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INTRODUCTION

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Stibbe is a leading, independent, international law firm with main offices in Amsterdam, Brussels and Luxembourg, as well as a branch office in London. It provides the highest-quality service in legal advice, transactions and litigation. The dedicated multidisciplinary teams are trusted legal advisers to clients that range from national and multinational companies and financial institutions to government organisations and other public authorities. The firm handles transactions, disputes and projects across a wide range of sectors. A thorough understanding of clients' commercial objectives enables the team to provide suitable and effective advice on complex legal issues and challenges. Stibbe works closely together with other international top-tier firms on cross-border matters outside its home jurisdictions; the firm's independence allows it to team up with any foreign law firm to suit clients' needs and preferences.

Contributing Editors

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2024: A Year of ESG Reporting, Due Diligence on ESG, and Global ESG Evolution

As we navigate through the 2020s, the ESG landscape continues to evolve at a rapid pace. The year 2024 stands out as a pivotal period, marked by significant regulatory developments and shifting priorities across the globe. This introduction to Chambers and Partners' ESG Guide 2024 aims to provide an overview of the key trends and themes that are shaping the ESG agenda globally.

The rise of the EU Corporate Sustainability Due Diligence Directive and climate litigation

2024 is undoubtedly the year of the Corporate Sustainability Due Diligence Directive (CSDDD). The adoption by the EU of the CSDDD represents a milestone in mandatory due diligence on sustainability issues. This directive mandates companies to identify, prevent and mitigate adverse human rights and environmental impacts in their operations and supply chains. The final text – albeit a compromise – sets a new standard for corporate accountability and transparency.

The impact of the CSDDD extends beyond the EU, as companies operating globally will have to comply with its stringent requirements. This directive is expected to drive significant changes in corporate behaviour, pushing companies to adopt more sustainable practices and improve their ESG reporting.

Furthermore, we observe a new surge in climate litigation throughout the world, targeting both companies and governments. A few examples are mentioned here.

ECHR climate cases in 2024

In April 2024, the European Court of Human Rights (ECHR) issued rulings on the obligations of EU member states to protect human rights in the face of climate change. EU member states have an obligation to take effective measures to meet climate change targets and to address the serious adverse effects of climate change, the ECHR ruled.

Advisory opinion on climate change obligations of states at the International Court of Justice

On 29 March 2023, the United Nations General Assembly adopted the request led by Vanuatu for the ICJ to deliver an advisory opinion on the obligations of states in respect of climate change and submitted the request to the ICJ. The request specifically asks for an opinion on the responsibility of states towards (vulnerable) states – in particular, Small Island Developing States (SIDS) – and towards present and future generations affected by the adverse effects of climate change. A large number of states submitted written statements and the first public hearing in the case is scheduled for December 2024.

Milieudefensie, v Shell (appeal) and Smith v Frontera

On 12 November 2024 the Court of Appeal of The Hague, the Netherlands, overturned the judgment requiring Shell to reduce CO2 emissions by 45% by 2030. The crux of the ruling is that the Court of Appeal finds that Shell is obliged by an unwritten standard of care and human rights to reduce its CO2 emissions, but rejects the injunction sought by Milieudefensie. Such an injunction would require that Shell is obliged to specifically reduce its CO2 emissions by 45% by 2030 and that Shell is in danger of breaching that obligation. In the Court of Appeal's view, this is not the case:

- Milieudefensie, has insufficiently argued that Shell will not meet its reduction target of 50% for scope 1 and scope 2 emissions
- There is insufficient ground to impose on Shell a specific reduction obligation of 45% by 2030 for scope 3 emissions
- The requested injunction in relation to scope 3 emissions would be ineffective because other market participants could take over any activities that Shell would cease, such as the sale of oil and gas. As a result, no CO2 reduction would be achieved.

Incidentally, the Court of Appeal suggests that a ban on Shell's proposed investments in new oil and gas fields might be allowable, because of the lock-in effect.

The initial ruling in the Milieudefensie, v Shell case in 2021 was a global first and gave rise to numerous other climate cases worldwide. For instance, the New Zealand Supreme Court recently allowed a similar case (Smith v Frontera) to proceed. In that case, the claimant is arguing that the GHG-emitting activities of New Zealand's seven largest emitters amount to breaches of common-law duties of public nuisance and negligence.

The Court of Appeal's rejection of the reduction in the Miliedefensie, v Shell case may put these climate case in a different light.

Global ESG trends and regulatory developments

North America

In the USA, ESG issues have become a focus of regulatory and political debate. The SEC has been at the forefront, proposing new rules for climate-related disclosures. However, these proposals have faced legal challenges, reflecting polarised views on ESG regulation. The upcoming Presidential election adds another layer of uncertainty, as the outcome could significantly influence the direction of ESG policies.

