

Integrating ESG Into Business Relationships: Practical Guidance for In-house Counsel

Commercial and Contracts

Compliance and Ethics

Cultural Competence

Energy and Public Utility

Environmental

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Corporate, Securities, and Governance



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Cheat Sheet

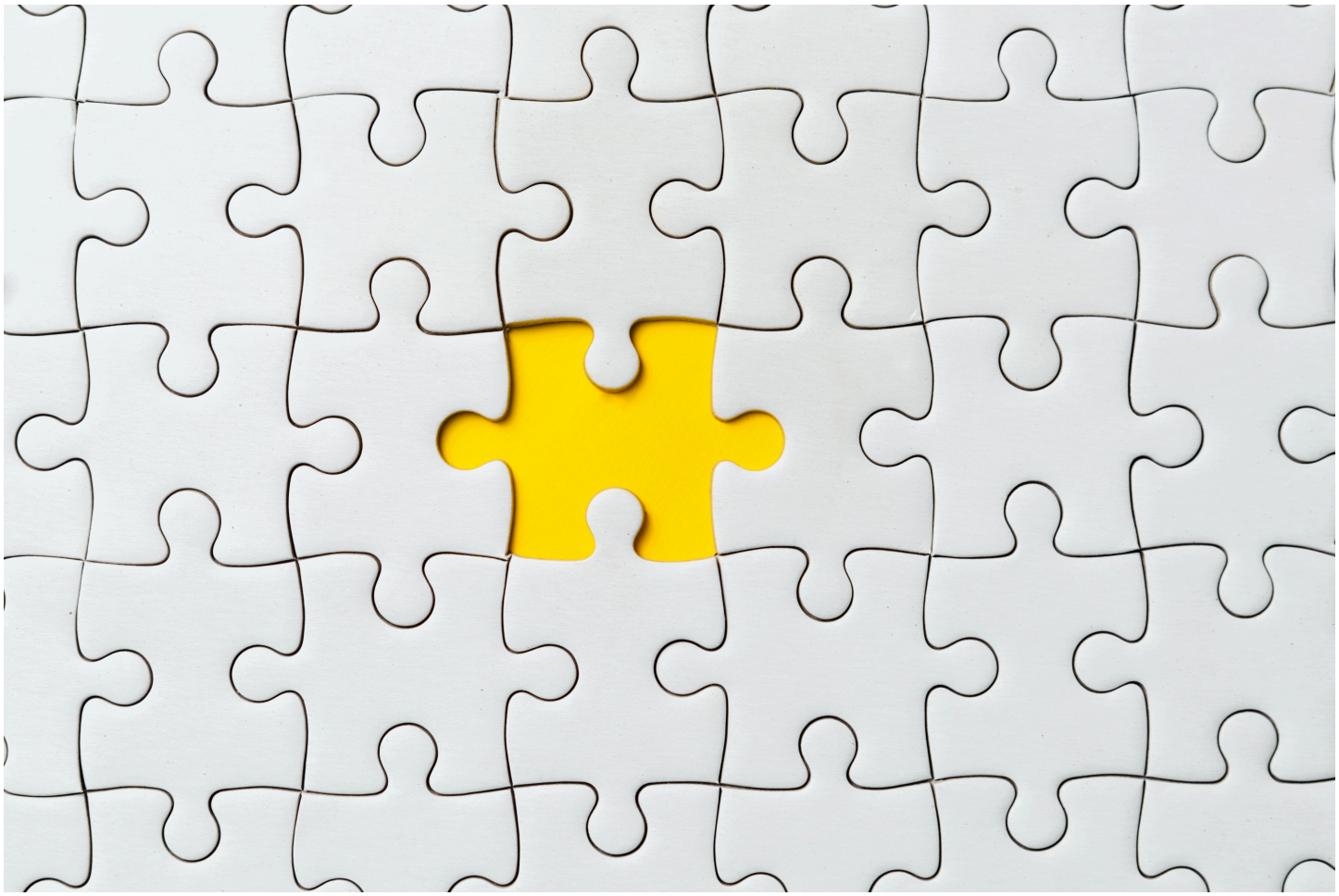
- **Recognize ESG as an opportunity.** It is a chance to align consumer trends, investor confidence and operational efficiency.
- **Stay updated.** Ensure compliance and anticipate future requirements by keeping abreast of ESG developments.
- **Conduct due diligence.** Prioritize ESG risks and maintain ongoing monitoring of business partnerships.
- **Embed ESG standards in contracts.** Use well-defined clauses.

