Convergence, Diversity, and Divergence: The Two Axes of Corporate Law and Governance

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Abstract

Corporate law and governance has now divided along two axes, the axis of Internal Governance and the axis of Externalities Governance. A generation after "corporate governance" became a global phenomenon, we see an established a vocabulary of corporate governance mechanisms, norms, and behaviors on the axis of Internal Governance. Within the convergent framing standard of "investibility," we can expect diversity that responds to local imperatives, including original and continuing ownership patterns and efforts by the State to shape corporate governance tools to promote the State's economic and social policy objectives. But the major move in corporate law and governance over the past decade has been the development of a second corporate governance axis, Externalities Governance. Climate change risk associated with greenhouse gas emissions is the most salient externality but a broader set of social welfare concerns, made visible through developing disclosure regimes, now figures into corporate governance. Commitments and behavior along the Externalities Governance axis will have substantial variance and are likely to be volatile because they are not anchored to a clear goal of maximizing production or linked to parties bound to the firm in the nexus of explicit or implicit contracts but rather depend on a time-varying socio-political consensus. The EU has been the most aggressive jurisdiction in mandating Externalities Governance by positive law. Although the scope of the EU mandate is now under revision for both the coverage threshold (and thus the number) of subject firms and the breadth of coverage, the extraterritorial ambition remains. A "Brussels" effect could achieve significant convergence on Externalities Governance. The counter of course is the United States, through an Administration that is determined to protect US fossil fuel interests and lumps all other externality concerns in the same basket. This could lead to significant divergence for US firms and there may yet be a retrograde "Washington" effect on the general idea that social welfare concerns should be at least a partial focus of corporate law and governance.

Keywords: corporate governance, investibility, climate change, sustainability, Brussels effect

JEL Classifications: D14, D62, F64, G38, J32, K22, K32, L20, M14, P16, P18, P51

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ABSTRACT

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[Draft of January 10, 2026]

INTRODUCTION

Twenty years ago Jeff Gordon and Mark Roe co-edited a book, CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE.[1] In their introductory essay, Gordon and Roe ("G&R") linked the convergence-persistence question to globalization in two distinct senses. The first is whether corporate governance is an element of comparative advantage in global *product* markets, which would imply that the corporate governance norms that tend toward efficient production would disseminate widely. The second sense is whether corporate governance is an element of comparative advantage in global *capital* markets, either because (1) acquirers in cross-border mergers and acquisitions would want to use a standardized "currency" or (2) equity capital suppliers such as institutional investors would push for a standardized corporate governance model. This source of comparative advantage would suggest a convergence toward an international standard of corporate governance because of its appeal to international capital markets and, generally, a lower cost of equity capital.

G&R also observed that a key feature of corporate governance is its embeddedness in national legal systems and particularly in patterns of ownership, control, and monitoring that have national origin. In consequence, notwithstanding the impact of globalization, the rate and extent of convergence will be constrained by the forces of path-dependency, along two distinct dimensions. First, from an efficiency perspective, a particular national system might well be linked to a set of complementary institutions, so that a governance change to conform to the "international" model might well reduce the value of the firm and, indeed, its global competitiveness. For example, imagine a governance regime dominated by blockholders that included "affiliated" directors placed by the large bank that provided debt finance and the lead underwriters of the company's public equity. These affiliated directors would have institutional backing for their efforts to check private benefit extraction and the misrepresentation of performance. Adoption of the convergent governance standard in favor of "independent" directors rather than affiliated directors would likely undercut the monitoring capacity of this particular national system. Independent directors would be an efficient substitute only if the domestic court

[1] Cambridge University Press (2004).

system became robust enough to control private benefit extraction and the domestic securities regulation system became robust enough to protect against fraud. Substitution of the convergent standard without regard for these institutional complements could result in companies that are less efficient and compete less well in global markets.[2] In consequence, national elites may defend the domestic corporate governance regime.

Second, an existing governance setup will inevitably create rents that incumbents will fight to preserve. Controllers in a blockholder regime may well resist a move toward convergent governance institutions that could impede various sorts of "tunneling"[3] (as from genuinely independent directors) or that could facilitate the growth of public capital markets that could finance rivals (as from an increase in minority shareholder protection). Unions may resist convergent measures that "empower" shareholders because of the concern that shareholder pressure could increase the likelihood of employee layoffs. The point is that even if corporate governance convergence was "efficient" in a macro-sense, important local actors might be disadvantaged and use their political tools to resist convergent legal and institutional change.

G&R conjectured that globalization could also affect the pace of convergence through its effect on complementarities. For example, if global competitive pressure forced banks away from a relationship model towards a transactional model, the mutual gains from "delegated monitoring" might well disappear. Alternately, global capital markets might give rise to an increased level of foreign share ownership run through large institutional investors and asset managers that would pursue a monitoring and activism strategy to exploit different complementarities.[4]

From another perspective, it has become hard to separate out the convergence/persistence question from "financial globalization"—the development of worldwide capital markets and a set of complementary actors that make it possible for firms from countries with persistently weak governance institutions to opt into higher governance regimes.[5] Firms can issue stock in a "global" offering: cross-listing on an exchange with higher governance standards; submitting to a more rigorous, better policed disclosure system of the "borrowed" jurisdiction; making use of an international network of credible investment intermediaries, such as underwriters and accounting firms (applying globally accepted International Accounting Standards)[6]; enlisting high-reputation

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[2] See, e.g., Carola Frydman & Eric Hilt, *Investment Banks as Corporate Monitors in the Early Twentieth Century United States*, 107 AM. ECON. REV. 1938 (2017) (removal of investment bank designees from railroad boards increased their cost of external capital).

[3] See Vladimir Atanasov, Bernard Black, & Conrad Ciccotello, *Unbundling and Measuring Tunneling*, 2014 UNIV. OF ILLINOIS L. REV. 1697 (2014).

[4] See Merritt Fox, *The Rise of Foreign Ownership and Corporate Governance*, this HANDBOOK.

[5] Craig Doidge, G. Andrew Karolyi, & Rene Stulz, T*he U.S. Left Behind? Financial Globalization and the Rise of IPOs Outside the U.S.*, 110 J. FIN. ECON. 546 (2013); Dhruv C. Aggarwal, *Law and the Rise of Foreign Issuer IPOs*, 107 IOWA L. REV. ONLINE 136 (2022). Chinese companies have made extensively used US IPOs to raise capital; see U.S.-China Economic and Security Review Commission, *Chinese Companies Listed on Major U.S. Stock Exchanges* (March 7, 2025), available at https://www.uscc.gov/sites/default/files/2025-03/Chinese_Companies_Listed_on_US_Stock_Exchanges_03_2025.pdf

[6] See, e.g., Vivian W. Fang, Mark Maffett, & Bohui Zhang, *Foreign Institutional Ownership and the Global Convergence of Financial Reporting Practices*, 53 J. ACCT. RESEARCH 593 (2015).

foreigners as independent directors,[7] and selling into the portfolios of global asset managers who will bring a certain level of monitoring.[8] More specifically, careful examination of "what matters" in corporate governance suggests that the quality of the national disclosure regime is a critical variable.[9] High-quality disclosure facilitates better monitoring internally and externally. Yet this is also the governance feature that is most readily borrowed through a global offering. The US disclosure pattern sets the general template because of the desire to include US institutional investors as offerees. The reputations of global intermediaries as well as legal enforcement play a role in making the disclosure credible.[10]

The first edition of this Handbook, evaluating the question of convergence vs. persistence circa 2017, proposed the not particularly informative answer: although there has been considerable convergence, there is also considerable persistence and diversity, even "divergence within convergence." In following almost-decade, there has been both considerable energy devoted to the creation and enhancement of mechanisms aimed at driving widespread adoption of "best practice," particularly corporate governance codes and stewardship codes, and yet we see vigorous argument that the "convergence" that is formally observed is "faux convergence"[11] or that particular national arrangements are persistently divergent from international patterns because they are rooted in a distinctive idea of corporate purpose[12] or because they may serve nationalistic efforts to limit the reach of globalization.[13]

Writing in 2025, I would now split the question of "convergence" along two axes. First is the axis of public shareholder value maximization: the extent to which corporate law and governance of a local regime is protective of the interests of public shareholders, who look to dividend payments and share price appreciation for their returns. Second is the axis that might be variously described as "ESG" or "climate and sustainability" or "minimization of corporate externalities." For convenience, let's call the first axis the "Internal Governance Axis," and the second, the "Externalities Governance Axis." The importance of this second axis has exploded since the First Edition and for that reason is the main focus of this chapter.

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[7] Mihail Miletkov, Annette Poulsen, & M. Banajide Wintoki, *Foreign Independent Directors and the Quality of Legal Institutions*, 48(2) J. INT'L. BUS. STUD. 267 (2017).

[8] Reena Aggarwal, Isil Erel, Miguel Ferreira, & Pedros Matos, *Does Governance Travel Around the World? Evidence from Institutional Investors*, 100 J. FIN. ECON. 154 (2011) (foreign institutional investors from countries with strong shareholder protection improve governance of firms in weak-governance jurisdictions); Miguel A. Ferreira & Pedro Matos, *The Colors of Investors' Money: The Role of Institutional Investors Around the World*, 88 J. FIN. ECON. 499 (2008).

[9] Bernard Black, Antonio Gledson De Carvalho, Vikramaditya Khanna, Woochan Kim, & B. Burcin Yurtoglu, *Which Aspects of Corporate Governance Matter in Emerging Markets: Evidence from Brazil, India, Korea, and Turkey* (May 2015), available at http://ssrn.com/abstract=2601107.

[10] See generally Alan Dignam & Michael Galanis, THE GLOBALIZATION OF CORPORATE GOVERNANCE (2009).

[11] See notes 32-34 *infra* and the accompanying text.

[12] See Mariana Pargendler, *Corporate Law in the Global South, Heterodox Stakeholderism,* 47 SEATTLE L. REV. 535 (2024) (examples from Brazil, India, Indonesia, South Africa and others).

[13] See Mariana Pargendler, *The Grip of Nationalism in Corporate Law*, 95 IND. L. J. 533 (2020); Jeffrey N. Gordon & Curtis Milhaupt, *China as a "National Strategic Buyer": Towards a Multilateral Regime for Cross-Border M&A*, 2019 COL. BUS. L. REV. 192 (2019).

The original axis, Internal Governance, focuses principally on production and its division among constituents of the firm. The parties in interest are the various contractual claimants, express and implicit, thus the shareholders, controlling and public, the employees, creditors, and, to a considerably lesser extent, suppliers and customers. The central corporate governance issues of Internal Governance have been the control of managerial agency costs and controlling shareholder agency costs. When it comes to employees, the question has been whether employee governance rights are "efficient" from an overall production perspective, by inducing the optimal level of firm-specific human capital investment,[14] or "inefficient," because of the misallocation of control rights.[15] The scope of Internal Governance model covered parties in contractual relationship with the firm, explicit, implied, and implicit, principally if not exclusively in light of this production objective.

