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Addressing ESG Considerations in the M&A Context

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Introduction

Environmental, Social and Governance ("**ESG**") considerations have come to the forefront of many aspects of modern commercial life, including mergers and acquisitions, and other corporate transactions. Taken together, ESG covers an extraordinarily broad scope, including but not limited to:

- **Environmental**: climate change and greenhouse gas emissions; energy efficiency; resource depletion, including water; hazardous waste; deforestation; and air, land and water pollution and waste management.
- **Social**: human rights; working conditions, including slavery and child labour; local and indigenous communities; conflict; health and safety; employee relations; and equality and diversity.
- **Governance**: bribery and corruption; tax; transparency; executive pay; political lobbying and donations; shareholder rights; board independence, diversity and structure; and ESG governance framework, including supply chain management and customer engagement.

Although individual elements of the "E", "S" and "G" have been present for decades, companies and their business development teams are now looking more at these matters in the round, with the dual aims of building sustainable businesses and managing risks. The ongoing COVID-19 pandemic and increasing manifestations of climate change have coincided to put in stark relief the importance of a sustainable global economy. Accordingly, national and international regulators have increased their focus on ESG considerations, and related initiatives in the private sector – particularly among institutional investors – have proliferated.

Regulation has grown on multiple fronts, including new affirmative diligence and disclosure requirements. Purchasers in M&A transactions should be mindful of both as they will be required to follow mandatory diligence procedures and, in control transactions, to report on the operations of newly acquired businesses.

This chapter focuses on current legal developments and market practice affecting ESG due diligence in M&A transactions. It begins by discussing new ESG diligence requirements in selected markets, then highlights certain risk management concerns, addresses benefits for businesses of robust ESG diligence, and concludes with a brief consideration of ESG metrics. As this is a limited survey in a rapidly evolving area, there are now and surely will soon be other national and super-national legislation that implicate these areas.

ESG: legislative and judicial action

ESG regulations affecting buyers conducting due diligence

Europe

European Union Mandatory Human Rights Due Diligence legislation ("MHRDD")

Overview. In April 2020, the European Commissioner for Justice, Didier Reynders, announced that the European Commission would commit to introducing rules for mandatory environmental and human rights due diligence.[1] In the latest step in the development of that law, on 10 March 2021, the European Parliament adopted a report of the Committee for Legal Affairs regarding "Mandatory Human Rights, Environmental and Good Governance Due Diligence". That report offered the European Commission several recommendations regarding corporate due diligence and accountability involving adverse human rights, environmental and governance impacts for companies domiciled or operating in the EU.[2] Additionally, the report contains a draft version of the new directive on MHRDD that sets out provisions for a future EU-wide regulation.

The report recommends requiring that EU Member States enact this into national law and provide for sanctions and civil liability regimes for non-compliance by any enterprises domiciled or operating in Member States, which would include foreign companies doing business in the EU and EU subsidiaries of non-EU undertakings.

These requirements will apply to all business relationships in the global supply chain, not just the first tier, which contrasts with Germany's new due diligence law, as noted below.[3]

Primary objectives. The draft MHRDD directive outlines the following primary objectives: (*i*) to prevent and mitigate potential or actual adverse impact on human rights, the environment and good governance in the value chain; (*ii*) to ensure that companies can be held accountable for such impact; and (*iii*) to provide anyone who has suffered harm caused by businesses' activities effective remedies in accordance with national law.[4]

Applicability. The draft directive would apply to: (*i*) all large companies (this currently remains undefined); (*ii*) publicly listed small and medium-sized businesses; (*iii*) high-risk small and medium businesses; and (*iv*) companies providing financial services and products.[5]

Effects. The draft MHRDD directive explains that due diligence will involve a "risk-based monitoring methodology that takes into account the likelihood, severity and urgency of potential or actual impacts on human rights, the environment or good governance, the nature and context of their operations, including geographic, and whether their operations and business relationships cause or contribute to or are directly linked to any of those potential or actual adverse impact". Such due diligence is an ongoing exercise that requires calibrating efforts in light of the available means, with proportionality as a guiding principle.[6] Further detail is expected in national implementing legislation.

