2019. Recital 10 of this regulation spells out its main objectives:

> This Regulation aims to reduce information asymmetries in principal-agent relationships with regard to the integration of sustainability risks, the consideration of adverse sustainability impacts, the promotion of environmental or social characteristics, and sustainable investment, by requiring financial market participants and financial advisers to make pre-contractual and ongoing disclosures to end investors when they act as agents of those end investors (principals).[785]

The regulation imposes the rules on transparency of information, whereas the European Supervisory Authorities — i.e. the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority — shall draft detailed technical standards on how information should be disclosed. An important development is the definition of "sustainable investments" for European investors, including investments in companies that (in their economic activity) contribute to environmental or social objectives, that do not harm any of these objectives and that follow good governance practices.[786] As of January 2020, the European Union was working on a proposal for a second regulation on the establishment

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Commission recognised that Article 19a would be too burdensome on SMEs. Based on the objective of facilitating the start-up and development of SMEs, the Commission decided to exempt them from this requirement. Listed SMEs may still disclose on a voluntary basis. See Impact assessment by the Commission Staff dated 16 April 2013, document number SWD/2013/127, p. 76.

[784] Möslein and Sorensen (2018) mentioned the Sarbanes-Oxley Act as an example of successful comply-or-explain regulation. The Act required listed companies to either disclose a code of ethics or explain why they did not have one. Over time, this requirement became a hard rule, p. 414.

[785] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

[786] Ibid, article 1(17).

of a framework to facilitate sustainable investment by defining criteria for what constitutes an economic activity that contributes to sustainable development.[787]

2 Weaknesses and potential

There is a positive side of course, among others, that the directive sets forth a reporting requirement for non-financial information. This requirement *per se* contributes to the development of responsibility for non-financial aspects and legitimates private initiatives for standardising non-financial reporting, such as the Global Reporting Initiative.[788] However, the practical consequences of the directive are hampered by various factors widely discussed in academia and by practitioners.

Möslein and Sorensen, La Torre et al. and Johnston and Sjåfjell pointed out some weaknesses of the Reporting Directive, some of which were confirmed by the European Commission in its inception impact assessment of the directive, as follows.[789] Each point has the potential to improve the directive:

(a) **Uncertainty about impact.** No evidence documents how many shareholders actually rely on non-financial reporting for making investment decisions;

(b) **Subtleness of wording.** Reporting requirements only result in a subtle, indirect incentive;

(c) **Excessive flexibility.** The reference to too many standards makes information less comparable and less reliable. Also, "empirical research demonstrates that mandatory NFR [non-financial reporting] does not necessarily mean better information or improvements to corporate accountability. As long as NFR is trapped in its symbolic and ceremonial use, NFR will be more a practice of 'talk' than of 'action.'"[790] The Reporting Directive actually aimed to ensure that the non-financial performance of listed companies could be compared. However, verbal vagueness, combined with flexible wording, run counter to the intended effect.

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787 Proposal by the Commission dated 24 May 2018 for a Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment, document number COM(2018) 353 final.

788 Ahern (2016), p. 629.

789 Inception Impact Assessment of the European Commission dated 30 January 2020, document number Ref. Ares(2020)580716.

790 La Torre et al (2018), p. 614.

(d) **Lack of coerciveness.** The consequence of either not reporting or reporting incorrectly may not be sufficiently severe. Some authors have found the wording of the directive too abstract and non-prescriptive.

(e) **Limited scope.** "Some companies from which investors and other users want non-financial information do not report such information."[791]

(f) **Accessibility.** "It is hard for investors and other users to find non-financial information even when it is reported."[792] This still appears to be a widespread problem. Benefit corporations, who must report on their social benefit, often do not make their reports publicly available.[793]

(g) **Low quality.** "Companies do not report all non-financial information that users think is necessary, and many companies report information that users do not think is relevant."[794]

(h) **Inconsistency with company's purpose.** Some authors have affirmed that the requirement to report non-financial information may conflict with the widespread idea that the company's purpose is to pursue economic value for shareholders only. Hommelhoff criticised the Reporting Directive for changing the corporation's purpose by adding a reporting obligation.[795] Hence, if the Commission's intention is to create a social dimension in the object of the company, then this should be done explicitly, as recommended in section V.4 (*Recommendations*). Johnston and Sjåfjell observed:

> By not confronting the social norm of shareholder primacy, there is a lack of regulatory coherence between the perceived role and duty of the board and management (to maximise returns for shareholders), and these "non-financial" issues that boards and management are asked to report on. To achieve an internalisation of environmental and other sustainability impacts, this lack of coherence needs to be corrected. We believe that far reaching company law and

791 Ibid.
792 Ibid.
793 Wilburn and Wilburn (2019).
794 Inception Impact Assessment of the European Commission dated 30 January 2020, document number Ref.Ares(2020)580716, p. 2.
795 Hommelhoff (2015) called this a revolution through the back door, i.e. changing EU material company law via (procedural) disclosure rules, p. 272.