The second axis, the Externalities Governance axis, assesses the extent to which corporate law and governance induces the firm to internalize a broad set of social concerns, well beyond efficient production and firm-specific challenges and well beyond parties with plausible contractual claims. The Externalities Governance axis looks to governance mechanisms that address whether the firm adds or subtracts from social welfare, not necessarily within a particular society even but globally. The fact that there exists such a second axis – a sufficient body of corporate governance theorizing, practices, and mechanisms focused on Externalities Governance – is a major change over the past decade. And so the extent of convergence (or divergence) on this axis is of first order importance.

THE INTERNAL GOVERNANCE AXIS

The Mechanisms of Convergence

The First Edition identified particular institutions of "global governance" as promoting convergence on the public shareholder value model, highlighting the roles of the IMF, the World Bank, and the OECD, particularly in the aftermath of the East Asian financial crisis of the late 1990s.[16] The generalized prescription for most governance ailments in that reform effort was "independent directors." The Global Financial Crisis of 2007-09 catalyzed further efforts to promote best practices, focusing particularly on the need to constrain excessive managerial risk-taking by financial firms that could threaten not only the public shareholders of the own-firm but could present a systemic threat. The G20 put its weight behind the corporate governance

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[14] This would be a claim on behalf of co-determination. To similar effect is the argument in favor of the board's power as a mediating heirarch to resist shareholder activism. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 U. VA. L. REV. 247. (breach of implicit contract at one firm undercuts firm specific investments not only by employees of own-firm but other firms).

[15] See, e.g., Henry Hansmann, *When Does Worker Ownership Work*?, 99 YALE L. J. 1749 (1990); Jens Damman & Horst Eidenmuller, *Codetermination: A Poor Fit for U.S. Corporations*, 2020 COL. BUS.L. REV. 265 (2020).

[16] Mariana Pargendler has built a more general argument, examining the promise and limits, in *The Rise of International Corporate Law*, 98 WASH. UNIV. L. REV. 1765).

"principles" of the OECD. The UK had adopted the first corporate code in 1992 but adoption became widespread as countries sought to signal their adherence to global corporate governance standards.[17] The critical feature of most codes was the soft law enforcement strategy, "comply or explain."

Although many countries converged on the idea of a corporate governance "code," the content has varied across jurisdictions, reflecting national differences about what counts as good governance, respect for existing local power relationships, and a government's desire to use the code as vehicle to promote (or change) the corporate objective function.[18]

An important subsequent innovation was the establishment first in the UK in 2010 and then diffused elsewhere of "Stewardship Codes" targeted at institutional investors and asset managers, who had come to own an increasing fraction of the public float of large public companies in many countries.[19] An influential organization of institutional investors, the ICGN, came to see the value of stewardship codes and encouraged their formulation adoption in many jurisdictions.[20] Such stewardship codes underscored these parties' obligation to take responsibility as active owners. One example was the need to insist on adequate risk management at financial firms, which had been neglected in the run-up to the financial crisis, but the stewardship codes were generally a mechanism by which the promulgating government could attempt to enlist the institutional owners to promote a conception of good corporate governance. Sign-up to a stewardship code was commonly voluntary and enforcement of the code's standards was generally soft law, comply or abstain.[21]

How Much Convergence?

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[17] Francesca Cuomo, Christine Mallin and Alessandro Zattoni, *Corporate Governance Codes: A Review and Research Agenda* 24 CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW 222 (2016). The increasing ambition and capaciousness of the UK Code is described in Brian R. Cheffins & Bobby V. Reddy, *Thirty Years and Done – Time of Abolish the UK Corporate Governance Code*, 22 J. CORP L. STUDIES 709 (2022). The ECGI website contains a depository of corporate governance codes.

[18] See, e.g., James E. Cion, Stephen P. Ferris, Armin J. Kammel & Gregory Noronha, *European Corporate Governance: a Thematic Analysis of National Codes of Governance*, 18 EUR. FINANCIAL MNGMNT 620 (2012) (Code diversity even in EU, major difference depending on issuer, government vs. stock exchange); Yasir Bin Tariq., Amir Ejaz, & Malik Fahim Bashir, *Convergence and Compliance of Corporate Governance Codes: A Study of 11 Asian Emerging Economies*, 22 CORPORATE GOVERNANCE: THE INT'L J. BUS IN SOC. 1293 (2022) (finding significant non-convergence from UN CG guidelines, especially China and India, but listed companies were more convergent).

[19] For discussion of the diffusion of Stewardship Codes and the country variations, see the chapters in Dionysia Katelouzou and Dan W. Puchniak (eds), GLOBAL SHAREHOLDER STEWARDSHIP (2020); Dionysia Katelouzou, *Investor Stewardship: The State of the Art and Future Prospects*, in this HANDBOOK. As of 2024, at least 19 jurisdictions have adopted stewardship codes. See Dan W. Puchniak, *The False Hope of Stewardship in the Context of Controlling Shareholder: Making Sense Out of the Global Transplant of a Legal Misfit*, 72 AM J. COMP. L. 109 (2024) (Appendix 6 lists the adopting jurisdictions in addition to the UK).

[20] The Global Stewardship Codes Network "convenes organisations responsible for developing, or monitoring the implementation of Stewardship Codes, Principles, and best practices." See https://www.icgn.org/global-stewardship-codes-network This project was run by the International Corporate Governance Network, established in 1995. It asserts that its members represent $90 trillion of AUM.

[21] For a table of country-variations of stewardship and fiduciary obligations of institutional investors and related intermediaries, ee OECD CORPORATE GOVERNANCE FACTBOOK (2025) at 142-147 (Table 3.17).

With the push of corporate governance codes and now the stewardship code and the increasing share of institutional and asset manager ownership both in individual counties and overall global stock market capitalization[22] and the increasing concentration of such ownership,[23] how much convergence is there, particularly in toward provisions favored by such global public shareholders? One way to measure is via the "report card" of the OECD 2025 Corporate Governance Factbook, which provides detailed information about the corporate governance provisions of 52 jurisdictions.[24] One way to read this evidence is identify substantial convergence but also to observe diversity within a convergent system.

For example, the OECD 2025 Factbook (updated biannually since 2015) identifies a series of specific elements that bear on the exercise of shareholder rights, such as the rules relating to shareholder meetings like notice, information, the right to request a meeting, and voting rules (such as multiple voting shares). In the country-specific tallies, we observe considerable variation.[25] On common shares with different voting rights, we see significant movement towards allowance, now 60 percent of jurisdictions, following the US practice that has become associated with start-ups.[26]

When it comes to boards, the differences among jurisdictions as to dual board and single board structures persist,[27] but the question of director independence is most salient, particularly in light of concentrated ownership patterns that also persist in much of the world outside of the US and UK. It has now become all but universal for jurisdictions to require some representation of independent directors on boards (convergence), but the most common requirement is for minority representation only.[28] Moreover, what suffices for director "independence" is exhibits considerable discordance.[29] In a jurisdiction like the US, the requirement for majority of independents reverts to a minority where ownership is concentrated.[30] And even in the US, as shown by recent legislative action in Delaware that limited the judicial warrant to test independence-in-fact, the definition of "independence" is labile.[31]

Board function has also evolved in a convergent way. The Global Financial Crisis led to a general move towards imposing a risk management responsibility onto boards. "Board

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[22] See Alejandra Medina, Adriana De La Cruz & Yun Tang, *Corporate Ownership and Concentration* (OECD WP 2022), at 31-33 (including figures), and *Owners of the World's Listed Companies* (OECD WP 2019); Miguel Anton, Florian Ederer, Mireia Gine & Guillermo Ramirez-Chiang, *Common Ownership Around the World* (NBER WP 2025), available at http://www.nber.org/papers/w33965, at 40-46 (figures) .

[23] See id., generally.

[24] OECD CORPORATE GOVERNANCE FACTBOOK 4 (2025)

[25] OECD CORPORATE GOVERNANCE FACTBOOK (2025) at 76-83; 104-108 (Tables); 116-117 (Tables).

[26] Id at 12: "Another significant trend is that 60% of jurisdictions now allow companies to issue shares with a different number of votes per share, up from 44% in 2020." Id. at 82-85 (including tables and figures).

[27] Id. 153: "One-tier board structures are favoured in 24 jurisdictions, while 7 favour two-tier boards. A growing number (18 jurisdictions) allow both structures, and 3 have adopted hybrid systems." See 173-179 (Tables).

[28] Id. at 153-157.

[29] See, e.g., Wolf-Georg Ringe, *Independent Directors: After the Crisis*, 14 EUR. BUS. ORG. L. REV. 401 (2013)

[30] OECD CORPORATE GOVERNANCE FACTBOOK (2025) at 154.

[31] See Del. Gen. Corp. L. §144(d)(2) added in 2025 (in evaluating conflict transaction, presumption of director independence if stock exchange listing standards is satisfied).

responsibility for risk management has also expanded, with 92% of jurisdictions now having provisions to this effect, compared to 62% in 2014." [32]

Another way to approach the convergence question is to look at a particular problem, related party transactions with a controlling shareholder, and look for a common approach. On the one hand, there is substantial convergence on immediate disclosure of a related party transaction (though not necessarily on the content),[33] and on the need for board approval.[34] Yet there is substantial diversity on the role of independent directors, the need for fairness opinions, and the role for shareholder approval.[35] Considerable scholarship bears evidence of the meaningful diversity on the treatment related party transactions.[36] There is even instability in the United States, reflected in recent amendments to Delaware corporate law that cut back on shareholder approval rights in the effort to placate controllers who had threatened to reincorporate in jurisdictions with more lenient standards.[37]

Notwithstanding the generally positive report card in the OECD Factbook, Dan Puchniak and his co-authors have mounted a sharp-edged critique of the "convergence"/"diversity within convergence" claim: what we see instead, they argue, is "faux convergence."[38] Drawing from Asian examples, the core of their argument is that governance mechanisms that promote convergence, like corporate governance and stewardship, and many of the convergent governance elements, like independent directors, have been repurposed for quite different purposes than making the world safer for global stock market investors.

For example, in many Asian countries, controllers exert considerable influence over the selection of "independent" directors, yet they still serve a useful function, whether providing legitimacy and government connections in China, or serving as family mediators in Singapore, or serving as change agents in Japan, pursuant to an explicit government policy of empowering shareholders.[39]

A similar case stands for stewardship codes, which have diffused across Asia. The initial goal of these codes was to enlist institutional investors to monitor management and thereby control managerial agency costs and to push management to engage in better risk management.[40] Yet given

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[32] OECD CORPORATE GOVERNANCE FACTBOOK (2025) at 12. See id. at 152, Infographic 4.1; 159-161 (figures and tables describing variations).

[33] Id. at 12: "Concerning related party transactions (RPTs), which involve the transfer of resources between a company and a related party, 87% of jurisdictions require board approval, up from 54% a decade earlier, and 94% require immediate RPT disclosure."

[34] Id.

[35] Id. See id., 117-129 (Tables).

[36] See, e.g., Luca Enriques & Tobias H. Troger, eds. THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS (2019) (including comparative discussions). See Luca Enriques, *Related Party Transactions*, this HANDBOOK.

