Academic Journal of Management and Social Sciences
ISSN: 2958-4396 | Vol. 15, No. 2, 2026

Challenges to Traditional Fiduciary Duties of Multinational Company Boards Under the Hardening of ESG Regulations

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Abstract: Environmental, Social, and Governance (ESG) principles have evolved from voluntary initiatives into legally enforceable norms. This paper examines how the trend reshapes fiduciary duties within multinational corporate boards, analyzes the resulting conflicts and dilemmas, and proposes adaptive governance pathways. Employing comparative law and case analysis, the study integrates recent legislation and practices from the European Union, the United States, and China. The study finds that the hardening of ESG regulations subjects directors to multiple challenges, including conflicting objectives, ambiguous liabilities, and cross-border compliance. This paper also recommends reconstructing the essence of fiduciary duties, innovating safe harbor and liability exemption mechanisms, and strengthening international rule coordination to establish a resilient and internationally compatible corporate governance framework.

Keywords: ESG Codification; Board of Directors; Fiduciary Duties; Multinational Corporations; Corporate Governance; Sustainable Transformation.

1. Introduction

Governance failures concerning global issues such as human rights and the environment have prompted the emergence of corporate social responsibility (CSR). The rise of private governance mechanisms, exemplified by Environmental, Social, and Governance (ESG) principles, has become a crucial benchmark for assessing corporate sustainability[1]. This evolution from the ethical appeals of CSR to the legal mechanisms of ESG reflects corporate law's profound engagement with societal realities. The global ESG wave is evolving from voluntary soft law norms into legally binding hard law through legal practices. Scholars consider the EU's ESG regulation to be the most stringent, having established a rigorous regulatory framework extending from corporate resources to legal mandates[2]. The EU has successively enacted key regulatory rules including the 2020 Framework Regulation on Promoting Sustainable Investment and the 2023 Corporate Sustainability Reporting Directive. These measures unify rules at the EU level while progressively refining mandatory corporate disclosure requirements.

Traditional corporate governance theory primarily directs directors' duties toward the company or shareholders. Centered on "shareholder primacy", with the core objective being the maximization of profits[1]. The standard for determining whether directors have fulfilled their duties adequately revolves primarily around business judgment. Within the framework of fiduciary duties, corporate managers must prioritize maximizing shareholder value as their guiding objective[3]. Issues of negative externalities fall under societal regulatory concerns and cannot be resolved through the director duty mechanism within corporate law. Instead, they should be addressed through specialized legislation such as labor and environmental law. In his 1970 article "The Social Responsibility of Business Is to Increase Its Profits," Milton Friedman explicitly opposed the expansion of managerial obligations advocated by proponents of "corporate social responsibility" at the time[4]. However, in the ESG era, as companies increase their internal and external commitments to environmental, social, and governance issues, numerous accountability measures have been implemented. This compels directors to prioritize societal public interests and corporate sustainability[5].

Although international organizations and related research strive to establish unified ESG standards, differences in corporate types and varying levels of national development mean that different countries and companies focus on different ESG issues at different stages. Consequently, multinational corporations face greater compliance challenges, subject to regulatory pressures under different standards from both home and host countries, confronting a dilemma where "compliance may constitute non-compliance. " Furthermore, corporate social responsibility (CSR/ESG) policies and practices in developing nations are profoundly shaped by their domestic governance structures, institutional frameworks, and legal systems. Blindly applying ESG templates from developed economies risks overlooking the unique contexts of settings, potentially sparking resistance or accusations of cultural or institutional "interference."

This paper explores how the codification of ESG standards redefines and expands the boundaries of directors' fiduciary duties, analyzing the resulting core legal conflicts and practical dilemmas, and attempts to rethink how to construct a new framework for fulfilling directors' obligations and liability exemptions that aligns with international sustainable development goals. This aims to alleviate the ESG compliance challenges faced by multinational corporations, with the expectation of further enriching and developing corporate governance and director liability theories in the era of globalization, providing reference for multinational corporations.

