Corporate sustainability and groups of companies

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Abstract:
The lack of effective regulations for group companies has created a notable regulatory shortfall, particularly concerning the rights of minority shareholders, creditors, and stakeholders. Corporate controlling entities often prioritize their own interests over those of subsidiaries, leading to recurring conflicts of interest. Despite the proliferation of soft-law instruments advocating sustainability and stakeholder interests, compliance remains challenging, especially within group dynamics where conflicts between controlling entities and minority stakeholders persist. Historical regulatory efforts have largely focused on curbing abuses, but traditional company law principles prove inadequate, particularly against the backdrop of complex tax optimization strategies and labor exploitation practices by transnational corporations. Initiatives like corporate sustainability due diligence regulations offer potential solutions, aiming to enhance accountability and transparency while mandating corporate responsibility for adverse human rights and environmental impacts. However, debates arise regarding the extension of liability to parent companies, raising questions about the intersection of corporate governance and public regulation. Yet, the directive highlights the necessity of balancing private autonomy with public interest, emphasizing the integration of fundamental values into corporate operations for a more equitable and sustainable global landscape. Critics argue against the politicization of corporate law, yet proponents emphasize the necessity of balancing private autonomy with public interest.

Keywords:
Groups of companies; due diligence; CS3D; duty of care; international jurisdiction; politicisation of company law

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1. From no regulation…

One vast field where there is a regulation deficit is that of *groups of companies.*

It is not the same thing for the controlling shareholder to be a human non-businessperson or a company. In either case, there is or may be a conflict of interest between the controlling shareholder

and the minority shareholders and/or the company, but usually the content, intensity and nature of the various interests or purposes are different in each of these cases.

Generally speaking, the interests of a human controlling shareholder converge with those of the minority shareholders: everyone wants to earn as much as possible from the same company. As a rule, differences in interests are sporadic or circumstance-dependent but, as a rule too, this is not the case in groups of companies (in the broad sense).

The controlling company acts in line with a corporate strategy that includes the controlled companies; the shareholder or shareholders of the controlling company intend to earn as much as possible from this strategy, even at the expense of the controlled companies. If the controlling company, by exercising its power of influence, loses or gains less profit from the controlled company, it is because it intends to earn more itself or from another controlled company; as a rule, the differences in interests are systematic and structural.

It is not uncommon, for example, for controlling companies to impose non-compensating prices on a controlled company in intragroup transactions or for industrial property right licences; to determine interest-free loans, low-interest-rate loans or unreasonable-risk loans; to move the business activity of a controlled company to another established in another country or region; or to take direct or indirect advantage of the controlled companies' business opportunities[1].

The risk of damage that the controlling company can cause to a controlled company is one of (indirect) damage to the latter's minority shareholders, but it is also a risk to its creditors and other third parties: if the net worth of the controlled company diminishes, the net guarantee of current and prospective creditors also diminishes. And the damage intensifies when the increasing number of companies that make up the group results in the fragmentation of a homogenous enterprise into undercapitalised limited liability units.

It is no wonder therefore that the few pieces of legislation that have proposed to regulate groups of companies around the world (initially, the 1965 German *Aktiengesetz* (AktG)) leaned primarily towards defending against abuses: while granting the parent company the right to manage the subsidiaries, they establish mechanisms to protect the interests of the minority shareholders and/or creditors of the controlled companies.

However, the overwhelming majority of national laws have not established any special or exceptional and systematic treatment for these groups, and appear to content themselves with the general rules and principles of company law. This also seems to appeal to the groups of companies, or rather to the dominant companies and shareholders: they have no wish to be subject to special laws, unless

[1] This is not to say that some or all controlled companies cannot benefit from the fact of belonging to a group of companies – the (good) image of the group can facilitate their obtaining external credit, complementarity of corporate purposes will foster market expansion, and technology transfers and shared services may drive productivity. Usually, however, controlled companies will be instrumentalised by the controlling companies to pursue their own ends. As a rule, whoever has (economic) power uses it primarily to their own advantage.

they can benefit from them. But praxis has shown the inadequacy of the rules and principles of ordinary company law (and of civil law)[2].