Businesses will be obliged to produce a statement in which they publicly communicate their due diligence strategy. This must be reviewed annually by businesses, and national authorities will be designated to ensure implementation of the obligations.[7]

Companies will be forced to get to know the details and actors within their supply chains to understand where they may be at risk in the areas of: (*i*) human rights (*e.g.*, charters and conventions relating to social rights, trade union activities and investment chains); (*ii*) environment (*e.g.*, the impact on climate change, deforestation, water quality, use of sustainable resources, biodiversity and ecosystems); and (*iii*) good governance (*e.g.*, bribery, anti-money laundering and tax compliance issues).[8]

Civil liability. This proposed legislation is notable because companies will be held liable in accordance with national law for any violations arising out of adverse impacts on human rights, the environment and governance that either they or the subsidiaries under their control have caused or contributed to by acts or omissions.[9] It remains to be seen whether the entire spectrum of stakeholders (as such term is used in the draft directive) will be afforded standing to bring claims under national liability regimes.

The result of such potential liability is that companies will no longer be able to protect themselves or investors from potential liability by simply performing basic due diligence.[10] Consequently, a need to expand ESG-related processes within companies or other investors, including private equity firms, is likely to arise in order to address the entire framework proposed by the EU, for those with any business relationships with or within the EU.[11]

Areas of consideration. This is a preliminary draft of the legislation and is still subject to change. However, certain key principles have been part of the concept since its inception, including the breadth of the law. The Commission still needs to make a judgment as to how to hold companies liable for harm by means of private actions, while at the same time ensuring an acceptable degree of legal certainty. Furthermore, as discussed above, the Commission will be relying on national systems to enact liability; it therefore may encounter difficulties in ensuring consistency across national regimes.[12]

It is expected that companies will incur administrative and financial burdens in connection with changes required to implement the obligations imposed by MHRDD, including engaging with potentially different tools to understand and track their value chains, though these measures are by and large directly proportionate to the level of risk contained in their value chains.

Other European due diligence regulations

French vigilance law

In 2017, France introduced into law a duty of vigilance requiring businesses to design, implement and publish a vigilance plan that includes due diligence measures to identify risks and forestall serious infringements of or harm to human rights and fundamental freedoms, personal health and safety and the environment.

In practice, the targeted companies are required to implement the following vigilance measures:

- risk mapping to identify, analyse and rank those risks;
- due diligence on all subsidiaries, subcontractors or suppliers with which a commercial relationship is established;
- appropriate actions to mitigate risks or prevent serious harm;
- the creation of a system to ensure alerts are raised over risks that eventuate; and
- a system to control the implementation of the above measures.

The law applies to any company having its head office in France that, at the end of two consecutive financial years, employs at least 5,000 employees by itself and in its direct or indirect subsidiaries whose head offices are also located in France, as well as to any company having its head office in France and employing at least 10,000 employees itself or in its direct or indirect subsidiaries regardless of where their head offices are located.

The law therefore does not apply to parent companies governed by foreign law, since the text is included within the chapter of the French Commercial Code regarding joint-stock companies (*sociétés anonymes*) and also applies to simplified joint-stock companies (*sociétés par actions simplifiées*) governed by French law. However, it would also apply to their French subsidiaries that reach the relevant threshold.[13]

A recent judicial challenge was filed under the vigilance law – brought by 11 NGOs against the supermarket chain Casino Group – alleging that it caused environmental and human rights abuses through involvement in the cattle industry in Brazil and Columbia.[14]

Germany Act on Corporate Due Diligence in Supply Chains

This draft human rights due diligence regulation aims to implement the 2016 "National Action Plan for Business and Human Rights in the Federal Republic of Germany", which requires companies to appropriately identify, address and report on human rights risks in their supply and value chains, with reference to their size, sector and role within the supply chain, and enable persons to notify relevant risks and infringements by means of a complaints procedure or grievance mechanism. The basis of the Action Plan and the new national requirements is the due diligence standard of the 2011 UN Guiding Principles on Business and Human Rights.