Canada, on the other hand, has been proactive in integrating ESG considerations into its regulatory framework. The Canadian Securities Administrators (CSA) has introduced climate-related disclosure guidelines, emphasising the importance of transparency and accountability.

Europe

Europe continues to lead the way in ESG regulation. In addition to the CSDDD, the EU Corporate Sustainability Reporting Directive (CSRD), the European Green Deal and the EU Taxonomy Regulation are driving significant changes in the way companies report and manage their environmental impact. The focus on sustainable finance is also gaining momentum, with the EU Sustainable Finance Disclosure Regulation (SFDR) setting standards for financial market participants. Finally, the increased focus on

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greenwashing and sustainable product design – with the proposed EU Green Claims Directive and the recently enacted Ecodesign Regulation, respectively – is expected to have a large impact on market participants in Europe (and beyond).

Asia-Pacific

The Asia-Pacific region is witnessing a growing emphasis on ESG issues, driven both by regulatory initiatives and market demand. Countries such as Japan and South Korea are enhancing their ESG disclosure requirements, while China is integrating ESG considerations into its corporate governance framework. The region's rapid economic growth and increasing environmental challenges make ESG a critical area of focus.

Africa and the Middle East

ESG factors have become increasingly important in Africa and the Middle East, especially considering that the region has been identified as one of the most vulnerable to the adverse effects of climate change. There is a noticeable trend towards the codification of ESG standards and reporting frameworks. As regards environmental sustainability, several countries have adopted legislation focusing on energy transition, security and efficiency.

Latin America

In Latin America, ESG issues are gaining traction – albeit at a slower pace compared to other regions. Brazil and Mexico are leading the way with regulatory initiatives to improve corporate transparency and sustainability. However, political and economic instability in the region poses challenges to the consistent implementation of ESG policies.

Key themes in 2024

Climate change and environmental sustainability

Climate change remains a central theme in ESG discourse. The increasing frequency of extreme weather events and the distortion in value chains due to the effects of climate change underline the urgent need to transition to a low-carbon economy. Mitigating these effects and managing the financial, physical and transition risks of climate change are driving regulatory and corporate action. Companies are under pressure to set ambitious carbon reduction targets and improve their climate resilience.

Social responsibility and human rights

Social issues, including human rights, labour practices, and community engagement, are gaining prominence. The CSDDD's focus on human rights due diligence highlights the growing importance of social responsibility in corporate governance. Companies are expected to adopt more robust policies to address social risks and ensure ethical practices throughout their supply chains.

Governance and accountability

Good governance is the cornerstone of effective ESG management. Companies are being held to higher standards of accountability, with increased scrutiny from regulators, investors, and stakeholders. This is reflected in the recent growth of ESG and sustainability provisions in Corporate Governance Codes around the world. Board diversity, executive compensation, and anti-corruption measures are key areas of focus, as companies seek to build trust and demonstrate their commitment to ethical governance.

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Outlook for 2025 and beyond

Looking ahead to 2025, several key developments are expected to shape the ESG landscape:

- US Presidential election – the outcome of the 2024 US Presidential election will have a significant impact on ESG policies. A change in administration could lead to shifts in regulatory priorities, impacting climate-related disclosures, corporate governance, and social responsibility initiatives.
- Global economic trends – economic conditions in different regions will influence ESG priorities. By way of example, the ongoing energy transition and the push for sustainable finance will drive investments in green technologies and infrastructure, while policymakers balance the interest to address generally high inflation levels.
- Climate targets – it has already been widely reported in the news that the climate goals of the Paris Agreement seem to be getting out of sight. There has also been a call from more than 15,000 scientists to act sooner rather than later. We are thus at a crucial point; additional measures may be (or have to be) taken to meet the targets. This could put additional pressure on companies.
- Technological advancements – innovations in technology, such as AI and blockchain, are expected to improve ESG data collection, analysis, and reporting. These advancements will enable companies to better manage their ESG risks and opportunities.
- Stakeholder engagement – the role of stakeholders, including investors, customers and employees, will continue to be crucial in driving ESG performance. Companies that actively engage with their stakeholders and respond to their concerns will be better positioned to succeed in the evolving ESG landscape.
- Diverging ESG regulations – companies that are active across jurisdictions are facing increasing regulatory pressure from a variety of ESG regulatory initiatives, posing impediments to global trade.

In conclusion, 2024 marks a significant year for ESG developments, with the CSDDD setting a new benchmark for corporate sustainability. As we move forwards, companies will need to navigate a complex and dynamic regulatory environment, while embracing the opportunities presented by the global shift towards sustainable and responsible business practices.