2. Structural Contradictions in the Redefinition of Directors' Roles

2.1. Expanding Stakeholder Scope: Shareholders Are No Longer the Sole Beneficiaries of Directors' Duties

Traditional corporate governance theory has regarded directors as "trustees" of shareholders, whose core duty lies in maximizing shareholder financial interests[6]. This principle was classically articulated in Dodge v. Ford Motor Co., where the judge explicitly stated that "the primary purpose of the organization and operation of a corporation is to generate profits for its shareholders." However, the codification of ESG principles is dismantling this "shareholder supremacy" logic, compelling boards to broaden their service scope. In the European Union, the Corporate Sustainability Reporting Directive (CSRD) mandates that large companies and publicly listed firms disclose the impacts of their operations on stakeholders, including employees, consumers, and communities, as well as the influence these stakeholders exert on corporate strategy and business models. Directors must identify, assess, and consider these impacts when formulating strategies and making decisions. It necessitates reinterpreting the core legal concept of "corporate interests." If directors neglect significant ESG risks, they may be deemed to have failed in their fiduciary duty to safeguard the company's long-term interests, even if short-term profits increase.

2.2. Duty Performance and Compliance Standards: The Transition from Business Judgment to Social Judgment

Accompanying the spillover effects on stakeholders is a profound transformation in the standards governing directors' duties. The focus is shifting from "business judgment" toward "social judgment" that integrates environmental and social values. The traditional Business Judgment Rule (BJR) offered directors substantial latitude: provided decisions were made with full information, in good faith, without conflicts of interest, and with a reasonable belief that actions served the company's best interests, courts typically granted deference even when outcomes were unfavorable. However, ESG standards is reshaping the boundaries of BJR application. Courts and regulators now scrutinize whether directors adequately considered ESG factors with "financial materiality" during decision-making. In other words, if an environmental or social risk is widely recognized as having a significant impact on the company's financial condition, and directors completely disregard addressing it, their decision-making process may be deemed unreasonable, thereby losing BJR protection. This shift has given rise to a new paradigm of "social judgment," requiring boards to establish systematic procedures for embedding ESG factors into strategic planning.

2.3. Types of Duty Constructs: The Emergence of the Duty of Good Faith and Its Tension with Traditional Fiduciary Duties

The core of traditional fiduciary duties comprises the duty of loyalty and diligence. The duty of loyalty addresses conflicts of interest, requiring directors to act in the company's best interests; the duty of diligence addresses competence and diligence, requiring directors to perform their duties with reasonable prudence and skill. Some advocates contend that the traditional framework is inadequate in addressing ESG issues and the normalization of conflicts — neither directly addresses the question of "for what purpose directors should actively act." Therefore, it is necessary to elevate the duty of good faith to an independent dimension of obligation. However, establishing it as an independent obligation faces significant legal and practical challenges. First, its scope is highly ambiguous. Concepts like "good faith," "fairness," and "proper purpose" without clear objective standards risks judicial uncertainty. Second, it potentially conflicts with the business judgment rule. The business judgment rule presupposes that courts should not second-guess directors' commercial decisions. Overly broad scrutiny of the duty of good faith could erode this principle, inducing "decision paralysis" among directors. In key corporate jurisdictions like Delaware, the threshold for establishing director "bad faith" is exceptionally high, typically confined to "extreme malice." The Stone v. Ritter case clarifies that directors do not have a fiduciary duty of good faith that is separate from other fiduciary duties. Rather, as explained by the court, the duty of good faith is a component of the duty of loyalty.

3. Core Challenges Facing Directors' Fiduciary Duties

3.1. Conflicting Objectives and Decision Dilemmas: The Paradox of Prioritizing Short-Term Financial Returns versus Long-Term Sustainable Value

Such dilemmas are ubiquitous in business practice: closing a highly polluting but profitable factory; investing heavily in low-carbon technology that won't yield short-term profits; rejecting a lucrative project in a country with a poor human rights record. Traditional shareholder primacy offered a clear answer: maximize shareholder value. However, the rise of ESG hard law renders this answer increasingly untenable. Laws now require directors to consider non-shareholder interests, while capital markets increasingly link ESG performance to long-term valuations, yet without providing explicit prioritization rules.

This conflict manifests legally as a battle over the interpretation of "corporate best interests." ESG-supporting shareholders argue that neglecting ESG undermines the company's long-term viability and social license, contrary to the best interests of the corporation. Traditional shareholders, however, invoke precedents like Dodge v. Ford, asserting that any deviation from maximizing shareholder wealth constitutes a breach of fiduciary duty. To date, courts worldwide have yet to establish uniform case law definitively resolving this conflict. This uncertainty propels boards into strategic decision-making minefields. The absence of clear guidance risks directors gravitating toward "defensive decision-making"—choosing the path least likely to invite lawsuits rather than the one most beneficial to the company and society.