This Act applies not only to companies with their registered office or principal place of business in Germany, but also to foreign companies that have a branch office in Germany and, in general, have at least 3,000 employees in Germany (not taking into account employees seconded to a foreign country).

The Act will come into force on 1 January 2023, giving companies a transitional period to prepare for their new supply chain due diligence obligations by revising existing compliance management systems, establishing new processes and training employees accordingly. In particular, it will apply to partnerships and corporations employing more than 3,000 employees domiciled in Germany from 2023 and then smaller business with more than 1,000 employees from 2024.[15]

*The Dutch Child Labour Due Diligence Act (the "**Child Labour Due Diligence Law**")*

The Child Labour Due Diligence Law applies to all companies that sell or supply goods or services to Dutch consumers, no matter where the company is based or registered, with no exemptions for legal form or size. Companies that fail to exercise child labour due diligence are subject to potential financial and legal enforcement actions, including multiple years of imprisonment. The Dutch government is currently developing implementing orders.[16]

The proposed Bill on Responsible and Sustainable International Business Conduct, tabled in March 2021, could repeal the Child Labour Due Diligence Law. This new bill would establish a duty of care for companies registered in The Netherlands or that sell products or provide services in the Dutch market to prevent and mitigate adverse human rights and environmental impacts along their value chains and, where necessary, to enable remediation.

The bill stipulates that companies engaging in activities outside The Netherlands and exceeding at least two of the following criteria – 250 employees, a total balance sheet of more than €20 million, and net revenues of more than €40 million – would be subject to a due diligence obligation modelled along the lines of the six-step framework contained in the OECD's "Due Diligence Guidance for Responsible Business Conduct Guidelines".[17] The companies meeting the above criteria would be required to develop a policy commitment, draw up an action plan, monitor progress and annually report.

Additionally, the bill foresees administrative, civil and criminal liability. As far as enforcement is concerned, an independent public regulator would be empowered to issue binding instructions and impose financial sanctions but also to offer positive guidance.[18] However, because the proposing parties lost power in the March 2021 Dutch elections, the next steps for the bill remain uncertain.

United Kingdom

Post-Brexit, it is currently unclear whether the UK will implement the EU's MHRDD. However, developments in this area are expected given the increasing focus on sustainable, stakeholder-oriented initiatives by the Johnson government.

A good example of this is the Environment Bill, a proposed vehicle for delivering the UK government's 25-year environmental plan. It sounds out the UK government's targets that will translate into obligations for private entities. Proposed amendments to the bill include mandatory environmental and human rights due diligence obligations, and royal assent is expected later this year, following a number of delays.[19]

United States

Dodd-Frank Act section 1502

Section 1502 of the Dodd-Frank Act – implemented as a rule by the U.S. Securities and Exchange Commission (the "**SEC**") in 2012 – requires all publicly-listed companies to disclose their use of tantalum, tin, gold or tungsten sourced from the Democratic Republic of the Congo and its neighbours, if "necessary to the functionality or production" of a product manufactured or contracted to be manufactured by the company.[20] While companies are not required or even encouraged to stop sourcing from the region, they must disclose due diligence efforts – including tracing and auditing – and other steps taken to ensure their purchasing is not funding armed groups or human rights abuses and to address identified risks.[21]

Under the rule, a company that uses any of the designated minerals must conduct a reasonable "country of origin" inquiry, performed in good faith and reasonably designed to determine the source of the material.[22] If the company either knows the mineral did not originate in the covered countries or has no reason to believe the minerals may have originated in the covered countries, then the company must disclose this determination along with a description of its inquiry.[23] If, on the other hand, the company knows or has reason to believe that the minerals may have originated in the covered countries, the company must undertake due diligence on the source and file a "Conflict Minerals Report" outlining the chain of custody of the mineral.[24] Both determinations must be made publicly available on the company's website.[25]