[37] See, e.g., *Delaware Revamps Its General Corporation Law — Will It Stop Companies from Leaving?* (Fenwick & West law firm memo), available at https://corpgov.law.harvard.edu/2025/04/06/delaware-revamps-its-general-corporation-law-will-it-stop-companies-from-leaving/ .

[38] See Gen Geto & Dan W. Puchniak, *Faux Convergence in Asian Corporate Governance: Unmasking the Illusion of Anglo-American Transplants, ECGI WP 811/2024, available at* https://ssrn.com/abstract=4993696 Prof. Puchniak has pursued this theme in many related papers.

[39] Id. at 8.

[40] Gen Goto, Alan K. Koh & Dan W. Puchniak, *Diversity of Shareholder Stewardship in Asia: Faux*

the controlling-owner pattern that is common in Asia, stewardship codes obviously do not serve that function. Unlike in the UK, for example, institutional investors are locked into a decidedly minority position. Instead, stewardship codes have been adopted and utilized for different purposes. In Japan, the stewardship code serves as a vehicle to nudge firms to engage in more business risk-taking. In Korea and Singapore, stewardship codes are fashioned to address governance issues that arise in family-controlled conglomerates; in other jurisdictions, such codes simply signal to adherence to global standards of minority shareholder protection.

It's also the case that "convergence" can develop through firm-specific actions. As noted above, financial globalization permits particular firms to opt-into "global standards" of corporate governance through, for example, charter provisions, listing decisions, disclosure practices, and director selection.

Capital Market Measures and Explanations

In a sense the strongest claim for significant convergence is the robustness of global capital markets. The OECD 2025 Factbook reports that Asian issuers account for an increasingly large fraction by number and amount raised, especially Chinese IPOs and also account for large share of secondary public offerings.[41,42] The OECD has documented the increasing level of institutional ownership in countries where the quality of corporate governance has been challenged in the past.[43] In a sense a highly relevant measure of convergence on the Internal Governance axis is a functional one: are the equities of a particular jurisdiction "investible." An "investible" corporate governance regime may fall short of the first-best international standard but if equities can be reliably priced, they can be acquired and held in the diversified portfolios of institutional investors and the investment products of asset managers. The critical feature is whether the imperfections are stable, for example, whether the level of controllers' rent extraction is stable; whether the level of the government's share of enterprise rents is stable.[44]

Convergence, 53 VAND. J. TRANSNATIONAL L. 829, 832-833 (2020); Alan K. Koh, Dan W. Puchniak & Gen Goto, *Shareholder Stewardship in Asia: Functional Diversity Within Superficial Formal Convergence*, in Dionysia Katelouzou & Dan W. Puchniak, eds., GLOBAL SHAREHOLDER STEWARDSHIP 613, 614 (2022); Dan W. Puchniak, *The False Hope of Stewardship in the Context of Controlling Shareholders: Making Sense Out of the Global Transplant of a Legal Misfit,* 72 AM. J. COMP. L. 109, 127-132 (2024).

[41] OECD CORPORATE GOVERNANCE FACTBOOK (2025) at 19-21 (including figures)

[42] Recent empirical work indicate that emerging market equities show lower values than developed markets on indicators such as market capitalization to GDP and valuation ratios like price/earnings and the dividend yield. Geert Bekaert, Campbell Harvey & Tomas Mondino, *Emerging Equity Markets in a Globalized World*, 56 EMERGING MARKETS REV (2023) 101034. I take this principally as a caution that corporate governance is only one element of a regulatory and investment climate.

[43] OECD CORPORATE GOVERNANCE FACTBOOK (2025), 29-30.

[44] See Sang Yop Kang, '*Generous Thieves': The Puzzle of Controlling Shareholder Arrangements in Bad-law Jurisdictions*, 21 STAN. J. L. BUS. & FIN. 57 (2015). See also Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV 1641 (2006).

The driver of functional convergence is the appeal of global capital flows and thus the over-arching test of functional convergence is "investibility."[45] Does a country's corporate law, corporate governance, and State governance falls within a range of acceptable and stable rent extraction by insiders and predictable actions by the State so that institutional investors (including their asset managers) are willing to make large scale investments in the pursuit of portfolio diversification? For example, some have warned of changes in China's governance regime that inserts the Party into the internal corporate governance of even private firms[46] and of abrupt changes in China's regulatory expectations.[47] Will these make China "uninvestable" in the future?[48]

This convergent "investibility" measure flows from the nature of globalizing investment practices, increasingly through indices of unending variety, put together by asset managers to appeal to various risk/return and sectoral allocations. It turns out that outside of the United States, the "Big Three" share of ownership is quite limited.[49] Although "stewardship" by the Big Three has been roundly criticized as inadequate, it still dwarfs engagement by other asset managers and those who assemble these index products.[50]

EXTERNALITIES GOVERNANCE: AN INTRODUCTION

Along the Externalities Governance axis there is far less convergence. Indeed, there is not even convergence on how this non-shareholder focused axis should be labeled or assessed. Is it "ESG" ("Environment, Social, Governance")? Is it "sustainability" and "mitigation of climate change"? Moreover, the technologies of implementation are different. The focus is less on mandatory rules or "comply or explain," techniques of shaping internal governance, and more on detailed disclosure relating to the identified "externality" variable of concern. The assumption is

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[45] "The odd thing is that the word has become more common even as the world has become more investible. Thanks to financial innovation and globalisation, far-flung assets are far easier to buy than they used to be. Back in 1988 MSCI's emerging-markets equity index included only ten countries with a combined market capitalisation of just over $50bn. The index now includes 24 countries with a market value of $6.9trn. At the end of last year the value of global investible assets reached a record high of $179trn, according to State Street, an asset manager. That is equivalent to 186% of world GDP in 2021, up from 116% in 2000." THE ECONOMIST May 19, 2022.

[46] See Lauren Yu-Hsin Lin & Curtis J. Milhaupt, *Party Building or Noisy Signaling? The Contours of Political Conformity in Chinese Corporate Governance*, 50 J. LEGAL STUDIES 187 (2021) Cf. Qiang Li, Windon Li,, Stewart Wang, Peter Chen, *China Makes Welcome Amendments to its Company Law* DLA Piper Memo (Jan 8, 2024) (addition of co-determination for private companies with director elected by employees' congress).

[47] *U.S. Does Not Want to 'Decouple' from China, Commerce Chief Says*, NYTIMES Aug. 29, 2023. (Sec'y Raimondo "expressed a litany of concerns" about regulatory actions).

[48] *Is China "uninvestible*"?, THE ECONOMIST, May 19, 2022 (discussing JP Morgan Chase report on China's internet firms). See generally Curtis Milhaupt, *The Governance Ecology of China's State-Owned Enterprises*, this HANDBOOK. A contrary view is expressed in Chun Zhou, Wei Zhang, Dan W. Puchniak, *The Overlooked Reality of Shareholder Activism in China: Defying Western Expectations*, forthcoming 2025, 15(3) HARV. BUS. L. REV., available at https://ssrn.com/abstract=4853552 (noting the very low percentage of foreign ownership and a high level of retail ownership suggesting a domestic "investibility" test).

[49] See Miguel Anton, Florian Ederer, Mireia Gine & Guillermo Ramirez-Chiang, *Common Ownership Around the World* (NBER WP 2025), available at http://www.nber.org/papers/w33965, at 40-46 (figures).

[50] See Alejandra Medina, Adriana De La Cruz & Yun Tang, *Corporate Ownership and Concentration* (OECD WP 2022), at 33- 34 (including table).

that capital market or "social license" reactions to the disclosed information will change behavior. For example, rating agencies score companies on ESG metrics. This facilitates the construction and marketing of portfolios designed to screen out or screen in based on the ESG ratings of interest.

The European Union has developed the most advanced Externalities Governance regulatory regime, as will be discussed below. Its ambition is to engender significant convergence by conditioning access to the EU market on compliance with its requirements, with the objective of a "Brussels effect" in global governance.[51]

Promotion of values reflected along Externalities Governance axis has been sharply, even explosively, contested in the United States, producing divergence rather than some sort of weak convergence, which is common along the Internal Governance axis. The underlying political economy that generates this divergence is a major theme of the chapter.

EXTERNALITIES GOVERNANCE: A SECOND AXIS IN THE MAPPING OF CONVERGENCE, DIVERSITY, AND DIVERGENCE IN CORPORATE LAW AND GOVERNANCE

The most important development in corporate law and governance over the past decade (since the First Edition) has been the development of an "Externalities Governance" axis. The original axis, Internal Governance, focuses principally on production and its division among constituents of the firm, the distribution of enterprise rents among the contending constituencies in the firm, especially employees.[52] Its focus is not redistribution or externalities but greater production. The scope of Internal Governance model covers parties in contractual relationship with the firm, explicit, implied, and implicit in light of this production objective.

The second axis, the Externalities Governance axis, assesses the extent to which corporate law and governance induces the firm to internalize a broad set of social concerns, well beyond efficient production and firm-specific challenges and well beyond parties with plausible contractual claims. The Externalities Governance axis looks to governance mechanisms that address whether the firm adds or subtracts from social welfare, not necessarily within a particular society even but globally.

The distinction between the two axes is illustrated through an analytic move made by Ron Gilson in Chapter 1 of this Handbook that expresses skepticism about stakeholderism. Every line on an income statement reflects a relationship with a stakeholder: employees, suppliers, customers, and most prominently, shareholders, insiders and outsiders, he argues. The allocation of enterprise rents among these stakeholders is the fundamental Axis One concern, Internal Governance. Gilson argues that shareholders are properly assigned the residuum as a way of increasing the whole.

But now, prominently, corporations are urged to address a series of concern that simply do not figure on the income statement or balance sheet, at least conventionally.[53] Climate change,

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[51] See Anu Bradford, THE BRUSSELS EFFECT: HOW THE EUROPEAN UNION RULES THE WORLD (2020).

[52] Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 U. VA. L. REV. 247. For similar, see Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, in Alan J. Auerbach, ed., CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES (1988) (breach of implicit contract at one firm undercuts firm specific investments not only by employees of own-firm but other firms).

[53] For an alternative accounting system, see Colin Mayer, PROSPERITY 130-146 (2018).

sustainability, human rights protection, various social effects – these are all covered by "Externalities Governance." To be sure, the issues are not new; "corporate social responsibility" is an on-going debate.[54] Indeed, Milton Freedman's New York Times 1970 jeremiad, *The Social Responsibility of Business Is to Increase Its Profits*, was a rejection of calls for corporations to take on a broad remedial role following the extremely disturbing events of the late 1960s, including the urban riots that followed the assassination of the Rev. Dr. Martin Luther King. What makes for a distinctive corporate governance axis is the breadth and depth of the call for various corporate commitments, brigaded to a particular corporate governance strategy with genuine carrying power. For convenience I call this axis Externalities Governance.