3.2. Legal Liability Risks: Judicial Uncertainty at the Boundaries of "Reasonableness"

When laws require directors to conduct "reasonable" climate risk assessments, implement "adequate" human rights due diligence, or ensure "effective" anti-corruption oversight, what constitutes "reasonable," "adequate," or "effective"? Answers vary by industry, region, and company size, lacking uniform judicial or regulatory precedents.

Substantively, directors may face personal liability if their company fails to meet ESG standards established retrospectively but unclear beforehand; Procedurally, in shareholder derivative lawsuits or regulatory investigations, boards may be required to produce extensive evidence demonstrating that ESG factors were considered in decision-making processes. More complexly, practices and scientific understanding in ESG evolve rapidly. What is considered a leading initiative today may be deemed inadequate tomorrow. While boards must maintain sufficient flexibility and foresight when setting ESG goals and overseeing their implementation, this inherently conflicts with the certainty and predictability sought by the law.

3.3. Legal Conflicts in Transnational Governance: Normative Clashes Between Home and Host Country ESG Standards

For multinational corporations, the most acute challenge in ESG compliance stems from direct legal conflicts between home and host countries. Recent years have seen the divergent paths of the EU's "regulatory expansion" and the US's "legislative counterattack." Through the Corporate Sustainability Due Diligence Directive (CSDDD) and the Corporate Sustainability Reporting Directive (CSRD), the EU has established the stringent regulatory framework. The CSDDD not only requires companies to manage risks within their own operations but also mandates they identify and address human rights and environmental risks across global supply chains. This effectively imposes EU sustainability standards on business partners worldwide through corporate governance channels. In stark contrast, multiple U.S. states have launched a sweeping wave of "anti-ESG" legislation, prohibiting state government entities from doing business with financial institutions or companies that "discriminate" against certain industries based on ESG factors. Texas's "Anti-ESG Law" mandates that the state pension system divest from asset management companies reducing investments in fossil fuels. The Texas Comptroller is tasked with compiling and publishing a "blacklist" of companies "boycotting" fossil fuels, with listed firms losing eligibility for major government-related contracts.

Beyond conflicts between Europe and the U.S., multinational corporations frequently encounter similar dilemmas in emerging markets. For instance, while the EU mandates supply chains to exclude products involving forced labor, certain host countries may view labor exports from specific regions as national poverty alleviation policies and enact laws prohibiting foreign enterprises from conducting so-called "discriminatory audits." Similarly, developed nations' demands for rapid energy transitions may fundamentally clash with developing countries' transformation plans and pathways, which rely on coal for employment and fiscal revenue. In essence, legal conflicts in transnational governance signify that ESG is no longer a purely commercial or compliance issue. It has become a complex chessboard intertwining law, geopolitics and economic development rights. The role of the board of directors is being forced to evolve from a commercial decision-making body into a "micro-diplomatic entity" that must mediate, balance, and make strategic choices between conflicting sovereign legal mandates.

4. Exploring Governance Pathways to Address Challenges

4.1. Proactive Reconstruction of the Fiduciary Duty Framework

The primary task in addressing ESG challenges is to proactively, clearly, and operationally reconstruct the essence of fiduciary duties at the legal level. This does not require overturning the traditional framework but rather advancing its modern evolution by weaving ESG factors into the fabric of the duties of loyalty and care.

Boards and management must fundamentally shift their mindset: ESG is neither philanthropy, nor marketing, nor a burden detached from core business operations. Actively managing risks and seizing opportunities is an inherent requirement for modern boards to fulfill their duties. The legal scholar's proposal to treat ESG as a "third-dimensional duty" holds core value in emphasizing ESG's independent significance. Operationally, however, internalizing it as a specific requirement for the "reasonable care" standard under the duty of diligence offers greater legal continuity and practical feasibility in the new era.