BRAZIL

Law and Practice

Contributed by:
Fernanda Bidlovsky, Aline Meyer, Renata Politanski and Mainara Massuella
Maeda, Ayres & Sarubbi Advogados

Contents

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Maeda, Ayres & Sarubbi Advogados

Maeda, Ayres & Sarubbi Advogados is a leading Brazilian law firm specializing in compliance, corporate integrity, investigations and government enforcement, with a team of over 30 dedicated legal professionals headquartered in São Paulo. The firm's partners are the pioneers of the practice since its origin in Brazil. The team has over a decade of experience in conducting internal investigations related to behavioural issues, human rights violations and environmental concerns, as well as extensive experience in corporate integrity risk analysis and implementing comprehensive integrity programmes including ESG aspects. Recent notable works include the engagement: (i) by the Independent Committee created by Vale S.A. to investigate the tailings dam failure in Brumadinho/MG; (ii) by the Independent Committee created by Americanas S.A. to investigate the circumstances that led to accounting inconsistencies; and (iii) to conduct a comprehensive human rights risk analysis and implement human rights due diligence processes for a major Brazilian oil and gas company.

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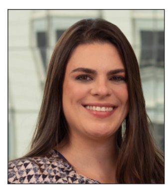
Fernanda Bidlovsky is a partner at Maeda, Ayres & Sarubbi Advogados with over 20 years of experience. She has worked in highly complex independent internal investigations, including with reporting to Brazilian and United States authorities. Fernanda leads the firm's ESG practice and has solid experience in conducting internal investigations related to behavioural (eg, harassment and discrimination) and human rights issues, conducting corporate integrity risk analysis and implementation of integrity programmes covering ESG aspects, as well as conducting human rights due diligence in companies and their supply chains. Fernanda holds an LLM degree from the University of Buffalo Law School and has earned a certification in Sustainable Capitalism and ESG from Berkeley Law.



Aline Meyer is a senior attorney at Maeda, Ayres & Sarubbi Advogados with 11 years of experience in compliance, specialising in corporate investigations and anti-corruption laws, including the Brazilian Anti-Corruption Law and the US Foreign Corrupt Practices Act (FCPA). She is currently a member of the Women's White Collar Defense Association (WWCDA) and Transparency International. Aline is also pursuing a course on ESG risk management at the University of Cambridge. Throughout her career, she has handled complex investigations, implemented compliance programmes and advised on third-party due diligence, as well as remediation and mitigation measures.

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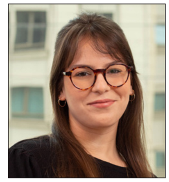

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1. Introduction

1.1 General ESG Trends

Brazil has witnessed significant advancements in ESG and sustainability regulations, with a particular emphasis on enhancing corporate governance structures and environmental accountability.

Additionally, new guidelines have been established for the responsible management of resources and achieving carbon neutrality, reflecting Brazil's commitment to global climate targets. There has also been a growing trend to integrate social issues, such as diversity and human rights, into corporate governance strategies, reflecting the increasing importance of the "S" and "G" pillars within the ESG framework.

1.2 Environment Trends

Ecological Transition Plan and Growth Acceleration Programme

A significant milestone was the launch of the Growth Acceleration Programme in August 2023, which includes investments of BRL1.7 trillion aimed at reducing inequality, accelerating economic growth, and facilitating the country's ecological transition. Alongside this programme, the Ecological Transition Plan was introduced, focusing on fostering development through environmental preservation and addressing climate change.

This Plan outlines new credit lines for sustainable development, the establishment of a regulated carbon market, the issuance of sustainable sovereign bonds, and a restructured Climate Fund to finance activities related to technological innovation and sustainability.

Investments in Energy Transition

Another noteworthy aspect has been Brazil's efforts regarding energy transition. Brazil invested BRL34.8 billion in energy transition initiatives in 2023, covering areas such as renewable energy, carbon capture, green hydrogen and electric vehicles.

In September 2023, during the Climate Ambition Summit at the 78th UN General Assembly, Brazil announced an increase in its greenhouse gas reduction target to 48% by 2025 (an increase from the previous target of 37%) and reiterated the government's commitment to achieving zero deforestation by 2030.

Brazil as Host Country for COP 30

In December 2023, the decision to host the 30th Conference of the Parties to the United Nations Framework Convention on Climate Change ("COP 30") in Brazil, from 10 to 21 November 2025, was formally approved. The Brazilian government officially announced that COP 30 will take place in Belém, in the State of Pará - marking the first time a COP will be held in an Amazonian city.

1.3 Social Trends

Brazil has seen significant developments in social issues, such as the following.

Federal Law No 14,457/2022, "Employ More Women" Programme

Federal Law No 14,457/2022 amended the Consolidation of Brazilian Labor Laws to assign new responsibilities to Internal Commissions for Accident Prevention and Harassment (CIPA, by its acronym in Portuguese) concerning prevention of sexual harassment.

According to Article 23 of the Law, to promote a healthy and safe work environment that encourages the inclusion and retention of women in the labour market, companies must adopt, among other measures: (i) procedures for receiving reports of sexual harassment and violence; and (ii) training actions for employees on topics related to violence, harassment, equality and diversity.