The construction of this second axis for questions of corporate law and governance was accomplished by seven coincident factors:

- First, the intellectual framework and coinage of the triplet "Environmental, Social, and Governance" ("ESG") in a report produced in 2004 under the auspices of the United Nations, WHO CARES WINS.
- Second, the parallel launch in 2005 (with UN prompting) of the Principles of Responsible Investment, a network of institutional investors, global governance institutions, and NGOs, that promotes incorporation of ESG issues "into investment analysis and decision-making processes."[55]
- Third, the Paris Agreement on climate change, a legally binding international agreement adopted at the UN Climate Change Conference (COP21) in 2015, coming into force in 2016.
- Fourth, the European Green Deal, launched in 2019, focusing on "sustainability" across climate and other environmental challenges as well as a "just and inclusive" transition.
- Fifth, intellectual ferment about the "purpose" of the corporation. A notable example is Colin Mayer's PROSPERITY (2018), which argues that the purpose of the corporation is not just profit, but "to produce profitable solutions to the problems of people and planet and in the process … produce profits."[56]
- Sixth, the concentration of share ownership into institutional investors, particularly asset managers like the "Big Three" in the US, and sovereign wealth funds, like the Norwegian Sovereign Wealth Fund.
- Seventh, and not least, the propulsive force of a network of NGOs and other not-for-profits, global business elites (e.g., the World Economic Forum), and key asset managers and institutional investors that pushed concerns about externalities, particularly climate change

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[54] See Cynthia A. Williams, *Corporate Social Responsibility and Corporate Governance*, this HANDBOOK.
[55] PRI, *What are the Six Principles for Responsible Investment*?, available at https://www.unpri.org/about-us/about-the-pri
[56] See generally Dorothy Lund & Elizabeth Pollman, *Corporate Purpose,* this HANDBOOK.

and some other ESG matters, into the business strategies of large public corporations, particularly multi-nationals.[57]

The key implementation strategy is disclosure relevant to the externalit(ies) of interest and then utilization of the internal governance mechanisms developed along the Internal Governance axis to attempt to change behavior of corporate actors.[58] Thus major effort has been given to the creation of the "International Sustainability Standard Board" (ISSB), tasked with providing a "global, consistent framework for sustainability-related financial disclosures" that can integrate prior disclosure projects covering discrete issues.

The founding of the ISSB was a global governance project. The original impetus came from the Financial Stability Board, a collaborative body established by the G-20 group of countries after the Global Financial Crisis of 2007-09 and charged with making concrete recommendations for a regulatory structure that would protect global financial stability.[59] The FSB established a Task Force on Climate Related Financial Disclosure which established key disclosure elements and which in general coordinated with other global governance actors in a process that led to the promulgation of ISSB climate-change related disclosure standards in 2023.[60]

The pivotal element in the creation of the Externalities Governance axis was a shift in the structure of share ownership.[61] Institutional investors increasingly became the dominant owners

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[57] One reflection of this is a new chapter in the 2023 revision of the G20/OECD PRINCIPLES OF CORPORATE GOVERNANCE on "Sustainability and Resilience" and the 2023 revision of the OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES ON RESPONSIBLE BUSINESS CONDUCT that explicitly targets climate change, biodiversity loss, and pollution as priority corporate governance matters. See also OECD CORPORATE GOVERNANCE FACTBOOK (2025), 221-252 (chapter on "Corporate Sustainability").

[58] For an overview on "sustainability" reporting, see OECD Global Corporate Sustainability Report 2024, at 8: "In 2022, out of 43,970 listed companies globally with a total market capitalisation of USD 98 trillion, almost 9,600 companies representing a total market capitalisation of USD 85 trillion disclosed sustainability-related information." The reliability of such disclosure is of course vital. Per the OECD: "Globally, an external service provider assures the sustainability disclosure of two-thirds of the companies that disclose sustainability information by market capitalisation. Among the companies that disclose the name of the independent assurance provider, 82% of the sustainability reports were assured by an auditor and the rest by other assurance providers. The share of companies that hire the auditor of the financial statement to assure their sustainability disclosures varies widely across regions: from 17% of companies by market capitalisation in Japan to 70% in Europe." Id.
There is a separate claim that directors' fiduciary duties should be expanded to include consideration of these external factors. Prof. Lim finds evidence of this broadening conception of directors' duties in China, particularly for SOEs, but this has yet to generalize. Ernest Lim, *Fiduciary Duty and Corporate Externalities: Rethinking Directors' Climate Obligations,* available at https://ssrn.com/abstract=5250589 See also Cynthia A. Williams, *Fiduciary Duties and Corporate Climate Responsibility*, 74 VAND. L. REV. 1875 (2021).

[59] For further discussion of the FSB, see John Armour et al, PRINCIPLES OF FINANCIAL REGULATION 619-625 (2016).

[60] Financial Stability Board, PROGRESS ON CLIMATE RELATED DISCLOSURES (2023), available at https://www.fsb.org/wp-content/uploads/P130723.pdf See also Stavros Gadinis & Siliva Fregoni, *Beyond the Brussels Effect: The Surprising Rise of the International Sustainability Standards Board*, ECGI WP 886/2025 (Nov. 19, 2025), available at https://ssrn.com/abstract=5777602 (SASB as "institutionalizing what had started as market-driven initiatives").

[61]The OECD has calculated that for "the 100 listed companies with the highest disclosed GHG emissions globally …institutional investors hold the largest share of the equity (41%) and that the public sector … 18% of the equity. *** Globally, the largest shareholder in each of these 100 highest emitting companies owns on average 24% of the shares, and the largest 20 shareholders own on average 54% of the shares. OECD GLOBAL CORPORATE SUSTAINABILITY REPORT 2024.

of many large public companies, particularly the multinationals, but there was further concentration in the hands of asset managers.[62] In part this was the result of financial innovation by asset managers that created products, such as exchange-traded funds (ETFs), that combined diversification at scale with liquidity. Moreover, in the pursuit of diversification, institutional investors and asset managers assembled global portfolios, taking equity positions in companies in every country that was "investible." In part because of regulatory pressure including the launch of "stewardship codes," asset managers developed "stewardship teams" tasked with exercising the shareholder franchise across the entire breadth of their portfolios, hundreds, thousands of companies worldwide.

The creation of the Externalities Governance axis was promoted by key business elites and NGOs in the belief that the world faced serious problems, like climate change and various social problems; that no single government had global jurisdiction over the relevant actors and in many cases appropriate government action was blocked by self-interested parties; but that the tools of corporate governance could be used to change the behavior of various companies, particularly multinationals and other global firms.[63] The change in ownership structure and the development of stewardship responsibilities provided a mechanism.[64]

One convenient strategy was to expand the role of "stewardship" beyond the original Internal Governance concerns of the original stewardship codes to the broader responsibilities of the Governance of Externalities. This is reflected in the 2020 revision of the UK code, which included "material environmental, social and governance issues, and climate change" as integral to the institutional investors' stewardship responsibilities.[65] Even earlier (2017), the EU's amended Shareholder Rights Directive II called for "effective and sustainable shareholder engagement" on the part of institutional investors to "improve the financial and non-financial performance of companies, including as regards environmental, social, and governance factors."[66]

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[62] See generally Edward B. Rock, *Institutional Investors in Corporate Governance*, this HANDBOOK.

[63] See Dorothy Lund, *Asset Managers as Regulators*, 171 U PA. L. REV. 77 (2023) This has been described from a more critical perspective as a form of "privatized neoliberal governance." See Jason Thistlewaite & Matthew Paterson, *Private Governance and Accounting for Sustainability Networks*, 34 ENVIRONMENT AND PLANNING C: GOVERNMENT AND POLICY 1197, 1204-06 (2016); Klaus Schwab, STAKEHOLDER CAPITALISM: A GLOBAL ECONOMY THAT WORKS FOR PROGRESS, PEOPLE AND PLANET (2021). (Schwab is founder of the World Economic Forum).

Commonly the question of "externalities" associated with the corporation's business has been regarded as matter for state law-making and regulation, for example, various environmental laws. Some jurisdictions have adopted laws with avowedly global reach, such as the US Foreign Corrupt Practice (1977) and various anti-money-laundering legislation. The UK Modern Slavery Act of 2015 requires companies with sufficient UK turnover to exercise due diligence to eliminate "slavery" (as defined) in their business operations and supply chains.

[64] For a sketch of this dynamic, see Tim Bowley & Jennifer G. Hill, *The Global ESG Stewardship Ecosystem*, 24 EUR. BUS. ORG. L. REV. On-line (April 2024). For skepticism about the possibilities of stewardship, see Zohar Goshen & Asaf Hamdani, *Will Systematic Stewardship Save the Planet*?, 70 VILL. L. REV. 467 (2025).

("Although climate change is a systematic risk, addressing it requires firm-specific engagement, as well as economy-wide coordination, which universal owners cannot provide." Best approach is to energize governments.)

[65] See Paul Davies, *The UK Stewardship Code 2010-2020 from Savings the Company to Saving the Planet*, ECGI WP 506 (2020), available at https://ssrn.com/abstract=3553493 ("The aim is clearly to mainstream ESG factors into stewardship, not simply to present them as an add-on").

[66] Directive (EU) 2017/828 (May 17, 2017) amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement. The Directive called for disclosure and a "comply or explain" mechanism.

The problem of climate change and excess CO_2 emissions provides a good example for how corporate governance could be utilized to address a critical global issue. The straightforward way to deal with climate change would be to impose a carbon tax, set at an appropriate level that measures the social harm from carbon. Taxing emissions would force the relevant parties to internalize these costs. Almost every economist would raise their hand approvingly if asked whether this is the first best solution. Of course, a carbon tax is a "tax" and its widespread adoption has been politically impossible. Moreover, since there is no global taxing authority, the required local imposition of such a tax would invite arbitrage and exceptions.[67] The alternative is to go after the emitters through a corporate governance solution.[68]

The key mechanism has been disclosure, specifically, robust disclosure of firm-specific carbon emissions, not just by the own-firm in its operations but also in the use of its products and even by suppliers of its inputs.[69] These disclosures were projected to induce a capital market reaction, such as a penalty for high emissions or slowness in transitioning away from carbon, especially relative to peers. These disclosures were also the raw material for specific corporate governance interventions, such as shareholder proposals, shareholder responses to executive compensation plans, passive objections to directors (withhold vote campaigns), proxy contests to challenge incumbents, and, more generally, through nudges in institutions' on-going engagement with investee companies. Persuasion through elite business channels, such as the World Economic Forum, was also an important part of the governance story.[70,71]

As noted above, an important element in the development of the Externalities Governance axis was the launch in 2021 of the International Sustainability Standards Board (ISSB), self-described as "an independent, private-sector body" that promulgates IFRS Sustainability

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[67] For discussion of the loopholes and carveouts that have weakened the 2021 OECD agreement on a global 15% minimum corporate tax for multinationals, see EU Tax Observatory, GLOBAL TAX EVASION REPORT 2024.

[68] See Madison Condon, *Green Corporate Governance: Curbing Climate Change*, this HANDBOOK.

[69] See OECD GLOBAL CORPORATE SUSTAINABILITY REPORT 2024: "The growing urgency in managing climate-related risks and opportunities has generated greater interest by investors about companies' greenhouse gas (GHG) emissions. Globally, 6,308 companies representing 77% of market capitalisation disclosed scope 1 and 2 GHG emissions in 2022, ranging from 43% of companies by market capitalisation in the People's Republic of China (hereafter 'China') to 92% in Europe. Extractives and minerals processing is the industry with the highest share of companies disclosing scope 1 and 2 GHG emissions by market capitalisation (85%). Companies report scope 3 emissions less often. In 2022, companies representing 60% of market capitalisation reported scope 3 emissions, ranging from 9% in China to 87% in Europe. See generally George Georgiev, *Disclosure as a Corporate Governance Tool*, this HANDBOOK.