2010 California Transparency in Supply Chains Act

The California Transparency in Supply Chains Act (the "**Supply Chains Act**") became effective in January 2012, making it the first supply chain disclosure act focused on consumers in the United States.[26] The Supply Chains Act requires all retailers and manufacturers doing business in California "and having annual worldwide gross receipts that exceed one hundred billion dollars" to disclose "efforts to eradicate slavery and human trafficking from its direct supply chain for tangible goods offered for sale".[27]

More specifically, the disclosure must outline to what extent, if any, the retailer or manufacturer: (*i*) verifies, evaluates and addresses the risks of human trafficking and slavery in its product supply chain; (*ii*) audits suppliers to ensure compliance with company standards; (*iii*) requires direct suppliers to certify that the supply chains for all constituent parts comply with human trafficking prohibitions enshrined in domestic law where the part is produced; (*iv*) maintains internal accountability standards and procedures in case of violation; and (*v*) trains employees and managers with direct responsibility for supply chain management.[28] At a minimum, the Supply Chains Act requires disclosure on the company's website "with a conspicuous and easily understood link" or written disclosure within 30 days of having received a request for disclosure from a consumer.[29]

With this focus on disclosure, the Supply Chains Act is intended to provide consumers with the information they need to be "able to force the eradication of slavery and trafficking by way of their purchasing decisions", *i.e.*, to reward companies with stronger practices and penalise those that fail to effectively monitor their supply chains.[30] Like other reporting statutes, the Supply Chains Act does not require that companies take steps to monitor their supply chains or eradicate forced labour, and it fails to outline what effective monitoring looks like or what adequate due diligence would entail. Thus, a company that states that it takes no efforts in any of the required reporting areas is still in compliance with the Supply Chains Act.

The Supply Chains Act also does not create a private right of action but instead provides that the exclusive remedy for violation "shall be an action brought by the Attorney General for injunctive relief".[31] However, some consumers and their attorneys have begun to bring cases under California consumer protection statutes focused on unfair competition and false advertising.[32]

<u>ESG regulations mandating ESG disclosure</u>

Europe

Non-Financial Reporting Directive

In 2014, the EU adopted the Non-Financial Reporting Directive (the "**NFRD**"), which requires large public interest entities to report on ESG information from 2018 onwards.[33] Large public interest entities include EU listed companies, banks, insurance companies and undertakings designated by EU Member States as public interest entities, subject to the threshold that the entity has more than 500 employees and a balance sheet of more than €20 million or net turnover of more than €40 million.

The NFRD aims to create greater transparency in relation to entities of a certain size across all sectors in all EU Member States, ensuring that investors and civil society organisations have adequate access to non-financial information. In particular, this directive identifies four sustainability issues: social responsibility and treatment of employees; respect for human rights; anti-corruption and bribery; and diversity on company boards. Entities in scope must disclose information about business models, policies, outcomes, risks and key performance indicators relevant to their business. The NFRD leaves flexibility in relation to the reporting standard and does not impose detailed disclosure requirements. Regarding climate change disclosure, the NFRD applies the recommendations of the Taskforce on Climate-Related Financial Disclosure (the "**TCFD**").

Following public consultations, commentators identified several deficiencies relating to the NFRD's implementation, finding that the disclosures have not led to relevant public information on the impact of non-financial issues on companies or the other way around, and caused companies to incur unnecessary costs.[34]

In April 2021, the Commission adopted a proposal to amend the NFRD known as the Corporate Sustainability Reporting Directive (the"**CSRD**").[35] The CSRD is a new sustainability reporting framework that extends the NFRD's scope to all EU "large" companies (that meet two of the following criteria: balance sheet greater than €20 million; net turnover greater than €40 million; or more than 250 employees) and all EU listed companies (including SMEs, but excluding micro-enterprises). It also introduces more detailed reporting requirements in accordance with the EU sustainability reporting standards (detailed in the following section). Depending on the CSRD's passage through the EU legislative process, it will apply at the earliest to financial years beginning on or after 1 January 2023.