Federal Law No 14,611/2023, Equal Pay Law

Federal Law No 14,611/2023 came into effect in the first half of 2024 and addresses wage equality and remuneration criteria between women and men. The Law requires companies with 100 or more employees to publish biannual reports on salary transparency and remuneration criteria. The reports must provide information that allows for comparisons between salaries and the proportion of positions held by women and men, along with information that can provide statistical data on other possible inequalities arising from race, ethnicity, nationality and age.

When inequalities are identified, companies must present and implement an action plan to mitigate the disparity. Failure to publish the reports may result in an administrative fine of up to 3% of the employer's payroll, limited to 100 minimum wages.

Bill of Law No 572/2022, National Framework on Business and Human Rights

The Bill intends to create the National Framework on Human Rights and Business and to establish guidelines for promoting related public policies. The current text of the Bill provides for human rights due diligence for companies domiciled in or economically active within Brazil and sets for joint liability for human rights violations in the supply chain.

National Human Rights Policy

In 2023, the federal government established an Interministerial Working Group led by the Ministry of Human Rights (see **4.1 Soft Law Becoming Hard Law**), which is currently in the phase of gathering relevant information from civil society to develop a proposal for the National Human Rights and Business Policy. The group will also propose measures and actions to enhance the effectiveness of public policies aimed at regulating corporate actions in the promotion and defence of human rights; the repair and monitoring of human rights violations; and the implementation of corporate policies aligned with the guidelines of national and international standards.

1.4 Governance Trends

Corporate governance has undergone significant transformations, driven by an increasing demand for enhanced transparency, accountability and ethical practices within businesses.

Resolution CVM No 193

A key milestone in governance in 2023 was the issuance of Resolution No 193 by the Brazilian Securities and Exchange Commission (CVM, by its acronym in Portuguese), which will be detailed in **5. Transparency and Reporting**. In short, the Resolution requires the preparation and disclosure of sustainability-related financial information reports based on the international standards established by the International Sustainability Standards Board (ISSB) by publicly traded companies, investment funds and securitisation entities. The aim is to improve the transparency and quality of information provided to the market, particularly concerning ESG-related risks and opportunities.

New Version of the B3 Issuer Regulation

Another significant development was the introduction of the new version of the Issuer Regulation by B3 (Brazil's main stock exchange), which took effect in August 2023. This Regulation establishes rules and procedures for issuers listed on the stock exchange or that have securities admitted to trading, incorporating changes that impact ESG measures in alignment with the United Nation's Sustainable Development Goals (UN SDGs), particularly those specified in SDG 5 (Gender Equality) and SDG 10 (Reduced Inequalities).

Key updates include (i) the adoption of diversity practices in the composition of companies' management bodies, requiring that companies elect at least one woman as a full member of the board of directors or executive management and one member from an underrepresented community, such as individuals identifying as Black, Brown, or Indigenous; members of the LGBTQIA+ community; or persons with disabilities; and (ii) in cases involving variable compensation for management members, the establishment of performance indicators related to ESG, which must be integrated into company policies or remuneration practices.

Brazil's Business Integrity Pact

In 2023, the Office of the Comptroller General (CGU, by its acronym in Portuguese) launched the Brazil Business Integrity Pact. This initiative encourages companies operating within Brazil to voluntarily commit to public business integrity.

The primary objectives of the Brazil Pact are:

- to foster integrity within the Brazilian private sector, encouraging institutions to cultivate an organisational culture that combats corruption and promotes socially relevant issues;
- to disseminate knowledge regarding business integrity; and
- to raise awareness among companies about the importance of adopting concrete actions to positively transform the corporate environment and their relationships with the public sector and society.

1.5 Government and Supervision

The Brazilian Securities and Exchange Commission (Comissão de Valores Mobiliários – CVM)

CVM has been a strong advocate for transparency in corporate disclosures related to ESG. In addition to the previously mentioned Resolution No 193, issued in 2023, CVM updated its Resolution No 59 in 2022. This revision enhanced the requirements for ESG-related disclosures in the financial statements of listed companies and aims to provide greater clarity to investors regarding the risks and opportunities associated with sustainable practices, prompting many companies to refine their strategies to attract foreign capital and align with global market expectations.

Federal Budget Oversight Board (Tribunal de Contas da União – TCU)

TCU is planning to implement a new monitoring tool that seeks to integrate the assessment of governance and management processes with environmental responsibility and sustainability initiatives across federal public administration entities.

Sectoral Regulatory Agencies

Sectoral regulatory agencies, such as the National Electric Energy Agency *(Agência Nacional de Energia Elétrica* – ANEEL,) and the National Agency of Petroleum, Natural Gas, and Biofuels (*Agência Nacional do Petróleo, Gás Natural e Biocombustíveis* – ANP), have established regulations to promote the use of renewable energy and reduce carbon emissions. For instance, ANEEL is advancing a regulatory agenda focused on energy transition to enhance discussions on the impacts of climate change, while ANP regulates the reduction of greenhouse gas emissions in the oil and gas sector.