[70] The UK has augmented this disclosure strategy through new climate-relevant disclosure requirements for companies seeking access to public markets, the new Prospectus Rules: Admissions to Trading on a Regulated Market (eff. Jan 19, 2026). A chapter of the issuing document is devoted to "sustainability-related disclosures." https://www.fca.org.uk/publication/policy/ps25-9.pdf

[71] The UK has also taken a more specifically-targeted corporate governance approach. Although the formation of a board "sustainability committee" is not subject to the Code's "comply or explain" regime, the Financial Reporting Council suggests that boards will increasingly have such a committee in light of "the related risks, opportunities, strategies, performance and disclosure." Its guidance indicates how such committee should function. https://www.frc.org.uk/library/standards-codes-policy/corporate-governance/corporate-governance-code-guidance/, at ¶¶142-150. Given the influence of the UK in corporate governance matters and its Code in particular, board-level "sustainability committees" could proliferate and become important promoters of company action.

Disclosure Standards. Such standard-setting imposes uniformity across companies and thus facilitates the use of disclosure in corporate governance engagements.

The ISSB standards, first issued in final form in 2023, have gained credibility because the ISSB is itself a project of the IFRS Foundation, which plays as critical role in international financial reporting as overseer of the International Accounting Standards Board, which promulgates "International Financial Reporting Standards." IFRS is the major global disclosure competitor to the US-based "Generally Accepted Accounting Principles" (GAAP). The ISSB standards have been endorsed by the International Organization of Securities Commissions (IOSCO). The IFRS Foundation reported that as of September 2024, 30 jurisdictions "have decided to use or are taking steps to introduce ISSB Standards in their legal or regulatory frameworks," representing more than 40% of global market capitalization (and more than half of global greenhouse gas emissions).[72]

A final element in the construction of Externalities Governance axis has been the effort to heighten governance pressures and effectiveness through investor alliances and asset manager that focus particularly on climate change, for example, the "Net Zero Asset Owners Alliance,"[73] the "Net Zero Asset Managers Initiative,"[74] "Climate Action 100+"[75] and the International Corporate Governance Network.[76] The goal is to overcome some of the collective action problems in using the corporate governance machinery on axis one to serve the objectives of axis two. Indeed, the goal has been to produce an "international corporate governance machine" on behalf of Externalities Governance.[77]

These various measure of "soft law" have produced some convergence on the Externalities Governance dimension, particularly as pertains to carbon-related measures in light of the

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[72] IFRS PROGRESS ON CORPORATE CLIMATE-RELATED DISCLOSURES—2024 REPORT, available at https://www.ifrs.org/content/dam/ifrs/supporting-implementation/issb-standards/progress-climate-related-disclosures-2024.pdf

[73] "The UN-convened Net-Zero Asset Owners Alliance is a member-led initiative of institutional investors committed to transitioning their investment portfolio to net zero GHG emissions by 2050 – consistent with a maximum temperature rise of 1.5 c." https://www.unepfi.org/net-zero-alliance/

[74] This initiative was launched in December 2020 and as of a highpoint in December 2023, had 315 asset manager signatories with collective AUM of $57 trillion. https://www.netzeroassetmanagers.org/the-long-road-to-net-zero-a-look-inside-the-net-zero-asset-managers-initiative/

[75] "Climate Action 100+ is an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take appropriate action on climate change in order to mitigate financial risk and to maximize the long-term value of assets." It integrates the efforts of various investor networks focused on climate change. https://www.climateaction100.org/

[76] The ICGN is a membership body, particular for pension funds, with AUM of $90 trillion. "[W]e focus our networking, education, and policy impact on material governance issues, advocating for high standards in corporate governance and stewardship in light of our members' fiduciary responsibilities." https://www.icgn.org/

[77] See Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563 (2021); Kishanthi Parella, *Corporate Governance & International Law*, 76 ALA. L. REV. 417 (2024).

consensus reflected in the Paris Accord. [78] The goals of the Paris accord united both governments and business communities with significant spillover for corporate governance.[79]

The most far-reaching effort for governance on the Externalities Governance axis comes from the package of directives and regulations from the EU in implementation of its "Green Deal" program.[80] The principal directives are the Corporate Sustainability Reporting Directive (CSRD), the Sustainable Finance Disclosure Regulation (SFDR) and the related Taxonomy Regulation (which classifies particular investments on their "sustainability" and "green" attributes), and, most recently the Corporate Sustainability Due Diligence Directive (CSDDD).

Disclosure under the CRSD covers 10 total ESG topics, required "independent assurance," and is subject to "double materiality" thresholds, meaning, materiality as assessed by either "impact" on the wider community or traditional financial metrics. "Impact materiality" was to consider the company's broader value chain. The SFDR requires asset managers to disclose the "sustainability" features of their products with the goal of shifting capital market flows in favor of sustainable investments. The CSDDD requires companies to adopt due diligence methods to assure compliance with various environmental and human rights standards throughout their supply chain and to adopt climate change mitigation plans consistent with achieving the 1.5 C. global warming limit of the Paris accord. The CSDDD also appears to require consultation with affected stakeholder and community interests as part of the due diligence exercise.

These directives impose far-reaching efforts to impel European companies to incorporate externality-focused concerns, environmental and social, into their decision-making processes. The idea of "double materiality" of the CSRD and "due diligence" responsibility throughout the supply chain of the CSDDD which will presumably lead to additional required disclosures that will create a robust Externalities Governance axis in our conception of corporate law and governance for the subject European companies. But the ambition of the European project is to foster global convergence on this model by conditioning access to the European market with compliance. Both the CSRD and CSDDD contain EU-sourced revenue thresholds that would lead to significant extraterritorial effect.

The ambition of these directives provoked pushback by business and political elites in the EU concerned about growth in the EU particularly at a time of the unraveling of trade relationships with the United States under Trump administration. This led to significant revision reflected in the EU Parliament's adoption in December 2025 of compromise "Omnibus" legislation that

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[78] The text focuses on the EU, because its role in the Governance of Externalities has been most aggressive, but measures taken in the "Global South," including Brazil, India, China, and South Africa, have been convergent on climate change. See Maria Eduarda Lessa & Mariana Pargendler, *Climate Disclosure in the Global South*, in Doug Kysar & Ernest Lim, eds., THE OXFORD HANDBOOK ON PRIVATE LAW AND CLIMATE CHANGE (2025).

[79] For a highpoint of business elites signing onto the importance of climate change mitigation in the operation of their businesses, see A CALL TO ACTION FROM THE GLOBAL BUSINESS COMMUNITY: GLOBAL BUSINESSES SUPPORT CLIMATE ACTION THAT ENHANCE COMPETITIVENESS (Oct. 28, 2021), issued by business roundtables in the US, Europe, Australia, Canada, and Mexico, available at https://www.businessroundtable.org/a-call-to-action-from-the-global-business-community-global-businesses-support-climate-action-that-enhances-competitiveness.

[80] For a survey of the adoption of corporate social responsibility provisions in corporate law in other jurisdictions, see Li-Wen Lin*, The Global Rise of "Corporate Social Responsibility" in Corporate Legislation: Symbolic Expression or Substantive Action?* TRANSNAT'L L & CONTEMP. PROB (forthcoming 2025).

revised the CSRD and CSDDD directives in some important respects.[81] The Omnibus took a "largest companies first" approach to reporting and due diligence requirements, extended the reporting transition period, limited reportable data points on some environmental and social metrics, and softened some monitoring elements of supply chain due diligence.[82] The reach of the Externalities Governance axis is of course to a significant extent a function of reporting thresholds, following the maxim of "you manage what you measure." Despite the modifications, the EU directives are a remarkable shift along the Externalities Governance axis.[83]

A recent article suggests that an important element of the convergent force of the European regime, especially the substantive environmental and social elements of the CSDDD, will come through a unique feature of the corporate law and governance of US corporations, since a large fraction of multinationals are US domiciled.[84] Profs. Enriques, Gatti, and Shapira observe that directors of Delaware corporations are responsible for oversight of the corporation's compliance with applicable law, and thus if the company is found to have failed in its CSDDD duties, the directors are potentially faced with monetary liability. Because the CSDDD imposes concrete legal duties, social and environmental concerns become "compliance" matters rather "corporate social responsibility" and thus directors have concrete oversight responsibilities and are likely to be receiving the "red flags" of potential violations that could trigger liability if not addressed. Given the importance of US multinationals to the global economy, this possible "Brussels effect" would promote widespread convergence on a robust Externalities Governance axis of corporate law and governance.[85]

At the very moment that these non-governmental and EU governmental actors sketched out a full-scale model of global convergence on a model of corporate law and governance that

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[81] See *Simplified Sustainability Reporting and Due Diligence Rules for Businesses* (European Parliament press release, Dec. 16, 2025), https://www.europarl.europa.eu/news/en/press-room/20251211IPR32164/simplified-sustainability-reporting-and-due-diligence-rules-for-businesses ; European Parliament, P10_TA(2025)(0324), *Certain Corporate Sustainability Reporting and Due Diligence Requirements*, Dec. 16, 2025, https://www.europarl.europa.eu/doceo/document/TA-10-2025-0324_EN.pdf.

[82] For a summary of terms, see, e.g., Ropes & Gray, *Political Agreement on the CSRD/CSDDD Omnibus Reached*, (Dec. 9, 2025) (law firm memo), available at https://www.ropesgray.com/en/insights/viewpoints/102lx77/political-agreement-on-the-csrd-csddd-omnibus-reached-15-key-details-to-know. In connection with the Omnibus, EFRAG, a private association of stakeholders, national organizations, and NGOs that provides technical advice to the European Commission, has proposed significant modifications to the initially proposed European Sustainability Reporting Standards.

[83] See, e.g., Daniel Litwin & Elsa Savourey, *Human Rights in EU Sustainable Finance*, 11 J. FIN. REG. 41 (2025).

[84] Luca Enriques, Matteo Gatti & Roy Shapira, *How the EU Sustainability Due Diligence Directive Could Reshape Corporate America*, 78 STANFORD L. REV. __ (2026). The authors identify push-back factors that may counter their conjectural path.

[85] For a hopeful account of this convergence, see Roza Nurgozhayeva & Dan W. Puchniak, *Corporate Purpose Beyond Borders: A Key to Saving Our Planet or Colonialism Repackaged*?, 57 VAND, J. TRANSNAT'L. L J. 1339 (2024). It should be noted that earlier draft of the CSDDD would have directly created a fiduciary duty of compliance running to directors. This provision was stricken in the adopted version.