The problems are exacerbated when *transnational* groups of companies (key players in globalisation) are involved. We see contrived intragroup transactions to declare profits in low-tax or tax-free jurisdictions and states which, in the absence of international consensus, engage in tax competition that prevents them from carrying out their social commitments. And we see the multi-fold increase in subsidiaries that are undercapitalised or have insufficient net worth to make reparation for the personal harm and environmental damage caused in the pursuit of hazardous activities (sometimes prohibited in the countries where the headquarters of the controlling company is located), and subsidiaries in underdeveloped countries exploiting child labour, or workers in deplorable health and safety conditions and with miserable salaries, with impunity (given the lack of laws or of the political and legal power to enforce them)[3].

All these things necessitate states having legally mandatory and effectively enforceable regulations on the liability of the controlling companies[4], thus piercing the traditional bastions of the corporate veil and the jurisdictional veil[5].

Notwithstanding, no general harmonisation exists in the EU regarding the law on groups, although proposals for a ninth company law directive were drafted in the 1970s and 1980s[6]. Nevertheless, there is already harmonisation in some significant legal fields such as competition law[7], and harmonisation on corporate sustainability due diligence is on the way. It is to the latter that I will dedicate the pages below.

2. …To regulation for sustainability

Worldwide, there are 'around 25 million victims of forced labour, 152 million victims of child labour, 2,78 million deaths due to work-related diseases per year and 374 million non-fatal work-related

[2] See J. M. COUTINHO DE ABREU, *Da empresarialidade – As empresas no direito* (Almedina, Coimbra, 1996 – reprinted 1999), 272 ff., 'The law of groups of companies according to the European Model Company Act' [2017] (3) ODC Rivista Orizzonti del Diritto Commerciale.

[3] See the examples and bibliographic references in J. M. COUTINHO DE ABREU, 'CSR — ´Responsabilità' senza responsabilità (legale)?' [2019] (6) *GC* Giurisprudenza Commerciale 1089.

[4] Ibid 1094-1095.

[5] See PETER MUCHLINSKI, 'Limited liability and multinational enterprises: a case for reform?' [2010] *Cambridge Journal of Economics* 920 ff.

[6] See COUTINHO DE ABREU, *Da empresarialidade* (2) 249-250 (because the directive never materialised, Ibid 279) and J. A. ENGRÁCIA ANTUNES, *Os grupos de sociedades: estrutura e organização jurídica da empresa plurissocietária* (2nd ed, Almedina, Coimbra, 2002) 177 ff.

[7] See J. M. COUTINHO DE ABREU, 'Os grupos de sociedades no direito dos cartéis da EU', [2023] (29) *DSR* Direito das Sociedades em Revista 13 ff.

injuries per year[8].' In a growing number of countries, we see 'excessive work hours, poverty-level wages, the gender pay gap and other forms of discrimination'[9].

As to the environment – very closely linked with human rights[10] —, we are suffering the impacts of several kinds of pollution, including greenhouse gases and waste production, on a daily and increasing basis.

This alarmingly bleak scene has been engineered mainly by a large number of companies and groups of companies. Many of the worst problems are observed in what are euphemistically referred to as developing countries (or the 'global south', as it is called by those in the centre-north), but as a result of the (co-)action of global companies (hailing from developed countries' economic centre).

This is despite the various instruments (including principles, guides and recommendations) issued by international organisations (e.g. UN, OECD, ILO) on the corporate sustainability due diligence. However, these soft-law instruments are non-binding and the vast majority of companies do not apply them[11] (in the short term at least, applying them would mean higher financial costs and/or fewer business opportunities) – despite any potential 'damage to reputation'.

And while the concept of stakeholder value increasingly runs counter to the (prevailing) concept of shareholder value, companies have to satisfy the interests of not only the shareholders but also of the stakeholders (ranging from workers, consumers and suppliers, local and national communities…).