Moreover, as detailed in **5.1 Key Requirements**, the Central Bank of Brazil oversees the annual preparation of reports on social, environmental and climate risks and opportunities by financial institutions; and the Superintendence of Private Insurance outlines sustainability requirements to be observed by insurance companies, open pension entities, capitalisation companies and local reinsurers.

1.6 Market Participants

ESG-related regulations encompass a broad range of industries and sectors. However, due to the nature of their activities, certain sectors may face greater regulation in the coming years. Below are a few examples.

Energy Sector

The energy sector is especially relevant in the environmental context, particularly due to its direct contribution to climate change, as it accounts for a substantial portion of global carbon emissions. Companies within this sector are experiencing pressure to implement sustainable practices, such as reducing emissions, investing in renewable energy sources and managing waste more efficiently.

In the fuels sector, there remains a strong reliance on fossil sources. Nevertheless, research into biodiesel production is gaining traction as a more sustainable alternative. Another important area of research involves carbon dioxide sequestration, which can be converted into carbon monoxide for use in the mining industry, where it serves as a reducing agent in mineral production. This process represents the transformation of an environmentally harmful waste product into a value-added commodity.

In the electricity sector, there is a growing demand for the replacement of coal-fired power plants, in line with the goal established at COP 26 to phase out coal mining by 2030. In Brazil, there has been significant expansion in wind and solar energy generation, accompanied by advanced studies aimed at increasing the share of these sources in the national energy matrix.

Livestock and Agriculture Sector

The Brazilian agribusiness sector is heavily influenced by environmental factors (eg, illegal deforestation, carbon emissions and water use reduction) as well as social aspects involving labour practices and working conditions. Consequently, companies in this sector are encouraged to adopt sustainable agricultural practices and demand greater transparency in supply chains.

Transportation Sector

Environmental concerns are also particularly relevant in the transportation sector, focusing on greenhouse gas emissions, material recycling and implications for urban mobility. Companies in this segment are increasingly incentivised to adopt vehicles powered by alternative energy sources and sustainable production practices. Initiatives, such as the ESG Cargo Project by the National Land Transportation Agency (ANTT, by its acronym in Portuguese), aim to promote an ESG-focused approach within the road transportation sector, integrating best practices into the organisational culture of the companies within the sector and into the public concession agreements.

Mining Sector

There is a significant movement within the mining sector to reduce emissions of carbon dioxide, heavy metals, halogenated and sulphur compounds, as well as volatile gases arising from extraction processes. The sector's reputation has been adversely affected by waste disposal issues, particularly due to severe environmental disasters in recent years.

Innovative studies in this area are focusing on new technologies for monitoring tailings dams, as well as alternative methods for disposing of and reusing mining waste, which can serve as inputs for other industries.

Efforts are also underway to reforest and rehabilitate mined areas to mitigate environmental impacts following mine closures, along with incentives for large companies in the sector to set targets aimed at achieving net-zero carbon emissions within the next 15 years.

1.7 Geopolitical Developments

Multilateral Trade Agreements

Trade agreements, such as the Mercosul-EU agreement (currently awaiting ratification), hold the potential to boost Brazilian exports to the European Union. However, specific restrictions imposed by EU countries, such as the potential for sanctions on Mercosul products sourced from deforested areas, could become trade barriers if Mercosul nations fail to meet environmental protection requirements.

Similarly, the EU's anti-deforestation law, set to take effect on 30 December 2024, will prohibit the importation of commodities produced in deforested regions. This law poses significant challenges for the Brazilian government, as commodities at risk of sanctions (including coffee, beef, cocoa, rubber, soy and timber) account for over 30% of Brazil's exports to the European market.

International Organisations and Forums

Brazil is member of organisations such as the United Nations and forums like the G20, which consistently emphasise the need for adopting ESG practices and advocate for measures aligned with global governance and environmental policies. Recently, the US State Department expressed its commitment to partnering with Brazil as part of its G20 agenda to combat hunger and poverty, mobilise against the climate crisis and enhance global governance effectiveness.

The United Nations Climate Change Conference and other multilateral forums have imposed commitments on Brazil concerning carbon emission reductions, reforestation and biodiversity protection. In 2023, Brazil reaffirmed its active participation in these forums but faced tensions among economic sectors, such as agribusiness and mining, that resist certain international demands.

International Financial Institutions

Measures implemented by international financial institutions, such as the World Bank, the International Monetary Fund, and the Inter-American Development Bank (IDB), also influence the advancement of ESG themes in Brazil. For instance, the IDB approved a financing line of up to USD1.2 billion for Brazil aimed at improving productivity and resilience in the agricultural sector, enhancing revenues, and expanding access to basic services in rural areas, thereby promoting sustainable agricultural development.