It may be that other jurisdictions will fashion a similar post-*Caremark* pathway for director liability. The Dutch case *Shell Plc & Sichting Milieu en Mens v. Vereniging Milieudefensie,* Case 200.302.332/01, (Hague Court of Appeal), RBDHA, C/09/571932, ECLI:NL:GHDHA:2024:2100, points the way. See Eric W. Orts, *Is There Really a Fiduciary Duty to Destroy the Climate*? CLS BLUE SKY BLOG (March 17, 2025), available at https://clsbluesky.law.columbia.edu/2025/03/17/is-there-really-a-fiduciary-duty-to-destroy-the-climate/

would include a robust Externalities Governance axis, powerful divergent forces have entered the picture. The US is plainly headed in a divergent direction. Indeed, when it comes to the development of a second axis of corporate law and governance, the picture is one not just of "diversity" alongside "convergence" as we see on the Internal Governance axis but radical divergence. The US and the EU are on quite different paths. It may be that the US is on a path different from every other jurisdiction.

There are some straightforward indicators of the divergent US path. First is the retreat from a regulatory mandate for the disclosure of greenhouse gas emissions. Throughout the Biden administration the SEC labored to produce a disclosure regulation that would satisfy political and legal desiderata, producing a final rule only in March 2024, and taking care to limit its reach to financial materiality only.[86] Following the predictable initiation of litigation by industry and state parties, the SEC voluntarily stayed the effectiveness of the rule pending resolution of the challenges. After the election the SEC withdrew its defense of the rule and subsequently the US Appeals Court in which the litigation had been consolidated suspended its consideration of the case (though it may eventually resolve the question).[87]

Second, following business withdrawals and litigation threats by various states and Congressional hearings initiated by Republican opponents of ESG, both proxy advisors and asset managers turned quite negative on the various climate-related proposals submitted by NGOs and other parties, which in turn have declined in number.[88] Third, major US asset managers have withdrawn from the various investor alliances that have been key in bring investor pressure to bear on climate change issues.[89,90] All of these measures undercut the development of an Externalities Governance axis for US companies, diverging certainly from European developments and a lower-profile but directionally convergent movement elsewhere.[91]

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[86] The Final Rule, "The Enhancement and Standardization of Climate-Related Disclosure for Investors," is set forth at https://www.sec.gov/files/rules/final/2024/33-11275.pdf

[87] See generally Alessio M. Pacces & David Zaring, *The Divergence of Mandatory Climate Disclosure in the U.S. and the EU*, ECGI WP 882/2025 (Oct. 2025), available at http://ssrn.com/abstract_id=5609873 . *But see* Gadinis & Fregoni, supra n. 60 (market participant origins of the ISSB disclosure requirements means that they will persist and become conventional).

[88] See Teneo, *Top Five Takeaways from the 2025 Proxy Season*, HARV. LS FORUM ON CORP GOV (June 16, 2025) available at https://corpgov.law.harvard.edu/2025/06/15/top-five-takeaways-from-the-2025-proxy-season/

[89] Morningstar, *Climate Action 100+ Departures Put Proxy Voting in the Spotlight*, HARV. LS FORUM ON CORP GOV (Ap. 28, 2024), available at https://corpgov.law.harvard.edu/2024/04/28/climate-action-100-departures-put-proxy-voting-in-the-spotlight/ Indeed, the Net Zero Banking Alliance, which in April 2024 issued guidelines for climate target setting in bank lending, saw withdrawals over 2025 by most global banks led by US firms and ceased operation in October 2025.

[90] Another vivid example is the reversal of ExxonMobil from a poster child for effective of climate change activism after a successful 2021 proxy battle, see Rusty O'Kelley & Andrew Droste, *Why ExxonMobil's Proxy Loss is a Wakeup Call for all Board* , HARV L. S. FORUM ON CORP GOV (July 5, 2021), to an aggressive corporate resistor to the legitimacy of shareholder climate change related proposals, Amy Roy & Robert Skinner, *Exxon Proxy Suit Highlights Divide between ESG Investing and Activism*, HARV L. S. FORUM ON CORP GOV (FEB. 5, 2024).

[91] See, e.g., Luh Luh Lan & Ernest Lim, *Contextualising ESG Funds' Engagement Strategies in Asia* (October 15, 2024). ECGI WP 807/2024, NUS Law WP 2024/010, available at https://ssrn.com/abstract=4989840; UN Environment Program, *China Embarks on a Journey of ESG Disclosure: 2024 Progress and Focus for 2025*, https://www.unepfi.org/industries/banking/china-embarks-on-a-journey-of-esg-disclosure/; Compliance & Risks, *China Advances 2030 ESG Roadmap with Public Consultation on Draft Climate Disclosure Standard*, (May 12,

There are three factors that explain this divergence of the US from the EU and other jurisdictions. First, the incoherence in the "ESG" framework that has been the normative framework that has guided much of the push for Externalities Governance; second, the political vulnerability of some of the key US actors, particular the asset managers, that have been important actors in promoting ESG concerns, and third, most fundamentally, the distinctive political economy of the United State. The US political economy is distinctive in two respects: first, the US is now a petro-state, the largest producer of oil and gas in the world; second, because of the structure of retirement provision in the US, voters will be generally unwilling to sacrifice maximization of shareholder value in favor of the mitigation of externalities.[92]

1. *Problems with ESG*

The rise of "ESG" as a significant element in assessing the firm's performance has been comprehensively discussed by Elizabeth Pollman in *The Making and Meaning of ESG.*[93] Although its origins are in the UN-sponsored report, WHO CARES? in 2004, Prof. Pollman identifies the takeoff point in 2017, when "the 'Big Three' assets managers – BlackRock, Vanguard, and State Street – started to speak in the language of ESG and offer ESG funds."[94] BlackRock CEO Larry Fink played an especially important leadership role. An increasing share of asset manager AUM was tied to ESG, which influenced proxy voting as well as marketing.[95]

The troubles in applying ESG are well known. First is the question as to whether "ESG" comprehends "value" (economic return) or "values" (a broader set of social consideration). A firm might consider "ESG" as identifying risks to its long-term business and thus seek to mitigate those risks to *promote* shareholder value. Alternatively, "ESG" could be seen as a new banner for "corporate social responsibility" in which shareholder value is *traded off* against other considerations.

Second is the problem of trying to construct an index of ESG performance that would be useful, for example, in constructing a portfolio that makes use of a company's ESG score, whether in over/under-weighting or screening in/out. Should a company that invented the electric vehicles marketplace but is alleged to have engaged in workplace discrimination have a high or low ESG score? Disagreement over scoring within each category and differences in the weights assigned to these quite different elements means that correlations among ESG scorekeepers are low.[96]

2025), available at https://www.complianceandrisks.com/blog/china-advances-2030-esg-roadmap-with-public-consultation-on-draft-climate-disclosure-standard/ For further comparisons that specifically identify China, Japan, and the US, see figures in the OECD Global Corporate Sustainability Report 2024.

[92] On the general importance of political economy in explaining corporate governance institutions, see Mark J. Roe & Massimiliano Vatiero, *Corporate Governance and Its Political Economy*, this HANDBOOK.

[93] 14 HARV. BUS. L. REV. 403 (2024)

[94] Id. at 422. See also Mathew Archer, *Governing through ESG and the Green Spirit of Asset Manager Capitalism*, 56 ENVIRONMENT AND PLANNING A: ECONOMY AND SPACE 662 (2024).

[95] See Michael Barzuza, Quinn Curtis & David Webber, *Shareholder Value(s): Index Fund Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1276–79 (2020) (promoting social goals like gender diversity as product differentiation and marketing tools).

[96] E.g., Florian Berg, Julian Kolbel, Roberto Rigobon, *Aggregate Confusion: The Divergence of ESG Ratings*, 26 REV. FIN. 1315 (2022).

Because of the lack of "generally accepted assessment principles" much less a liability-creating audit, ESG also lends itself to overclaiming and "greenwashing."[97]

In the US ESG has been caught up in the "culture wars," with motivated parties claiming it has become a channel for various elements of "wokeness," including "Diversity Equity and Inclusion." Larry Fink, a key initial proponent, has disavowed the term, "because it has been entirely weaponized." In the US "ESG" has become too controversial to provide a reliable normative foundation for the Externalities Governance axis.

2. *The Political Vulnerability of US Asset Managers*

The core business model of the large US asset managers, for-profit enterprises, is to assemble diversified portfolios of securities, market these portfolios widely, and earn fees.[98] Asset managers are also regulated entities under the US federal securities laws, subject to regulatory oversight by the SEC. Asset manager compensation is generally limited to AUM-based measures rather than performance. In addition to individuals, major clients include various state public pension funds and sponsors of retirement plans that are subject to fiduciary standards under federal law.[99] The returns to scale in portfolio construction, especially for passive strategies, and the competitive success of the "Big Three" has meant that considerable shareholder voting power is concentrated in just a few hands. This has discomfited even those analysts who may well favor various ESG proposals on the merits[100] but of course provides an avenue of attack as reflecting the anti-democratic values of "elites."[101] Even if the sole motivation for the ESG promotion by the large asset managers is the "value proposition" of maximizing portfolio returns, or even better, risk-adjusted returns, [102] the asset managers' business model makes them an easy target for parties on the other side of the normative questions.[103]

Indeed, even before the 2024 election, asset managers had come under fire for purportedly "woke" investment normativity. The attacks had a partisan dimension reflecting political and

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[97] See, e.g., David F. Larcker, Lukasz Pomorski, Brian Tayan & Edward M. Watts, *ESG Ratings: A Compass Without Direction*, available at https://ssrn.com/abstract=4179647 .

[98] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013).

[99] Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 403(c), 404(a).

[100] See, e.g., John Coates, THE POWER OF TWELVE: WHEN A FEW FINANCIAL INSTITUTIONS CONTROL EVERYTHING (2003); Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493 (2018).

[101] Thus asset managers are eager to construct "pass-through" voting schemes that give beneficial owners the opportunity to vote their own preferences. See Alon Brav, Tao Li, Dorothy Lund & Zikui Pan, *The Proxy Voting Choice Revolution* (forthcoming 2026).

[102] Jeffrey N. Gordon, *Systematic Stewardship*, 47 J. CORP. L. 627 (2022).

[103] Id. at 660-661(activist intermediaries, not asset managers, should initiate corporate governance measures because of political and economic frailty of asset managers).

social polarization in the US.[104] Republican-leaning states were at the forefront of laws (proposed or adopted) prohibiting "ESG" considerations in the investment of public funds and some state pension funds withdrew mandates. Congressional investigations[105] and the threat of antitrust actions led to what a Bloomberg survey described as a "greenhushing … as asset managers in the US try to duck controversy over sustainable investing."[106] Most recently, 21 state financial officials, all Republicans, sent a letter to BlackRock and 24 other assets managers insisting on demonstration to a "fiduciary model grounded in financial integrity, not political advocacy" related to climate or other social or environmental issues.[107] These state officials are not saying, "and we therefore want separate accounts, in which we control the voting," but apparently want to assert proxy voting and engagement control over BlackRock's entire equity portfolio.

It's easy to see why the asset managers duck controversy. The loss of mandates cuts the fee-based income. Increases in portfolio values affect fees only indirectly. The asset managers' very existence could be at risk from a vengeful Administration and Congress. Thus even if an asset manager voted in support a particular ESG objective, such as the mitigation of climate change risk, solely because it believed this would improve risk-adjusted portfolio returns, in the polarized US environment, this could put the business model at risk.