> corporate governance reform is needed to give greater priority to environmental sustainability, and to counteract the harmful narrow and short-term pressure for maximisation of returns to shareholders that results from the shareholder primacy drive.[796]

The Commission intends to tackle points (e), (f) and (g) with a new amendment to the Reporting Directive. Indeed, tweaking the process with respect to (e) *limited scope* and (f) *accessibility* may increase the prominence and reach of non-financial information. This new amendment shall ensure that the investors and civil society have access to coherent and consistent non-financial information, and reduce the reporting burden on business.[797] Nevertheless, changes addressing point (g) *low quality*, which is intrinsically related to point (h) *inconsistency with company's purpose*, hold the greatest potential. As long as companies (their directors), employees, shareholders and other stakeholders are under the impression that profit maximisation is the goal, non-financial reporting will have merely limited influence. Only when company law expressly incorporates long-termism into the company's purpose will stakeholders have clarity about the reasons for preparing and sharing non-financial information.

To this end, in addition to incentivising directors and shareholders via nudging, lawmakers may impose responsible conduct and sanction irresponsible behaviour (command-and-control). Section VI.2.1 (*Shareholder engagement*) criticises the fact that the Union has enacted procedural rules without any corresponding substantive rules. This lack of substantive guidance certainly affects the efficacy of the existing procedural rules. In case of the CSR Amendment, the goal of addressing the responsibility of businesses for their impacts on society should be made substantively clear. As discussed, the ideal strategy is to combine several regulatory tools,[798] e.g. nudging with command-and-control and principles-based rules. This is the purpose of recommendation R.10 (section V.4: *Recommendations*).

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[796] Johnston and Sjåfjell (2019), p. 15.

[797] Inception Impact Assessment of the European Commission dated 30 January 2020, document number Ref. Ares(2020)580716.

[798] Möslein and Sorensen (2018), p. 397. See also the discussion in box IV.2.2.2 (*Legal pluralism*).

3 Recommendation

For three reasons, this chapter VII (*Reporting Directive*) makes only one recommendation. First, the Reporting Directive is already very comprehensive and has been supplemented by guidelines 2017 and 2019, and by Regulation 2019/2088. Second, the European Union is addressing many of the weaknesses described in section VII.2 (*Weaknesses and potential*) at the time of submission of this thesis. Third, the main potential for improving the Reporting Directive (which is not in the expressed scope of the upcoming amendment to the directive) is already covered in recommendation R10 of section V.4 (*Recommendations*). Therefore, the recommendation in this chapter refers to disclosure relating to R10.

R20. Companies shall publicly disclose on an annual basis how the long-term interests of the affected stakeholders were taken into account.

Chapter VIII: Final remarks

This final chapter concludes this study and offers various final remarks. These are divided into four sections. Section VIII.1 (*Findings*) discusses the main findings of the research. Section VIII.2 (*Main contributions*) reviews the recommendations made in chapters V (*Takeover Directive, Merger Directive and Insolvency Directive*), VI (*Shareholder Directive*) and VII (*Reporting Directive*). Section VIII.3 (*Limitations and opportunities*) states the limitations of this study, which — at the same time — represent opportunities for future research. Section VIII.4 (*Practical versatility*) states the potential practical ramifications of this study.

1 Findings

Writing this study has been an inspiring exercise in legal thinking. Besides the stated aims of each chapter, new findings emerged as the research progressed.

First, chapter I (*Introduction*) addressed a specific gap in the legal literature on long-termism: normative foundations. Team production theory and the principles of justice proved to be solid cornerstones for discussing long-termism. These normative foundations combined with the principles for the internal market in the Treaty on European Union advanced a new strategy for drafting regulation in order to foster long-termism.

Second, the literature reviewed as a basis of chapter II (*Methodology*) revealed a more autonomous approach to scientific methods and empowered me to design my own research pathway for this study. Many scholars have generally criticised the methodology of legal research, which evolved into a criticism of the law as a scientific field. This study, apprehensive about the lack of clarity in legal methodology and unwilling to blindly follow existing research designs, combined available tools to tailor an adequate process for addressing long-termism and Union company law.