In this affirmation of stakeholder discourse, the corporate social responsibility (CSR) movement that developed since the middle of the last century played an impressive role (it appears to have been formally replaced by the environmental, social and governance — ESG — movement).

The ideas of 'corporate responsibility' – which is not legally binding either – after the tests regarding the (legal) possibility of companies implementing them were successfully passed (all the more so because they have been promoted by certain legislative acts, such as Directive 2014/95/EU on non-financial information, or 'sustainability' information as it is now referred to in Directive 2022/2464 of 14 December 2022), appear to have even been enshrined in several national laws. But this is essentially an illusion…[12]

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[8] European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability, https:www.europarl.europa.eu/doceo/document/TA-9-2021-0073_PT.html, recital M.

[9] Ibid recital O.

[10] In Article 3(6) of the draft directive attached to the above-mentioned resolution ('Draft Directive' or 'Draft'), a broader concept of human rights is positively received. Article 3(7) singles out the adverse impacts on the environment, but the often narrow connection between environmental risks and human rights risks is acknowledged in recital 22 of the Draft.

[11] See recitals 3 and 4 of the Draft.

[12] See COUTINHO DE ABREU, 'CSR' (3) 1092-1093, giving the example of section 172 of the 2006 UK Companies Act and Article 64(1)(b) of the Portuguese Companies Code.

Recently, stakeholderist institutional texts have been multiplying.[13] Are (large) companies voluntarily taking seriously the protection of human rights, environmental rights, and so on? I doubt it, and I will give an example.

In 2019, the *Business Roundtable* (BRT), which brings together the CEOs of the largest US corporations, published a new *Statement on the Purpose of a Corporation,* undertaking to provide value to customers, invest in employees, deal fairly and ethically with suppliers, support the communities in which they operate and, lastly, generate long-term value for the shareholders. And then Covid-19 struck: 'Members of the Business Roundtable who took the pledge to look after all their stakeholders went on to cut hundreds of thousands of jobs last year, and are busy campaigning against tax rises to pay for the social cost of the pandemic.'[14]

But change is afoot …

In the wake of the European Parliament Resolution of 10/3/2021, the Commission published, on 23/2/2022, the Proposal for a directive of the European Parliament and of the Council 'on corporate sustainability due diligence and amending Directive (EU) 2019/1937' [COM(2022) 71 final]. The proposal was revised in the meantime and, on 1/12/2022, the Council adopted the version finalised by COREPER on 30/11/2022 as a 'general approach'.[15] This is the version that we will consider in the following paragraphs, unless otherwise indicated.

The proposed directive contains rules on corporate obligations regarding actual and potential adverse impacts on human rights and the environment related to their own operations, the operations of their subsidiaries or their business partners in the chains of activity, liability for breaching these obligations, and the obligation for companies to adopt plans that are consistent with transitioning to a sustainable economy and capping global warming at 1.5ºC (Article 1(1)).

The main targets of the directive are companies (see Article 3, subparagraph (a)), but only large companies incorporated under the laws of a Member State or of a third country and with specific minimum business thresholds in the EU (Article 2(1) and (2))[16].

The relevant human rights are laid down in international conventions such as the 1966 International Covenant on Civil and Political Rights, the 1966 International Covenant on Economic, Social and Political Rights and several International Labour Organization (ILO) conventions, and are listed in Part I of Annex I of the proposal, to which we are referred by Article 3, subparagraph (c)).

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[13] See J. M. COUTINHO DE ABREU, 'Estado de direito e empresa (sociedade) de direito' [2021] (26) DSR Direito das Sociedades em Revista 25-26.

[14] *The Economist* (17/4/2021) 10. See also WORLD BENCHMARKING ALLIANCE, *Covid-19 and human rights*: *Assessing the private sector's response to the pandemic across five sectors*, 2021 (the vast majority of companies interviewed did not identify or deal with the human rights risks associated with Covid-19).