Global Geopolitical Conflicts

Global geopolitical conflicts, such as the war in Ukraine, directly impact ESG-related issues. The war has led to increases in energy, fuel and commodity prices, compelling Brazil to reassess its energy security and sustainability policies. Concurrently, global demand for Brazilian agricultural and mineral products has surged, pressuring the country to balance economic growth with its ESG commitments, particularly concerning environmental protection and the sustainable exploitation of resources.

2. Corporate Governance

2.1 Developments in Corporate Governance

The following developments related to corporate governance are expected in the upcoming year.

Expansion of the Role of Boards of Directors

In line with new regulatory requirements, boards of directors are expected to adopt a more proactive stance in overseeing ESG practices and integrating them into the company's strategic decisions. Board members should be equipped to identify major trends in ESG investments and understand how these trends may impact the company's ability to secure financing. With this information, they should seek to influence senior management's decisions regarding resource allocation, promoting diversity and inclusion within corporate leadership.

Diversity in Board Composition

It has become increasingly important for boards of directors to be composed of a diverse group of individuals, encompassing various areas of expertise, experiences, sexual identity, ethnicity, age and other factors.

Creation of Specialised Committees

For some companies, the creation of a dedicated sustainability committee may be necessary to ensure that sustainability decisions are aligned with the company's business strategy. Companies that decide to create said committees should consider having members focused on sustainability and diversity, with the authority to allocate investments and incur expenses on behalf of the company.

Changes in Executive and Board Compensation

It is anticipated that by 2025, there will be a growing adoption of ESG criteria in the variable compensation structure for board members and executives, directly linked to the achievement of sustainability and governance goals. This represents a clear method for influencing behaviour, decision-making, and accountability for the implementation of ESG-related projects, both in the short and long term.

2.2 Differences Between Listed and Unlisted Entities

The corporate governance requirements for listed and unlisted companies differ significantly, primarily due to the legal obligations imposed on listed entities by the Brazilian Corporations Law (Federal Law No 6,404/76), as well as regulations set forth by CVM and B3.

Listed companies are required to disclose audited financial statements, along with quarterly and annual reports, adhering to specific governance standards and protections for minority shareholders. Additionally, they must establish a board of directors responsible for overseeing executive management and safeguarding the interests of shareholders, while also complying with stringent transparency and accountability rules.

These companies are also subject to regulations and, depending on their listing segment - such as the Novo Mercado - must adopt additional governance practices, such as the presence of independent directors and the issuance of only voting shares.

Conversely, unlisted companies enjoy greater flexibility in their governance structures, facing fewer formal requirements regarding financial information disclosure and the composition of their governing bodies. Nonetheless, they remain subject to the Brazilian Corporations Law and other specific regulations that protect shareholder rights.

While these unlisted entities are not mandated to comply with all the requirements imposed on listed companies, there has been a growing trend towards the voluntary adoption of good governance practices each year, aimed at enhancing management, increasing transparency and attracting investors.

2.3 Role of Directors and Officers

The roles of directors and executives are increasingly shaped by ESG requirements, which demands a comprehensive integration of these practices into corporate strategy.

In addition to establishing governance guidelines, directors and executives are implementing concrete ESG initiatives within their organisations, which include:

- the formation of sustainability committees;
- the production of environmental and social impact reports; and
- the promotion of diversity and inclusion efforts.

Such practices not only enhance the company's reputation but can also yield significant financial benefits, including reduced operational costs and the attraction of investors committed to sustainability.

Furthermore, companies are linking ESG goals to performance evaluations for leadership, which can create incentives for senior management to commit to human rights, environmental preservation and fostering an organisational culture that embraces diversity.

However, the journey towards integrating ESG practices is not without challenges. Leaders must navigate issues such as resistance to change, lack of human, material, and financial resources, and the complexity of measuring outcomes.

2.4 Social Enterprises

Impact Businesses in Brazil

In Brazil, there is no specific legal framework for "social enterprises." However, the concept that most closely aligns with this notion is that of "impact businesses," initially regulated by Decree No 9,977/2019, which has recently been repealed and replaced by Decree No 11,646/2023. These enterprises aim to generate positive socio-environmental impacts alongside sustainable financial results.

These ventures are intended to facilitate the regeneration, restoration and renewal of natural resources while promoting the inclusion of communities, thereby contributing to an inclusive, equitable and regenerative economic system.

The Decree does not specify the corporate structure that impact businesses must adopt, thus they may be organised under traditional corporate law frameworks.

Third-Sector Entities

Non-profit organisations are part of Brazil's third sector, operating in areas of public interest such as education, health, culture, environment and the promotion of human rights. The most common legal structures for these organisations include associations, foundations, non-governmental organisations and civil society organisations of public interest.

2.5 Shareholders

Traditionally, the obligation to uphold shareholder's fiduciary duties is associated with the notion that investment decisions and business strategies should focus on maximising financial returns. In parallel, there is a growing trend to integrate ESG criteria into business strategies and investment decisions, recognising that such practices can result in long-term sustainability and positive impact, even if they do not yield short-term financial benefits.