Disclosure Regulation and Taxonomy Regulation

In December 2019, the Sustainable Finance Disclosure Regulation (the "**SFDR**") entered into force, requiring all EU financial market participants and financial advisors (including non-EU firms marketing in the EU) to make ESG disclosures in relation to their financial products, sustainability risks, and adverse sustainability impacts, in their investment processes.[36] The level of disclosure and obligations depends on the level of integration of ESG considerations within the financial product. Products promoting environmental or social characteristics and products having sustainable investments as their objective are subject to pre-contractual and ongoing disclosures on sustainability indicators used to monitor performance. The SFDR became applicable, in most part, from March 2021.

Alongside the SFDR, the European Union adopted the Taxonomy Regulation, to apply from 1 January 2022.[37] The Taxonomy Regulation puts forward a common set of technical screening criteria to test and measure to what extent an economic activity qualifies as environmentally sustainable. It applies where financial market participants make available products that promote environmental characteristics or products that have sustainable investment as an objective. The Taxonomy Regulation (and associated technical screening criteria) initially focuses on climate change issues, with the Taxonomy Regulation applying on 1 January 2022 in respect of the two climate change objectives and on 1 January 2023 for the other environmental objectives.

Combined with the SFDR, the Taxonomy Regulation ensures that investors investing in financial products in scope will obtain adequate information about the alignment of their portfolios to the Taxonomy. Moreover, combined with the NFRD (and the CSRD, when implemented), the Taxonomy Regulation ensures that companies falling under the scope of the NFRD disclose information about a company's Taxonomy-aligned economic activities.

The European Union has also adopted the Low Carbon Benchmark Regulation, which seeks to ensure that low-carbon benchmarks comply with a standard methodology to limit the possibility of presenting outcomes without a proper basis (otherwise known as "greenwashing").[38]

United Kingdom

UK Modern Slavery Act 2015 (the "MSA")

The UK implemented the MSA in 2015, one of the first global modern slavery regulations. The MSA requires large businesses to produce a statement each financial year stating the steps the organisation has taken during that year to ensure that slavery and human trafficking is not taking place in any part of its own business or any of its supply chains, or a statement that the organisation has taken no such steps. This requirement applies to all commercial organisations (wherever formed) that carry on a business (or part of a business) in any part of the UK, that supply goods or services and have an annual turnover of at least £36 million (calculated on a group-consolidated basis).

The statement may include information about the organisation's policies regarding slavery and human trafficking, its due diligence processes in relation to slavery and human trafficking in its business and supply chains and its effectiveness in ensuring that slavery and human trafficking are not taking place in its business or supply chains. The statement must be approved by the board and signed by a director. The organisation must publish this statement on its website and include a link to the statement in a prominent place on the homepage.

Earlier this year, the UK government created a central registry for publishing MSA statements and announced the creation of a government watchdog to protect the rights of

UK workers. Additionally, a bill to amend the MSA to strengthen enforcing obligations under section 54 of the MSA is currently before the House of Lords.

TFCD

The UK is implementing legislation to make the voluntary disclosure framework under the TCFD mandatory for UK companies, UK asset managers and types of regulated investors, in each case subject to a size threshold. This will require entities in scope to publish detailed TCFD reports that cover their approach to climate risks (the impact of climate change) and opportunities (the transition to a lower-carbon economy) in terms of governance, strategy and risk management. Entities in scope will also need to collect and disclose data on carbon emissions and climate-related targets.

Premium-listed companies will publish TCFD reports for financial years beginning on or after 1 January 2021, and large UK occupational pension schemes will first need to publish information for scheme years ending on or after 1 October 2021. The UK proposes to make "large" UK private companies and LLPs in scope, potentially from financial years beginning on or after 6 April 2022. The Financial Conduct Authority proposes to apply TCFD reporting to asset managers at an entity and product (fund and segregated account) level initially from 1 January 2022.