Environmental, social, and governance (ESG) matters are no longer optional, but are central to corporate strategy. As in-house counsel, your role in embedding ESG principles into business relationships is crucial as ESG compliance is quickly becoming the norm for doing business. This not

only ensures regulatory compliance and risk management, but also turning those risks into business opportunities, and the relevant costs into investments accordingly. This article offers practical steps for legal professionals to leverage ESG compliance as a chance for value creation for their companies through business partnerships and best practices.

Understanding the ESG regulatory framework and turning its challenges into opportunities

The ESG regulatory landscape is quickly evolving, with governments and regulatory bodies implementing new requirements in all regions. Staying updated on both local and global regulations is crucial for in-house counsel to provide effective advice to their companies and internal stakeholders. In this regard, it is of essence to align strategic planning and communication, by ensuring robust communication and coordination among functions and departments in charge of collecting data, ensuring compliance and communicating externally.



Figuring out how to connect ESG-related initiatives can feel like solving a jigsaw puzzle.

All public claims, announcements, and reports should be aligned and consistent (or at least not contradictory) in order to reduce the risk of misunderstanding or misinterpreting the information. This alignment is crucial to meet the growing demand for transparency and clarity from all internal and external stakeholders, including NGOs and regulators.

All ESG-related initiatives (including, but not limited to the EU's Corporate Sustainability Reporting Directive (CSRD), Carbon Border Adjustment Mechanism (CBAM), and Corporate Sustainability Due Diligence Directive (CS3D); French Duty of Vigilance Law; German Supply DD Act; UK Modern Slavery Act; US Forced Labor Prevention Act and SEC initiatives; Australian Modern Slavery Act; Norwegian Transparency Act) may be envisioned as a puzzle, where each piece must be meticulously connected to create a clear overall picture. Companies should align their commitments, strategies, and actions to achieve effective and useful policies.

Non-compliance with ESG regulations can lead to serious consequences, such as reputational damage, financial losses, and a decline in investor confidence. For example, companies accused of poor labor practices in their supply chains have faced public scandal and divestment, emphasizing the need for strong ESG protocols.

Risks and opportunities are two sides of the same coin. For large corporations, sustainability is mainly a risk because of legal and regulatory obligations, and market and stakeholders' expectations. For Small Medium Enterprises (SMEs), sustainability can be a huge opportunity.

Are you interested in gaining the knowledge and skills needed to understand ESG legal principles effectively? Check out the online education series **"Key Topics in ESG Law: Making Sense of an Increasingly Complex Legal Landscape"** starting January 15, 2025.

Indeed, although adherence to ESG laws is directly required of large corporations, all enterprises will have a role in ESG compliance as part of a specific industry or value chain or as it may offer competitive advantages. In fact, companies that align with consumer trends benefit from increased brand loyalty and a positive image with investors, as stakeholders increasingly favor brands with sustainable practices. Being sustainable is a huge opportunity to gain new market share and to attract new investors, and companies should be prepared to effectively meet and wisely manage such opportunity. Legal teams can support and provide guidance to their companies to follow standards and incorporate robust controls that result in consistency, accuracy, and comparability of data and disclosures, also in order, on one hand, not to provide misleading information and not to run risks of "green washing" and, on the other hand, by creating awareness instead of fear, not to refuse ESG communication and take shelter in the "green hushing."

Investors are attracted to companies with strong ESG practices, by viewing them as more resilient and focused on the future. Initiatives such as setting carbon reduction goals show this commitment to investors and stakeholders, establishing a clear path toward sustainable growth.

Implementing ESG best practices can also enhance operational efficiency, by leading to cost savings through measures like energy reduction and waste minimization, or improved access to capital. However, the connection between sustainable practices and business success extends well beyond immediate financial savings, as it also brings a range of non-financial and indirect benefits that can be equally, if not more, impactful. These advantages significantly contribute to a company's growth, resilience and reputation, offering value that goes far beyond cost savings. Companies that adopt sustainable practices early can avoid costly fines and ensure uninterrupted operations. A McKinsey study revealed that one-third of a business's profits could be at risk due to ESG-related regulatory changes, making proactive compliance a smart financial strategy.