This shift has raised questions about whether fiduciary duties require shareholders to prioritise short-term profitability, potentially hindering the broader adoption of the ESG agenda within corporate environments. In Brazil, investment in ESG criteria is often associated with risk mitigation and enhanced reputation, which can lead to long-term gains. In this context, the adoption of standards such as the IFRS S1 and S2 provides investors with greater transparency and assists officers and managers in their decision-making processes.

3. Sustainable Finance

3.1 Progress in Green Financing

The Brazilian public sector has adopted broad commitments to promote sustainable finance through joint actions among agencies and specific regulations.

- In August 2024, the federal government launched the Ecological Transition Plan, which aims to promote ecological transformation through an integrated commitment among the executive, legislative and judicial branches. The Plan is structured around six pillars, including one dedicated to sustainable finance, and employs various financial and regulatory instruments.
- CVM approved its Sustainable Finance Policy (CVM Ordinance No 10/2023) in January 2023, aimed at strengthening the roles, consolidation, organisation and structuring of sustainable finance efforts within CVM, while also enhancing the disclosure and communication of activity results. In October of the same year, CVM launched the Sustainable Finance Action Plan for 2023-2024, which includes 17 initiatives designed to promote sustainable finance in alignment with the UN SDGs.

There are also relevant Bills of Law being discussed in the Brazilian Congress relating to sustainable finance:

- Bill of Law No 182/2024, which aims to regulate the carbon credit market;
- Bill of Law No 460/2024, which aims to create a specific fixed-income bond to raise funds for financing environmental service projects; and
- Bill of Law No 735/2022, which aims to create the Green Investment Seal for companies.

3.2 Sustainable Finance Framework

Apart from general laws and regulations concerning regular financing, issuance and emissions in the Brazilian legal framework, the most widely used guideline for raising and providing finance is the Green Bond Principles (GBP), issued by the International Capital Market Association. B3, the Brazilian stock exchange and CVM apply the definitions of green, social, sustainability and sustainability-linked bonds using the same taxonomy employed internationally.

Moreover, in 2023, the federal government issued the Brazilian Framework for Sustainable Sovereign Bonds, aimed at establishing guidelines for the issuance of green, social and/or sustainable public bonds in the international market.

Earlier, in 2021, the National Bank for Economic and Social Development (BNDES, by its acronym in Portuguese) launched the Sustainability Bond Framework, a document that allows for the issuance of green, social and sustainable bonds by BNDES.

The Brazilian Association of Financial and Capital Markets Entities (ANBIMA, by its acronym in Portuguese) has issued a "Guide for Sustainable Bond Offerings: Best Practices for Issuing and Public Offering of Fixed-Income Securities Related to Sustainable Finance", which is also a good source for companies considering raising and providing financing.

3.3 Access to Green Financing

Access to sustainable finance in Brazil has improved significantly in recent years, although it still presents some challenges.

Growing Market and Enhancement of the Regulatory Framework

There is an increasing interest in sustainable finance, driven by both domestic and international investors looking for environmentally and socially responsible investment opportunities. In parallel, regulations such as CVM Resolutions No 59 and No 193 foster transparency in ESG reporting, making it easier for investors to assess the sustainability practices of companies.

Green Bonds

Moreover, in the past years Brazil has seen a rise in the issuance of green bonds, which provide funding for projects with positive environmental impacts. The Green Financial Letter (LFV, by its acronym in Portuguese) is a type of security issued by financial institutions (such as banks and credit co-operatives) aimed at raising long-term funds. In return, it offers investors more attractive returns due to the longer duration and the lack of early redemption options. The funds raised through LFVs are specifically allocated to "green" investments, which are related to environmental or social issues.

In October 2020, BNDES issued BRL1 billion in LFVs, becoming the first institution to do so in Brazil. The proceeds from this issuance were directed towards investments in wind and solar energy, specifically in the Cutia and Bento Miguel Wind Complex, located in the state of Rio Grande do Norte, and in the Paracatu Solar Complex, in the state of Minas Gerais.

Social Bonds

In January 2022, Banco do Brasil (BB) issued social bonds amounting to BRL500 million, with the proceeds allocated to financing social projects in areas such as affordable housing and small and medium enterprises. In April 2023 and March 2024, BB issued sustainability bonds, each worth BRL750 million, aimed at promoting sustainable economic activities, both socially and environmentally, such as supporting renewable energy usage and providing credit for women-led small and medium enterprises.

3.4 Stranded Assets and Non-bankables

One concern regarding an inclusive and just transition to ESG in Brazil include the significant participation of the agribusiness sector in the economy (24% of GDP), which is responsible for approximately 75% of Brazil's gross greenhouse gas emissions in 2023. The energy matrix is diversified and includes various renewable sources (such as hydropower, wind, biomass and solar); however, a significant portion still relies on fossil fuels, primarily oil and natural gas.