United States

Historically, the SEC generally has taken a principles-based approach to ESG disclosure, focusing on materiality relative to each company's results. But the SEC recently released its spring 2021 rulemaking list, including several proposed regulations that would bolster ESG disclosure in the areas of climate change, board diversity, human capital management and cybersecurity risk governance.[39]

In parallel, on 16 June 2021, the U.S. House of Representatives passed legislation that would impose new ESG due diligence and disclosure requirements on publicly traded companies. H.R. 1187, the ESG Disclosure Simplification Act of 2021 (the "**ESG Disclosure Simplification Act**"), would require publicly traded companies to disclose their efforts to ensure that ESG standards are reflected in their operations, activities and supply chains based on metrics established by the SEC. The ESG Disclosure Simplification Act would also allow the SEC to incorporate any internationally-recognised, independent, multi-stakeholder ESG disclosure standards in defining ESG metrics and the disclosure process.

H.R. 1187 would also establish the Sustainable Finance Advisory Committee (the "**SFAC**"), a permanent body with no more than 20 members that would advise the SEC on ESG metrics, standards and disclosure, as well as sustainable finance issues more broadly. Section 4 of the Act would require that the SFAC submit to the SEC recommendations regarding which ESG metrics the SEC should require companies to disclose. Within 18 months after the SFAC's first meeting, the body would be required to issue a report that identifies challenges and opportunities for investors associated with sustainable finance and to recommend policy changes that facilitate the flow of capital towards environmentally sustainable investments.

The Act was drafted by the House Financial Services Committee. Since coming under Democratic control in 2019, the Committee has spearheaded a parcel of legislative initiatives focused on increasing accountability and social responsibility within the corporate sector. In championing the legislation, the Financial Services Committee noted that: (*i*) the SEC does not currently require companies to disclose information related to their ESG commitments or to adhere to standards for disclosing such information; (*ii*) investors have reported that voluntary disclosures of ESG metrics are inadequate; (*iii*) statutes and regulations requiring reporting and standardisation of ESG disclosures are in the interest of investors; and (*iv*) ESG standards are "material to investors" such that the SEC is obligated to establish standards for disclosure of such matters.[40]

With or without the ESG Disclosure Simplification Act, SEC regulations on ESG disclosures are likely forthcoming. Then-Acting Chair Allison Lee directed the Division of Corporate Finance to "enhance its focus on climate-related disclosure in public company filings", with the ultimate aim of revising the Commission's 2010 Climate Change Guidance.[41] Towards that revision, the SEC has also solicited input from the public[42] and received over 5,000 comments.[43] In March 2021, the SEC launched a Climate and ESG Task Force in the Enforcement Division with a mandate to "identify any material gaps or misstatements in issuers' disclosure of climate risks under existing rules";[44] the Division of Examinations also announced climate-related risks as one of its 2021 examination priorities.[45] On 7 July 2021, the SEC's Asset Management Advisory Committee adopted recommendations to the SEC regarding disclosures of material ESG matters by issuers and ESG investment product disclosures.[46] Looking ahead, current SEC Chair Gary Gensler's agenda includes a commitment to expanding ESG disclosures.[47] The SEC is set to move forward in October 2021 with notices of proposed rulemaking on disclosures relating to climate-related risks[48] and board member diversity,[49] and in April 2022 regarding requirements for investment companies and advisors related to ESG claims and disclosures.[50]

Benefits of robust ESG due diligence

There have been claims that improved ESG performance can lower the cost of capital by 10%[51] or by a more modest but still meaningful premium for green bonds (otherwise known as a "greenium") of up to 0.11 percentage points.[52] By contrast, the European Central Bank last year found that "green bonds do not consistently differ from similar conventional bonds either in terms of interest rates or liquidity", perhaps as a result of a lack of clear standards and accountability for targets (see below).

Evidence for positive ESG-related debt issuance can be seen in Germany's debut green government bond that has consistently traded at a premium in price relative to its conventional counterpart since it was issued in September 2020 – and that "greenium" has now risen to 0.05 percentage points. Similarly, a study by the Climate Bond Initiative found that the level of demand from investors was higher for green bonds and many were priced at more favourable borrowing costs.[53]

Gains through the establishment of a level playing field. The legal framework described in the section "ESG: Legislative and Judicial Action" above goes a significant way in ensuring that businesses are provided legal certainty and clarity, at both national and supra-national levels, in an area of the law that has often been filled with many, sometimes confusing, non-mandatory codes, principles and guidelines as to best practice.