[15] See https://www.consilium.europa.eu/pt/press/press-releases/2022/12/01/council-adopts-position-on-due-diligence-rules-for-large-companies/.

[16] It is estimated that only around 13 000 EU undertakings and 4 000 undertakings from other countries will be affected – Commission Proposal Explanatory Memorandum 18.

These include, among others, the right to life; the prohibition of torture, cruel, inhuman or degrading treatment; the right to liberty and security; the prohibition on interference with freedom of thought, conscience and religion; the right to decent, safe and healthy working conditions and remuneration that will provide a decent existence; the right of workers to adequate housing when accommodation is provided by the company and to adequate food, clothing, water and sanitation in the work place; the prohibition of forced labour; the right to freedom of peaceful assembly and association, especially the right to join trade unions, the right to collective bargaining and the right to strike; and the prohibition on unequal treatment in employment.

As we can see, fundamental *personal* (liberal tradition) rights and fundamental *social and workers'* rights (sometimes termed third-generation rights) coexist here with equal dignity.

Part II of the above-mentioned annex establishes the prohibitions and obligations relating to environmental protection referred to in Article 3, subparagraph b) and laid down in several international conventions, such as the prohibition on importing, exporting, re-exporting or introducing from the sea certain specimens of wild endangered species without a permit; the prohibition on the manufacture, import and export of mercury-added products; the prohibition of mercury waste treatment; the prohibition on the production and use of persistent organic chemical pollutants; the prohibition on the import and export of specific ozone-depleting substances; the prohibition on exports of hazardous or other waste in certain circumstances; and the obligation to prevent pollution from ships.

Compliance with human rights and environmental obligations requires companies to comply with 'due diligence'. The content of this due diligence is explained in the seven articles of the proposal (5 – 11) to which we are referred by Article 4(1).

In essence, due diligence involves adopting suitable procedures and measures to *identify* the actual or potential adverse impacts on human rights and the environment related to the operations of the parent company, the subsidiaries and/or the companies in the respective chains of activities; *prevent or mitigate* the potential adverse impacts; and *terminate or minimise* the actual adverse impacts.

Failure to comply with due diligence may lead to the imposition of various *penalties* (Article 20), including *civil liability* (Article 22). This civil liability requires *the unlawful and culpable act,* which may be wilful or negligent, of failing to perform the duty to prevent/mitigate potential adverse impacts or terminate/minimise actual adverse impacts; *damage or loss* (whether pecuniary or non-pecuniary) suffered by protected persons; and the *causal link* between the act and the damage.

We have already seen that the proposed directive derogates from the rule on the separation of the parent company and its 'subsidiaries'.[17]

[17] Art. 3 defines 'parent company' (subparagraph (r)), 'subsidiary' (subparagraph (d)), and 'group of companies' (subparagraph (s)).

The parent – which is usually a company too – establishes and applies a diligence policy for the entire group (Article 5a(1), especially subparagraph b)), which must identify the potential or actual adverse impacts on human rights and the environment related to the operations of its subsidiaries (Article 6(1) and 6a(1)); prevent or mitigate the potential adverse impacts that have or should have been identified (Article 7(1)); terminate or minimise the actual adverse impacts that have or should have been identified (Article 8(1)); and periodically assess the subsidiaries' operations and measures to oversee the effectiveness of the identification, prevention, mitigation, termination or minimisation of adverse impacts on human rights or the environment (Article 10(1)).

To increase the effectiveness of due diligence in the context of these groups and reduce the costs for companies, Article 4a enables the parent companies covered by the scope of application of the directive to comply with the obligations established in Articles 5 – 11 and in Article 15 on behalf of subsidiaries that are likewise covered by the directive's scope of application.

Significant consequences flow from this treatment, which will likewise mean a considerable expansion in EU harmonisation of the laws on groups of companies. On the one hand, it enshrines *due diligence or the duty of care, and the corresponding liability, of parent companies towards the subsidiaries' stakeholders* with regard to human rights and the environment but, in exchange, it enshrines the *right* (power-duty) *of the controlling companies to give binding instructions to the controlled companies regarding such matters*[18].