Third, chapter III (*Trend and counter-trend*) ascertained that empirical quantitative evidence is not the only resource for policy discussions. Consequently, data on perceptions and discourse on short-termism and long-termism also came into play to support the argument that long-termism is a growing counter-trend to widely established short-termism. This view enabled highlighting the urgent need for reforms and the long way ahead to achieving longer-term behaviour in equity markets.

Fourth, reviewing the legal trajectory of long-termism in Union company law and the Better Regulation Guidelines revealed the complexity of translating policy goals into action. Chapter IV (*Regulatory strategy*) showed how easily bearings may be lost in the myriad of available regulatory instruments. There is no guarantee of a one-size-fits-all regulatory strategy, and choosing the right instruments must be a case-by-case exercise.

The final chapters — V (*Takeover Directive, Merger Directive and Insolvency Directive*), VI (*Shareholder Directive*) and VII (*Reporting Directive*) — established that nudging has limited efficacy unless clear and intelligible direction is ensured. If law does not explain the meaning of the company's interest, nudging measures to protect team members other than shareholders will be a matter of luck. Regulatory dualism has its limitations, and a booming economy (and a degree of social and political stability) is required for the desired reform to succeed. In less auspicious times, reforms need more than a "light-touch" approach. For this reason, several of the recommendations in this study go beyond nudging.

2 Main contributions

The most evident contributions of this study are its recommendations for legislative adjustments, in order to pave the way for long-termism in Union company law. The practical dimension was a priority throughout this study, especially for the recommendations. Consequently, the twenty recommendations made here contribute to the debate about the next steps for Union company law. Perhaps some of these recommendations will become part of forthcoming Union legislative activity.

All of the recommendations in this study aim to translate the definition of long-termism in section III.2.1.1 (*Three conditions*) into legal rules according to which the timeframe is extended (e.g. "long-term interests"), profits are instrumental (e.g. R10 on the interest of the company, as an overarching provision), and all stakeholders are considered (e.g. "employees and other affected stakeholders"). While some recommendations may be used separately, the likelihood of their efficacy increases if they are all applied together. The most important recommendation is R10, which serves as a starting point for all other recommendations. As noted, all recommendations are subject to the normative finding that the purpose of the company is, in pursuing its economic activity, to contribute to creating long-term economic, environmental and societal value for all its stakeholders and for society at large.

Box VIII.2 restates the twenty recommendations made in sections V.4 (*Recommendations*), VI.4 (*Recommendations*) and VII.3 (*Recommendation*).

Box VIII.2 – Recommendations

R1. Employees and other affected stakeholders have the right to receive and request information about decisions affecting their short- and long-term interests prior to a decision being taken. This right shall be exercised on an ongoing basis, including yet not limited to critical events.

R2. The board of directors has a duty to inform shareholders, employees and other affected stakeholders about decisions affecting their short- and long-term interests prior to a decision being taken. The information shall include (i) the long-term effects of the decision on shareholders, employees and other affected stakeholders; and (ii) in case of negative effects, the measures to minimise such effects and to indemnify affected stakeholders. This duty shall be exercised on an ongoing basis, including yet not limited to critical events.

R3. Employees and other affected stakeholders have the right to consultation (including the right to provide an opinion that will be published) about decisions affecting their short- and long-term interests prior to a decision being taken. This right shall be exercised on an ongoing basis, including yet not limited to critical events.

R4. In critical events, including takeovers, cross-border mergers and financial difficulty, employees and other affected stakeholders have the right to request an independent opinion about decisions affecting their short- and long-term interests prior to a decision being taken.

R5. The board of directors of companies with at least fifty (50) employees shall include a director who is a member of the workforce and is responsible for representing the interests of workers.

R6. The board of directors of companies with at least fifty (50) employees shall have a non-executive director who is designated as a long-term director. This director shall have the duty to issue an annual statement on the company's compliance with its obligations towards its stakeholders. This director must fulfil independence requirements. This director shall communicate with affected stakeholders on a semi-annual basis with respect to any decisions taken by the company that affect the interests of such stakeholders.

R7. All members of the board of directors owe to the company a duty to act in good in faith and in the best interest of the company. In case of violation of this duty, the company (upon the initiative of the general assembly of shareholders) shall have the right of action against the director.