3. *Distinctive Features of US Political Economy*

US "exceptionalism" to a convergent position on Externalities Governance is the result of two distinctive features of US political economy. First is the economic importance of fossil fuel interests and the resulting political clout. Second is the role that stock ownership plays in the provision of retirement welfare. These are notably different in the EU.

a. <u>Importance of fossil fuel production to the economy, US v. Europe</u>

The short description is that the US is a petro-state, the world's largest producer of oil gas, and Europe is most certainly not. In 2024 the US registered a record high of oil and gas production, 4.8 billion barrels for the year, out-pumping Saudi Arabia. The average WTI price for 2024 was approximately $77/ barrel, so a value of $372 billion. Natural gas production in 2024 matched the record high year of 2023, 41.2 trillion cubic feet. At an average price of approximately $3.00/

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[104] See, e.g., David A. Cifrino, *The Politicization of ESG Investing*, HARV. ADV. LEADERSHIP INITIATIVE SOCIAL IMPACT REVIEW (January 2024), available at https://www.sir.advancedleadership.harvard.edu/articles/politicization-of-esg-investing

[105] See "Asset Managers Prioritize Damaging ESG Measures, Risking Americans' Hard-Earned Money & Energy Security," H. REP. COMM ON OVERSIGHT (June 7, 2023) (press release summarizing hearings).

[106] *ESG Investing Goes Quite After Blistering Republican Attacks*, BLOOMBERG, May 19, 2023. Indeed, a federal district court refused to dismiss an antitrust action alleging concerted activity by the Big Three asset managers against coal producers through their activity as shareholders. *Texas et al. v. Blackrock, Inc., State Street Corp. & Vanguard Group, Inc.*, 2025 WL 2201071 (E.D. Tex.,Aug. 1, 2025).

[107] The latter, dated July 29, 2025, is available at https://sfof.com/wp-content/uploads/2025/07/Fiduciary-Duty-Letter-to-Asset-Managers_BLACKROCK.pdf The "State Financial Officers Foundation" says its goal is to promote "free-market pro-growth strategies" and aligns itself with "education resources" that are affiliated with the Republican party. https://sfof.com/about/

million BTU, that works out to approximately $124 billion, meaning a total oil and natural gas commodity output value of $498 billion.

The "added value" of refining and related activity was approximately $1.2 trillion, for a total industry impact of approximately $1.7 trillion. In terms of the overall economic impact, given 2024 US GDP of approximately $29 trillion, the direct contribution of the oil and gas industry was approximately 5.8%. Over a multi-year period, the value of oil and natural gas production has remained around 2% of GDP and when including refining and related sectors, the industry total is consistently around 6–7%.[108]

What's the EU comparison? Domestic production of oil was approximately 140 million barrels annually, valued at approximately $11 billion; natural gas production of approximately 1.1 trillion cubic feet, valued at approximately $13 billion, an oil and natural gas production total of approximately $24 billion. With EU GDP of approximately $17 trillion, this is approximately 0.15%. Annual profits from refining and related downstream processing were at most $25 billion, for an industry total of approximately 0.4% of EU GDP.

In sum: in the US, oil and gas production and processing accounts for 6-7% of GDP; in the EU, 0.4% of GDP.

And on the opposite of the ledger: In 2024 the EU imported (approximately) 3.3 billion barrels of oil and 2.9 trillion cubic feet of natural gas, yielding import costs of approximately $256 billion for oil and $40 billion for natural gas, almost $300 billion for imported energy costs.[109]

With the departure from the EU of the UK and its potential North Sea production after Brexit, no major EU state has a large stake in protecting domestic crude oil extraction as a source of local wealth and high-paying jobs. Indeed, in the EU, reducing oil consumption is favorable from a balance of trade perspective. Energy-consuming businesses may resist, because conversion away from oil to alternative energy sources may be costly, but this is a transition issue. Few businesses have a long-term stake in a high level of energy produced from fossil fuels. Thus, one would expect the political economy dynamics in the EU to facilitate a transition away from crude oil and other fossil fuel products.

The US story is quite different. Apart from the GDP statistics, the oil and natural gas industries support over 10 million jobs[110] and are famously concentrated, with major production in Texas and related refining activities throughout the Gulf States and the Southwest but also with

[108] The US and EU figures are drawn from information published by the U.S. Energy Information Administration and the European Commission.
[109] See European Commission, Eurostat, *EU Oil and Petroleum Products – A Statistical Overview*, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Oil_and_petroleum_products_-_a_statistical_overview
[110] Am. Petroleum Inst., *Oil & Natural Gas: Supporting the Economy, Creating Job, Driving America Forward* (2018), available at dm2018-086_api_fair_share_onepager_fin3.pdf. (visited Aug. 18, 2023) (the industry supports 10.3 million jobs).

significant production throughout the Rocky Mountain States.[111] This produces state legislatures and Congressional delegations attuned to the industry's interests.[112]

There is another factor. As of year-end 2021, proven reserves of crude oil and other liquid hydrocarbons in the U.S. were approximately 44 billion barrels.[113] Fossil fuel energy companies have comprised 5-10% of the market capitalization of the S&P 500 in recent years and a higher percentage of specialized market indices.[114] Thus a move away from fossil fuels in the U.S. is not a matter of a transitional shift in industry and popular usage patterns but entails potentially a massive wealth shift.

An additional complication is that a significant fraction, perhaps more than half of these U.S.-based reserves, is held by private companies. For example, the U.S. Energy Information Administration recently reported that the 53 publicly traded companies with large U.S. production collectively produced only about one- third of all U.S. crude oil in the first quarter of 2022.[115] This has significant implications for corporate governance. The influence of investors through the corporate governance machinery is limited to public companies. Without pushing too hard on the numbers, one can see how $1 or $2 trillion tied up in fossil fuels is held by private owners, and these owners are unlikely to hold their oil wealth as a fraction of fully diversified portfolios with strong incentives to mitigate climate change risk. Indeed, private parties may benefit from the pressure on public fossil-fuel companies to shed assets.

This economic power translates into political power. The license for virtually unlimited campaign contributions that the US Supreme Court has discovered in the U.S. Constitution means that fossil fuel interests wield considerable political power in various forms of US governance, including corporate governance. The then-candidate Trump fund-raised heavily from oil and gas interests, promising to roll back Biden-era climate change policies,[116] and has not disappointed the industry's expectations.[117]

Thus far the argument has been that distinctive elements of US political economy suppress climate change in Externalities Governance. But spillover effects also suppress other ESG

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[111] See, e.g., US Energy Information Administration, *Proved Reserves of Crude Oil and Natural Gas in the United States, Year-End 2021*, p. 23 fig. 14, pp. 30-31 Table 7 (Dec. 2022) (proved reserves by state). The direct contribution of the oil and gas industry to state GDP is significant: Texas, 6-8%; Louisiana, 4.5%; Oklahoma, 10-11%; Wyoming (especially coal) 14%, for example, according to estimates drawn from recent U.S. Commerce Department Bureau of Economic Analysis surveys.

[112] The industry engages in extensive climate lobbying, concentrated on "anti-climate" side. See Markus Leippold, Zacharias Sautner & Tingyu Yu, *Corporate Climate Lobbying,* ECGI W.P. 960/2024 (April, 2025), available at https://ssrn.com/abstract=4711812 .

[113] US Energy Administration, supra n. 108, at p. 10, Fig. 9a

[114] See Roberto Tallarita, *The Limits of Portfolio Primacy*, 76 VAND. L. REV. 511 (2023).

[115] U.S. Energy Information Administration, Today in Energy, July 22, 2022, available at https://www.eia.gov/todayinenergy/detail.php?id=53140 "In the first quarter of 2022, these 53 publicly traded companies collectively produced 3.9 million barrels per day (b/d) of crude oil in the United States, or about 34% of all U.S. crude oil produced in the quarter."

[116] *At a Dinner, Trumped Assailed Climate Rules and Asked $1 Billion from Big Oil*, NY TIMES, May 9, 2024.

[117] *How the G.O.P. Bill Will Reshape America's Energy Landscape,* N.Y. TIMES, July 3, 2025 (legislation will revoke Biden-era credits and promotion of renewables and electric vehicles while boosting production and use of oil, gas, and coal). *How Trump's First Year Reshaped U.S. Energy and Climate Policy*, N.Y. Times (Dec. 22.2025).

elements from consideration. In particular, fossil fuel backers have made common cause with "cultural" opponents of ESG in the effort to build a stronger coalition against efforts to mitigate climate change risk. ESG is "woke," not just DEI that might be included in some versions but all of it, including efforts focused on climate change risks.[118] This rhetorical union is reflected, for example, in the Executive Order of April 8, 2025, PROTECTING AMERICAN ENERGY FROM STATE OVERREACH, which instructs the Attorney General to "prioritize the identification of any such State laws purporting to address 'climate change' or involving "environmental, social, and governance" initiatives …" and to seek to block the enforcement of such laws "that the Attorney General determines to be illegal."

b. <u>Stock ownership as retirement savings, US vs. Europe</u>

In general the proponents of Externalities Governance axis contemplate a willingness to trade-off some shareholder value maximization for some level of externalities mitigation and require pro-social attitudes among the shareholders.[119] The different role that stock market wealth plays in retirement provision in the US vs. the EU underlies a core fact of political economy. In the US, politically active citizens see a direct connection between stock market returns and their personal retirement security that is not present in the EU. This is another reason to expert considerable divergence in the US from the EU pattern of requiring corporate governance attention to "sustainability," human rights, and other externalities of concern.

In the U.S., state-provided pensions – Social Security – offer only a thin level of retirement security for private sector employees. Defined benefit pension plans have been substantially phased out for most companies over the past 40 years.[120] Instead, retirement security is left to a mixture of personal savings (including plans where tax benefits provide an incentive to save) and company-sponsored defined contribution plans. Employees are given an incentive to participate

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[118] For a sketch of some of the connections, see Jeffrey N. Gordon, *Unbundling Climate Change Risk from ESG* (Aug. 19, 2023), available at https://ssrn.com/abstract=4547679; *Rightwing War on "Woke Capitalism Partly Driven by Fossil Fuel Interests and Allies,* THE GUARDIAN, (June 22, 2023); Pleiades Strategy, *2023 Statehouse Report*, 7-8; (2023), available at https://drive.google.com/file/d/1VJ82mMNupoFSZPQ98nLcW7AtcyBQWB18/view; 2025 Statehouse Report, 7 (2025), available at https://static1.squarespace.com/static/60c10f47894447090b1b6567/t/6862f47af380d07ac8a94eb0/1751315578927/2025_Statehouse_Report.pdf; Steven Mufson & Tom Hamburger, *How the Right Is Waging War on Climate-Conscious Investing*, THE ATLANTIC (July 18, 2025); Chris Crews, *The Far Right Culture on ESG*, 14 RELIGIONS 1257 (2023) (showing how Heritage Foundation "ESG Hurts" campaign links climate change activism with "woke" parts of ESG agenda). See also the letter, referred to above, from 21 state financial officers, all Republicans. The letter is promoted by the "State Financial Officers Foundation," which says its goal is to promote "free-market pro-growth strategies" and aligns itself with "education resources" almost all of which are affiliated with the Republican party. https://sfof.com/about/ .