4.2. Innovation in Safe Harbor Principles and Liability Exemption Mechanisms

To incentivize boards to manage ESG issues proactively rather than defensively, innovative legal safeguards must be established to create effective safe harbors. This requires shifting from substantive reviews focused on the economic outcomes to process-oriented reviews emphasizing whether processes were reasonable, prudent, and conducted in good faith. Provided the board can demonstrate that its decision-making process met a series of reasonableness standards—such as basing decisions on thorough investigation and professional advice, following internally established procedures, engaging in full discussion, remaining free from personal interest, and ultimately acting in good faith with a sincere belief that the decision served the company's long-term best interests—then even if the decision is later proven to have adversely affected short-term stock prices, the court should respect and protect it. This process-rationality-centered standard of review significantly reduces directors' litigation risks for engaging in necessary and forward-looking investments and transformation efforts, thereby encouraging bolder focus on long-term value creation. To provide clearer and more robust legal safeguards, consideration should be given to creating dedicated ESG decision liability exemptions or mitigation clauses through statutory amendments or authorized by company bylaws. By providing procedural safe harbors for boards' reasonable exploration and necessary risks in ESG domains, this mechanism effectively balances directors' legal accountability with the excessive personal risks they bear while pursuing long-term sustainable value, genuinely fosters innovation and corporate governance, ultimately driving companies to make substantive contributions toward broader societal and environmental objectives.

4.3. International Coordination

International coordination provides a framework for reducing systemic compliance costs and legal uncertainty, while locally rooted wisdom and practices form the micro foundation for gaining societal acceptance and achieving truly sustainable operations.

Multinational corporations should not merely be passive recipients of rules but active shapers of communication. This requires boards to transcend corporate boundaries, engaging in collective action through multilateral platforms. They should advocate to policymakers in major economies for coordination mechanisms centered on the core principles of "equivalence" and "mutual recognition." Simultaneously, companies should deeply engage with global standard-setting bodies to help establish clear and development-stage-sensitive global disclosure benchmarks. Furthermore, boards must leverage their senior management's transnational networks and influence to foster constructive policy dialogues between home and host countries to articulate the practical challenges regulatory conflicts pose to corporate operations.

On the parallel track of local implementation, successful ESG governance is never a simple copy-paste of international templates. Instead, it must be a creative transformation deeply integrated with local laws, cultures, developmental stages, and priority issues. Take Chinese multinational corporations as an example: national strategies such as the dual-carbon and common-prosperity goals provide a distinct local context and strategic depth for corporate ESG agendas. Boards can lead a profound strategic integration, precisely aligning global ESG frameworks with China's national priorities. In overseas investment and operations, this entails not only assessing and mitigating environmental and social risks but also proactively designing projects to foster local employment, technology transfer, and community development[7].

5. Conclusion

This paper examines the restructuring of traditional fiduciary duties within multinational corporation boards and the multiple governance challenges arising from this transformation, against the backdrop of environmental, social, and governance (ESG) factors increasingly evolving from ethical advocacy to mandatory legal norms globally. The codification of ESG principles is driving a profound shift in corporate governance paradigms. However, this legal evolution aimed at promoting sustainable development has not provided boards with clear actionable guidelines， instead, it has placed them at the center of a series of acute conflicts and dilemmas. The most severe challenge stems from legal conflicts in transnational governance, trapping multinational corporations in the fault line dilemma of “lawful compliance equating to unlawful conduct.” To address these systemic challenges, this paper proposes an adaptive pathway designed to enhance governance resilience. At the jurisprudential level, it advocates for the proactive reconstruction of fiduciary duties, deeply integrating ESG factors into—rather than merely appending them to—traditional duties of loyalty and diligence. At the level of legal protection mechanisms, it advocates expanding the process-oriented “business judgment rule,” exploring the creation of dedicated ESG decision-making safe harbors and liability exemption clauses; Internationally, it proposes building a dual-track system, developing a governance model that aligns with international trends while being rooted in local contexts.

This study also has certain limitations. It primarily relies on analysis of legislative texts, policy documents, and representative cases, lacking empirical examination of how multinational corporation boards concretely discuss, weigh, and ultimately make ESG decisions in real-world scenarios. Furthermore, global ESG regulation is undergoing rapid and uncertain evolution, with new legislation and litigation continually emerging, potentially causing this analysis to lag in dynamic responsiveness. By deepening research, we can continually enrich the theory of corporate governance and director liability in the era of globalization, providing more precise navigation for multinational corporations during the sustainable transformation.

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