R8. All members of the board of directors owe to the company a duty to consider, balance and protect the long-term interests of all stakeholders affected by a given decision. If the interests of one or more stakeholder groups cannot be protected in a given decision-making process, the board of directors shall state a clear and reasoned explanation for this decision.

R9. The national supervisory authority(ies) responsible for approving the terms of a takeover, cross-border merger or restructuring plan shall verify the takeover, cross-border merger or restructuring plan with respect to the adequate treatment of the short- and long-term interests of all affected stakeholders, including the measures to minimise negative effects and to indemnify affected stakeholders.

R10. The interest of the company includes the short- and long-term interests of all affected stakeholders.

R11. Companies shall retain a certain amount of capital, in order to indemnify employees and other stakeholders affected by decisions in critical events, including takeovers, cross-border mergers and financial difficulty. The amount shall be proportionate to the size and risk profile of the company vis-à-vis its stakeholders.

R12. Companies shall implement mechanisms to foster long-term shareholder engagement, including yet not limited to the incentives concerning political and economic rights discussed in section VI.3.1 (*Long-term shareholding*). The incentives contingent upon a minimum holding period shall apply to shareholders holding shares for at least three years.

R13. Shareholders have the right to receive and request information about how the matters discussed in a general meeting affect the short- and long-term interests of affected stakeholders prior to that general meeting.

R14. The remuneration policy shall explain (a) how the multi-year performance of the individual, as well as the overall results of the company and the group and (b) how the directors' performance of their fiduciary duties as set out in recommendations R1 to R8 (section V.4: *Recommendations*) are taken into account by variable remuneration.

R15. Variable remuneration shall be spread over time and at least 40% of variable remuneration must be deferred over a period of three to five years.

R16. The remuneration policy shall detail the non-financial appraisal metrics and how they affect the career plan of employees.

R17. Proxy advisors shall publicly disclose on an annual basis how the long-term interests of the companies and the stakeholders affected by voting recommendations were taken into account.

R18. Proxy advisors owe to their clients a duty to consider, balance and protect the long-term interests of the stakeholders affected by voting recommendations. If the interest of one or more stakeholder groups cannot be protected in a given decision-making process, shareholders shall state a clear and reasoned explanation for this decision.

R19. Shareholders owe to the invested company and to their clients a duty to consider, balance and protect the long-term interests of the stakeholders affected by their decisions. If the interest of one or more stakeholder groups cannot be protected in a given decision-making process, shareholders shall state a clear and reasoned explanation for this decision.

R20. Companies shall publicly disclose on an annual basis how the long-term interests of the affected stakeholders were taken into account.

The subsequent paragraphs review the plausibility of the above recommendations and the limits of regulation.

Plausibility

The academic debate in relation to the recommendations made in chapter V (*Takeover Directive, Merger Directive and Insolvency Directive*) is much less controversial. Many authors agree with conferring more rights upon employees and other stakeholders, and very few voices explicitly oppose such recommendations. The most controversial issue regarding the recommendations presented in chapter V (*Takeover Directive, Merger Directive and Insolvency Directive*) is the fiduciary duty of directors. Nevertheless, a considerable number of authors have advocated (and continue to advocate) developments in this direction.[799] On the other hand, almost all recommendations in chapter VI (*Shareholder Directive*) are highly debated in the literature, including quantitative empirical evidence supporting both sides of the debate. This is especially true for incentives for long-term shareholding based on political and economic rights (recommendation R12). The corresponding recommendation in chapter VII (*Reporting Directive*) is limited in scope, because the scholarly discussion must await the outcome of the Union's current amendment efforts.

In terms of effects, I expect that the recommendations in chapter V (*Takeover Directive, Merger Directive and Insolvency Directive*) would less directly influence share prices, meaning directors and investors might see such recommendations as "less hurtful." Yet precisely these recommendations are the most far-reaching (especially R10). Executive pay and loyalty shares, as proposed in chapter VI (*Shareholder Directive*) are more easily translated into adjustments by credit rating analysts and into buy-and-sell decisions by asset managers. The recommendation in chapter VII (*Reporting Directive*) depends on the success of recommendation R10.