Frequently, subsidiaries have been incorporated under the laws of the non-EU country in which the damage occurs. Which court has (international) jurisdiction to decide on the civil liability of the parent company, and under which substantive law?[19]

In the absence of special rules in the proposed directive, under Article 4(1) and Article 63(1) of Regulation (EU) 1215/2012, a parent company domiciled in an EU Member State (where it has its registered office, central administration or principal place of business) shall be sued in the courts of that Member State.

As a rule, the applicable substantive law is that of the country in which the damage occurred – Article 4(1) of Regulation (EC) 864/2007 (Rome II); see however Article 7 on environmental damage. But, under Article 22(5) of the proposed directive, the Article 22 treatment will have compulsory *prevailing application*.

[18] In the case of a foreign (non-EU) subsidiary, the respective law may prohibit the board of the parent company from (extra-organically) issuing instructions to the board of the subsidiary. But, given the former's *de facto* power or its influence over the latter and, in general, the fact that measures protecting human rights and the environment are not unlawful in the third country, the parent company will be able (including through the subsidiary's general meeting where it will usually have the majority vote) to give these instructions and have them implemented.

[19] Regarding these issues, see RUI P. DIAS, 'CSDD (Corporate Sustainability Due Diligence): primeiras observações sobre a proposta de diretiva de 23 de fevereiro de 2022' in Coutinho de Abreu, Soveral Martins, Rui Dias (co-ord) *Dever de diligência das empresas e responsabilidade empresarial* (IJ/FDUC, Coimbra, 2022) 124 ff. (public access e-book).

Some have criticised the proposed directive claiming that it jumbles the spheres of corporate governance (which falls within the realm of company law, private law and for private purposes) and due diligence (which belongs to the field of public regulation for the protection of third parties or public goals), thus bringing about a politicisation or publicization of company law[20].

But companies are not separate islands lying off the political, legal and social mainland. Company law is not simply a law of 'pure' or 'neutral' organisation and management relating to general interests.[21] Companies have a strong (bilateral) external projection, they have stakeholders and (also) create negative externalities – they are not restricted to the shareholders alone.

Private and public autonomy should coexist in a state of balance.[22] And if – as experience shows – the negative externalities of companies relating to fundamental values such as human rights and the environment are not prevented and corrected by way of goodwill, soft law or self-regulation, then we must take the step (which the proposed directive aims to take) towards mandatory legislation[23].

This will bolster the *principle of legality* to which the corporate governance system has been and will be subject. And it is a positive thing that the setting of general interest (or common good) goals is not left to the discretion of companies, but to legitimate political powers.

[20] See, for example, CARMEN ALONSO LEDESMA 'La propuesta de directiva sobre diligencia debida de las empresas en materia de sostenibilidad', *Estudios de derecho de sociedades y de derecho concursal – Libro em homenaje al Profesor Jesús Quijano González* (Ed. Universidad de Valladolid, 2023) 61 ff, 71.

[21] See MARC-PHILIPPE WELLER/NINA BENZ, 'Klimaschutz und Corporate Governance' [2022] ZGR Zeitschrift für Unternehmens- und Gesellschaftsrecht 567 ff., GREGOR BACHMANN, 'Zielsetzung und Governance von Unternehmen im Lichte der Klimaverantwortung' [2023] ZHR 173 ff.

[22] See STEFAN GRUNDMANN, 'European Company Law in transformation – strive for participation and sustainability', [2023] Yearbook of European Law 16-17.

[23] See COUTINHO DE ABREU, 'CSR' (3) 1093 ff. This is also the approach taken in the United Nations' *Legally Binding Instrument to regulate, in International Human Rights Law, the Activities of Transnational Corporations and Other Business Enterprises (Third Revised Draft 17.08.2021*); the preparatory work began in 2014.