[119] See Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J. LAW, FIN. & ACCTG 247 (2017). Hart & Zingales would trade off financial maximization against utility maximization. I have argued that for externalities with systemic effect, for example, climate change or financial stability, mitigation of the externality will improve risk-adjusted financial returns. See Jeffrey N. Gordon, *Systematic Stewardship,* 47 J. CORP. L. 628 (2022).

[120] See, e.g., Jeffrey N. Gordon, *Employees, Pensions, and the New Economic Order*, 97 COLUM. L. REV. 1519, 1546-1550 (1997).

in company plans through a combination of company matches and tax benefits. In general the management of these plans is left to individuals, who see regular reports on their investment returns. Individuals' retirement well-being thus materially depends on the success of their investment strategy, both through retirement plan savings and personal savings, and they come to have insight into factors that may affect investment returns.[121] President Trump, an ace marketer, campaigned in 2024 on the basis of how well voters' stock market portfolios and defined contribution plans had prospered during his prior presidency.

"Millennials," according to some survey evidence, have a stronger preference for ESG-tilted/externality constraining investment than older generations, but according to the latest tabulation of the Federal Reserve, this age cohort (<= age 40) has relatively little wealth (less than 10 percent of all assets) and even less ownership of equity (less than 3 percent of all equity). "Boomers" and older own approximately 75 percent of all equity.[122] This means that the accumulation of wealth is inversely related to remaining years of work; the impact of the externalities mitigation/shareholder value tradeoff becomes more acute as retirement approaches; and the nature of retirement savings in the U.S. provides individuals with motive to become sensitive to the potential tradeoffs.

The political economy of Externalities Governance in the US is thus constrained by this function: Willingness to substitute ESG and other externalities-mitigation benefits for pecuniary returns declines with age, but propensity to vote increases with age. This constraining function holds even though equity ownership is concentrated, and only 50 percent of the population has any pension assets. The vote that matters here is the vote in the public electoral process, one person one vote irrespective of wealth, not a corporate election in which votes are weighted by share ownership. An individual holding that is trivial from an aggregate perspective nonetheless may be a significant fraction of that individual's wealth and material to that individual's retirement planning. Voters will be sensitive to the impact of "shareholder value" to their personal portfolios, not economy-wide aggregates.[123,124]

The provision of retirement savings is altogether different in the EU and produces a different political economy function. As per a recent European Central Bank report, most retirement provision in the EU runs through Member State PAYG plans.[125] Pension payouts are

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[121] See Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909 (2013).
[122] Federal Reserve Board, Distributional Financial Accounts, drawn from Survey of Consumer Finances and Financial Accounts of the United States (2023).
[123] Here is a numerical example that illustrates the point. Assume that 90 percent of stock market value is held by the top 1 percent, the remaining 10 percent is held by the next 49 percent, and ESG accommodation results in a 10 percent reduction in stock market values. Even though 90 percent of the total loss is borne by the top 1 percent, the loss itself is widely disseminated throughout the voting pool. Moreover, assuming a declining marginal utility of money, the impact on owners/voters will far outstrip the nominal amount lost.
[124] Another way to understand voters' behavior is through the age-effect on discount rates on parties without strong bequest motives . Retired or near-retired shareholders may assume that negative climate change effects will after their expected lifespan and so they place little weight on the avoidance of these outcomes relative to the immediate adaptation costs.
[125] ECB, New Pension Fund Statistics, ECB Economic Bulletin 7/2020, available at https://www.ecb.europa.eu/pub/economic-bulletin/articles/2020/html/ecb.ebart202007_03~5ead7cb1dc.en.html.

funded by contributions paid by current workers; unlike state level public pension plans in the US, such plans do not accumulate funds that could be invested in equities. Robust private employer pension plans, "occupational pension plans," are found only in the Netherlands and Germany. Although private pensions have given way to defined contribution plans in recent years, the overwhelming share of pension assets are held in defined benefit plans, approximately €2.2 trillion vs. €200 billion. The point is this: In a defined benefit plan, the risk-bearer is the sponsoring institution. Short of default, the payout stream does not vary in correlation with the return on the underlying assets; the sponsor is exposed to measures that affect returns, but the pension plan beneficiaries, the individuals, the voters, are not.

More generally, individual equity ownership is generally less prevalent and counts for a smaller share of net worth in EU countries than in the US. A recent study showed that the general stock market participation rate in the EU was approximately half of that in the U.S. (26 percent vs. 49.7 percent).[126] On a country basis, only Sweden (70.8 percent) and Denmark ((56.1 percent) had a higher participation rate; Germany's, for example, was 25.4 percent.

More striking was the much lower fraction of household net worth invested in the stock market for a given level of wealth, among those who owned stocks. For example, for median net worth households in the U.S. that held any stocks, the fraction of net worth in stocks was 30.5 percent and for the EU, 7.4 percent. We see a similar pattern of markedly less wealth invested in stocks even in high participation rate countries: Sweden, 14 percent; Denmark, 8.1 percent for median net worth households.[127] Lower stock market participation rates and less wealth sensitivity to changes in stock values means that governments and firms will have greater freedom of action to take externalities-mitigation measures that may affect stock market returns.[128] This is enhanced by the extent of foreign ownership of EU companies, recently estimated at approximately 30 percent.[129]

SUMMARY

Corporate law and governance has now divided along two axes, Internal Governance and Externalities Governance. A generation after "corporate governance" became a global

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[126] Dimitris Christelis, Dimitris Georgarakos & Michael Haliassos, *Differences in Portfolios Across Countries: Economic Environment Versus Household Characteristics*, 95(1) REV. ECON & STATS 220 (2013). This general stock market investment pattern seems persistent. See Ashok Thomas & Luca Spataro, *Financial Literacy, Human Capital and Stock Market Participation in Europe*, 39 J. FAMILY & ECON ISSUES 532, 534-53 fig 1 (2018).

[127] The *participation* rate also seems to track the *household equity wealth* rate, according to a recent Allianz Global Wealth Report: "US savers hold just under 55% of their financial assets in the form of securities, primarily equities….In Western Europe, this proportion is just under 28%....* * * The success of this investment strategy can be clearly quantified. Over the past five years, the increase in value of asset holdings accounted for 70% of total asset growth in the US. For Western Europe, this ratio is 46% and for Germany a very modest 11%." ALLIANZ GLOBAL WEALTH REPORT 2021 at 3.

[128] Thus EU pension funds and other institutional investors may promote sustainability in ways that would be contested in the US. For the EU sensibility, see Wolf-Georg Ringe, *Investor Empowerment for Sustainability*, 74 REVIEW OF ECONOMICS 21 (2023).

[129] European Commission, FOREIGN DIRECT INVESTMENT REPORT: CONTINUOUS RISE OF FOREIGN OWNERSHIP OF EUROPEAN COMPANIES IN KEY SECTORS, March 13, 2019.

phenomenon, we see an established a vocabulary of corporate governance mechanisms, norms, and behaviors on the axis of Internal Governance. Within the convergent framing standard of "investibility," we can expect diversity that responds to local imperatives, including original and continuing ownership patterns and efforts by the State to shape corporate governance tools to promote the State's economic and social policy objectives.

But the major move in corporate law and governance over the past decade has been the development of a second corporate governance axis, Externalities Governance. Climate change risk associated with greenhouse gas emissions is the most salient externality but a broader set of social welfare concerns, made visible through developing disclosure regimes, now figures into corporate governance. Commitments and behavior along the Externalities Governance axis will have substantial variance and are likely to be volatile because they are not anchored to a clear goal of maximizing production or linked to parties bound to the firm in the nexus of explicit or implicit contracts but rather depend on a time-varying socio-political consensus. The EU has been the most aggressive jurisdiction in mandating Externalities Governance by positive law. Although the scope of the EU mandate is now under scrutiny for both the coverage threshold (and thus the number) of subject firms and the breadth of coverage, the extraterritorial ambition remains. A "Brussels" effect could achieve significant convergence on Externalities Governance. The counter of course is the United States, through an Administration that is determined to protect US fossil fuel interests and lumps all other externality concerns in the same basket. This could lead to significant divergence for US firms and there may yet be a retrograde "Washington" effect on the general idea that social welfare concerns should be at least a partial focus of corporate law and governance.

AND AFTERTHOUGHTS

Reactions to the paper require further consideration of the convergence/divergence prospects along these two axes of corporate law and governance.[130] There is a self-enforcing pressure along the Internal Governance axis. Different claimants on the corporate "pie" jockey for bigger slices against a background understanding that a bigger pie might yield more pie per slice. Governments and other parties that promote "best practice" governance should do so even if others do not because in a competitive race for productivity, virtue is its own reward. Accepting lots of local variety, including local rent-seeking and path dependence, "convergence" pressures on axis one are "natural" in a competitive global economy.

The Externalities Governance axis presents a different convergence problem. The major beneficiaries of externalities control are not claimants on the firm's cash flow; rather, the benefits accrue to outsiders from the firm's forbearance in pursuing profitable activities. The "natural" move is defection (and divergence) rather than convergence, and so governmental coordination, some form of compulsion, seems necessary. This is why the EU sustainability project is both important and problematic. The EU is attempting to use access to its markets as the inducement

[130] Special thanks to Roy Shapira.

for non-EU based firms to submit to its externalities governance regime for two reasons: the missionary impulse of widespread benefits but also the competitive impulse of harm minimization that EU-based firms would otherwise suffer if they alone traded shareholder value for a broader sense of global good.

Thus the metaphor of "Brussels Effect" (at least in the "California Effect" sense) is not quite right. California can set a high emission standard across the automotive industry because its car market is both so large and the productive efficiency advantages of a single standard are high. But when it comes to labor standards for sneakers, California's requirement of a minimum wage in the supply chain for sneakers sold in California would merely segment the production chain, not unify it on a higher standard. The EU is attempting to mobilize the corporate governance machinery to enforce a high global standard on "sustainability" but unlike for internal governance, there is no natural impetus for convergence on the Externalities Governance axis. This implicitly is the importance of the Paris Agreement on climate change, trying to fashion a form of coordination and, ultimately, convergence.

Moreover, firms can, acting independently, converge on a "best practices" standard of Internal Governance, through (for example) charter provisions, choice of incorporation, and listing on an exchange with high quality governance standards in a jurisdiction with strong mandatory disclosure. Externalities Governance is more complicated. A firm can, acting independently, decide to adopt less polluting technology for a particular plant or even to insist on high labor standards throughout its supply chain. But the control of many externalities including the most serious, like climate change, requires coordination that own-firm corporate governance cannot supply. One approach has been coordination provided by investor groups with a common Externalities Governance agenda. That "common ownership" approach has provoked a backlash, especially in the U.S. The EU's effort is an alternative: Externalities Governance mandated by a supra-national regulator trying to lever market access as a global coordinating mechanism. As to its effectiveness and durability, we shall see.

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