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799 Recent initiatives have shown that the market is ripening for recommendation R.10. Two examples in Switzerland with global reach are worth citing. In November 2019, the Advisory Board of the Corporate Governance Competence Centre at the University of St. Gallen — a body composed of professors as well as members of the private sector and civil society — issued four guiding principles of corporate governance: 1. The role of the public company in society; 2. Bearers of societal responsibility; 3. Investing and innovation; 4. Patient capital. Retrieved from https://fim.unisg.ch/en/competence-centres/corporate-governance. Last accessed 24 January 2019. Second, in December 2019, the 2020 Davos Manifesto launched, stating that the "purpose of a company is to engage all its stakeholders in shared and sustained value creation." Retrieved from: https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/ Last accessed 24 January 2020.

Limits of regulation

This study acknowledges that Union company law is but one of the many spaces requiring change with a view to better balancing short- and long-term behaviour. The reviewed literature often refers to the importance of long-termist leadership,[800] including the work of CEOs, politicians and leading think tanks. Another frequently mentioned factor is providing market participants with tailored further training at business and law schools.[801] Therefore, the recommendations in this study require a favourable ecosystem including leadership and training in order to achieve long-termism in equity markets. In this context, law may be one instrument of transformation among others. It may serve as preventive and co-creative public policy rather than as an instrument of correction and punishment.

3 Limitations and opportunities

Every limitation of this study offers an opportunity for future research.[802]

- The normative discussion in chapter I (Introduction) does not encompass a thorough review of company law and its history, nor of the legal philosophy and economic scholarship surrounding the concept of the "company." Future research could build on and supplement the work started by various authors (Stout, Blair and Kedar) and by this study.
- Except for specific discussions — such as section III.2.1 (Definition) and section VII.1.1 (Why: Corporate social responsibility) — this study has not analysed in-depth the relationship between Union law for long-termism with that for sustainability, sustainable development, corporate social responsibility and sustainable finance. While these objectives seem to be converging, future research could contribute to the debate and add further

[800] Krehmeyer (2006), p. 4. See also Fox and Kenagy's (2012) discussion of the academic mainstream.
[801] Ibid.
[802] I look forward to a continuing debate in relation to Union company law and long-termism. As Keynes wrote (1933): "There is no harm in being sometimes wrong — especially if one is promptly found out," p. 175.

insights by considering regulation through the lens of these overlapping concepts.

- This study has not explored how the Union's courts and Member States' national judiciaries are treating short-termism and long-termism. This is a promising topic for future legal research.[803]
- The review of the legal landscape in chapter IV (Regulatory strategy) is limited to Union law. Future research might therefore investigate how Union company law relating to long-termism has been implemented (transposed) in Member States.
- The recommendations in this study have not been subject to cost-benefit analysis. A team of legal researchers, economists and specialists in public administration could complement the recommendations with cost-benefit analyses.
- The recommendations do not include grievance mechanisms for stakeholders nor specific enforcement mechanisms. Research on these topics would certainly contribute to the efficacy of said recommendations.
- The recommendations do not take into account triggers of unselfish prosocial behaviour. The theory developed by Stout prescribes three triggers of this type of behaviour: (a) instructions from authorities (trigger obedience), (b) beliefs about others' prosocial behaviour (trigger conformity); and (c) the magnitude of the benefits to others (triggers empathy).[804] This theoretical framework could support analysing the recommendations of this study.

[803] For example, Heaton (2017) analysed how Delaware courts looked at long-termism. Ambachtsheer and Johnson (2019) also reviewed similar decisions. With respect to case law of the European Court of Justice, cases C-438/05 The International Transport Workers' Federation and The Finnish Seamen's Union v Viking Line ABP and OÜ Viking Line Eesti and C-341/05 Laval un Partneri Ltd v Svenska Byggnadsarbetareförbundet, Svenska Byggnadsarbetareförbundets avd. 1, Byggettan, Svenska Elektrikerförbundet would be interesting for the review in chapter V (*Takeover Directive, Merger Directive and Insolvency Directive*).

[804] Stout (2011), p. 99.

4 Practical versatility

While the recommendations in this study focus on Union company law, other legislators might use them in debating long-termism. Even investors and companies might incorporate the proposed measures into internal or bilateral documents, such as constitutional documents, internal policies, shareholder agreements, employment agreements, loan agreements, etc. In this exercise of incorporation, a disclaimer is necessary: The recommendations presented here build on existing mechanisms in Union company law. For instance, the existing disclosure of the Reporting Directive already nudges certain behaviours (e.g. *ex ante* consideration of non-financial information) and hence provides a basis for linking variable compensation to non-financial criteria. Therefore, this study encourages equity market participants — all direct and indirect team members — not to wait for legislation to be passed, but to join a bottom-up movement, and to adopt half, one or some of the measures recommended here.

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