Gains from improved governance. A study by the *Financial Times* Moral Money Forum found that a long-term approach to corporate governance could have a positive effect on corporate and financial performance and long-term productivity. Such effects are competitive advantages that could make companies more attractive to investors and successful in the long run.[54]

Valuation gains. One FactSet study[55] suggested that companies under the Ethibel Sustainability Index Europe and the MSCI Global Environment Index trade at about 12x the EV/EBITDA enterprise multiple, compared to 10x EV/EBITDA for the Stoxx Europe 600. A McKinsey survey of investment professionals suggested that the majority would be willing to pay a premium of about 10% to acquire a company with a positive ESG profile compared to a negative one.[56] Similarly, a survey of private equity partners found that 54% had reduced a bid price after ESG due diligence, while 32% had increased the bid price.[57] Other surveys have cast doubt on the extent to which market participants might in fact be willing to pay a premium for acceptable ESG performance, but suggest that the vast majority have reduced the valuation of an acquisition target or abandoned a deal because of poor performance on ESG factors.[58]

Financial incentives and disincentives. There have also been a number of recent efforts to link ESG performance with financial incentives (or disincentives). Some recent high-profile examples include:

- **BlackRock's** $4.4 billion lending facility linking borrowing costs to staff diversity targets.[59]
- **WSP Global's** $1.2 billion syndicated revolving credit facility with borrowing costs linked to greenhouse gas emissions, "green revenues" and the proportion of women in management positions.[60]
- **Enerplus's** $900 million bank credit facility where borrowing costs vary by plus or minus five basis points according to performance against targets on greenhouse gas emissions, water management and health and safety.[61]
- **Gibson Energy's** $750 million revolving credit facility with borrowing costs linked to the diversity of its board and workforce.
- **Bridgestone's** $1.1 billion credit facility with an interest rate based on its ESG risk rating as determined by independent ratings providers Sustainalytics and FTSE Russell.

ESG metrics

When conducting ESG due diligence in an M&A context, it is important to understand how the buyer intends to account for and potentially disclose ESG information. For example, diligence conducted for an impact-focused fund will likely serve as the baseline from which the fund will measure and report ESG changes during its period of ownership. Similarly, a social impact fund aimed at improving financial inclusion will want to know the number of "unbanked" people currently served by a target company so that it can measure the shift in access to financial services during the life of its investment.

As another example, a large public company that reports on ESG matters under the Sustainability Accounts Standards Board (the "**SASB**") standard will want to understand the *pro forma* effect of a potential acquisition on its ESG reporting. This is no different in concept to understanding the accounting framework used by the buyer when conducting accounting and financial due diligence.

As discussed above, some regulators have mandated ESG-related reporting on specific matters, such as supply chain or climate risks. Beyond those legally mandated, various systems of ESG reporting standards have arisen over the last few years. Notable examples are the SASB and the Global Reporting Initiative (the "**GRI**"). SASB's set of 77 Industry Standards identifies "the minimal set of financially material sustainability topics and their associated metrics for the typical company by an industry".[62] The GRI Standards are divided by topic: the three universal Standards are used by every organisation that prepares a sustainability report; and the remainder are chosen by an organisation from topic-specific Standards.[63]

Efforts are currently underway to harmonise these standards to allow better direct comparisons of ESG reporting (see for example the discussion above regarding the Taxonomy Regulations).

Final thoughts

ESG due diligence can prove instrumental in evaluating both the value and appropriateness of a particular transaction. Especially given unavoidable resource and other constraints in the M&A context, successful execution of such due diligence requires carefully identifying and assessing the key ESG exposures and related mitigation efforts. In this regard, the ever-increasing legal requirements around ESG due diligence should help level the playing field among businesses as the momentum shifts from voluntary due diligence and self-regulation towards mandatory diligence and disclosure along the lines discussed above. As the ESG landscape continues to evolve, there are significant opportunities for businesses to reap the rewards of more stringent due diligence, including through gains in valuations, improvements in governance and in value chains, and incentive-based deal-making.

* * *

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