To align with evolving stakeholders' expectations, legal teams can play a key role, promoting

dedicated training on communication, due diligence across the value chain and embedding specific commitments into contractual agreements.

Key steps for implementing ESG due diligence in business relationships

Legal teams shall support all size companies in implementing appropriate policies and strategies without forgetting — rather having this as a priority — that sustainability shall also be sustainable.

Comprehensive ESG due diligence is essential for managing risks across diverse partnerships and investments. Here are four key steps for applying ESG due diligence in business relationships.

1. Define the scope.

Clearly define the scope of each relationship, understanding the unique ESG impacts and risks associated with different partners, from joint ventures to long-term clients or suppliers. Distinguish between direct impacts (e.g., environmental or human rights risks with a production partner) and indirect risks (e.g., governance risks in financing partnerships). These distinctions allow for targeted due diligence tailored to each relationship.

2. Conduct broad due diligence.

Conduct broad due diligence on your partners/targets by categorizing relationships based on the risk level (similar to the risk assessments in supply chains and credit risk) and prioritize partnerships/investments based on ESG risks. This approach also allows for efficient allocation of resources to monitor potentially high-risk relationships closely.

3. Mitigate risk by embedding ESG commitments directly into contracts.

For example, require partners to uphold human rights, and environmental and ethical standards. Beyond this, use your influence to encourage or require partners to adopt best ESG practices, such as reporting on supply chain standards or agreeing to third-party ESG audits. This strategy extends the ESG influence across business interactions.

4. Establish ongoing monitoring, communication, and remediation processes.

Implement internal systems to track ESG metrics and regularly communicate these efforts to stakeholders. When issues arise, act promptly to address them with partners or, if necessary, disengage from partnerships which fail to meet ESG standards. Shared platforms or hotlines for reporting ESG concerns offers additional transparency and accountability.

By extending ESG due diligence to all business relationships, you not only ensure regulatory compliance but also create a robust and ethically grounded network of partners. In any event, there is no single or “right” way to sustainability or ESG compliance. Rather, each company must find its own path also with the assistance and support of its legal team.

Managing ESG contract clauses

Contracts provide a structured way to enforce ESG compliance. Key clauses can help in ensuring that business partners uphold ESG standards, covering a range of important areas.

Compliance

Specify the applicable ESG regulations, including local, national and international laws, and make reference to recognized standards, such as ISO for environmental management or the UN Global Compact.

Permits and licenses

Clearly define any permits and licensing requirements, stating that failure to maintain permits constitutes a breach.

Sustainability practices

Contracts should include language requiring partners to make commercially reasonable efforts to meet ESG goals, with commitments for waste reduction, energy efficiency, or use of sustainable materials. Here is important to balance specific expectations with flexibility, defining sustainability while leaving room for practical applications.

Social and governance terms

In addition to environmental terms, address social and governance aspects: social clauses should cover labor standards, diversity and inclusion, health and safety and community engagement; governance clauses should mandate anti-bribery and anti-corruption compliance, transparency in reporting, data privacy and security and ethics programs.

Reporting and audits

Regular reporting and auditing clauses ensure accountability. Specify the frequency and format of reports, aligning them with the annual ESG report, for instance, to avoid excessive burden; also allow for third-party audits to maintain transparency.

Remediation

Include clear procedures for breaches and corrective actions. Flexibility, such as accounting for external factors that may impact compliance, protects both parties.

Continuous improvement

Encourage partners to commit to year-over-year improvements or adopt eco-friendly technologies, as they become available. Using “commercially reasonable efforts” in these clauses can balance ambition with feasibility.

In the context of extraordinary transactions and investments, these areas and topics should be properly included in the scope of the due diligence exercise.

From a compliance requirement to a source of long-term value

Integrating ESG practices into business relationships is not only about meeting regulatory demands; it is about building sustainable and resilient businesses. For in-house counsel, ESG provides a strategic advantage to empower their organization and proactively respond to global trends and stakeholders' expectations. By conducting in-depth due diligence across all partnerships, embedding ESG requirements into contracts and promoting a culture of continuous improvement, legal teams can transform ESG from a compliance requirement into a source of long-term value and responsible business leadership.

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