Moreover, in the oil and gas industry, the just transition to ESG shall address the concern that a significant portion of the Brazilian population potentially might not have access to renewable energy sources. This means that not only Brazil needs to invest in reducing emissions, but also ensure that the entire population would be able to benefit from new energy sources.

3.5 Challenges Ahead

Among the challenges in sustainable finance in the coming years, the following are worth highlighting.

- Risks of greenwashing and greenbleaching caused by the misleading presentation of companies as environmentally responsible, through false advertising, use of fake sustainability certifications, and insufficient disclosure of information about their environmental practices.
- Challenges for small and medium-sized businesses to report ESG-related information and to comply with requirements in sustainable financing operations.
- Resistance by less sustainable sectors, such as mining, oil and gas and agriculture and livestock, to adhere to sustainability practices. For instance, Brazil is home to the Agribusiness Parliamentary Front, a ruralist collective of congressmen and senators who advocate for the interests of agribusiness development, which may lead to legislative and regulatory initiatives that prioritise short-term gains over sustainability.

4. ESG Due Diligence

4.1 Soft Law Becoming Hard Law

The Shift Towards Human Rights Due Diligence

In recent years, Brazil has experienced a movement to strengthen legislation on due diligence related to ESG, particularly concerning human rights violations. For instance, in 2023 Federal Decree No 11,772/2023 established an Interministerial Working Group led by the Ministry of Human Rights tasked with drafting the proposal for the National Policy on Human Rights and Business. Among the Group's responsibilities is the formulation of measures and actions to develop business policies in alignment with national and international standards, including strengthening legislation on ESG due diligence.

Another significant development is Bill of Law No 572/2022 ("Bill No 572/22"), which is currently being discussed in the Brazilian House of Representatives. If approved, companies that are domiciled or economically active in Brazil may be required to conduct human rights due diligence. The Bill aims to establish a National Framework on Human Rights and Business in Brazil, providing guidelines for the application of national and international standards and norms to protect human rights.

4.2 Towards Vertical Responsibilities

To date, there is no specific legislation in Brazil requiring human rights due diligence in supply chains. However, the current text of Bill No

572/22 establishes that companies domiciled in or economically active within Brazil are responsible for human rights violations directly or indirectly caused by their activities. Liability for such violations will be joint and extend throughout the entire production chain, including Brazilian economic and financial entities that invest in or benefit from any stage of the production process.

In addition, based on the existing Brazilian legislation, companies may be held subsidiarily liable for ESG-related violations. For example, employers may be held liable in labour courts if third-party companies are involved in labour rights violations. This includes responsibility for unpaid overtime and moral damages in cases of harassment and/or discrimination.

On 22 February 2023, a joint operation by the Ministry of Labour and Employment, the Labour Prosecutor's Office and the Federal Police rescued approximately 200 workers subject to modern slavery at wineries in the state of Rio Grande do Sul. Recent labour court decisions have indicated that both the contracted companies and the winery receiving the services are liable to compensate one of the rescued workers for moral damages.

4.3 Partner Selection

Considering the evolving legislation, companies with operations in Brazil have been implementing human rights internal policies and procedures and requiring their suppliers to comply with them in their own operations and activities. Some companies also provide training for, and more mature companies may even finance the implementation of these guidelines by these suppliers. While this is not yet a legal requirement, the market practices suggest a growing trend where Brazilian companies will increasingly choose their business partners based on ESG criteria, driven by self-interest, by contractual obligations, and eventually by legal requirements. For instance, some Brazilian companies do business with companies located in the European Union and may be affected by the EU Corporate Sustainability Due Diligence Directive (CSDDD), and thus be required to conduct ESG due diligence when selecting suppliers.

4.4 ESG in M&A Due Diligence

"E" in Merges and Acquisitions

In many ways, ESG matters have long played important roles in mergers and acquisitions in Brazil, particularly concerning environmental issues. Compliance with environmental regulations and licensing, as well as a thorough analysis of any ongoing or potential environmental litigation involving target companies, have always been a part of issues analysed in pre-acquisition due diligence. These factors can create liability risks and directly impact deal pricing, which is also why they are typically addressed in robust representations and warranties clauses in the agreements formalising the deals.

The Growing Role of the "G" in Merges and Acquisitions

Matters relating to corporate governance have also played an increasingly important role in mergers and acquisitions in Brazil in the past ten to fifteen years. Due to the enaction of anti-corruption legislation and regulations that provide for successor's liability for wrongdoings committed by an acquired entity, investors and shareholders have shifted to focusing on structuring deals with companies with robust governance structures.

The Expectations Towards the "S" Are Developing An Important Role in Merges and Acquisitions

Even though Brazil currently does not have legal mechanisms to require companies to consider concrete social aspects in merges and acquisitions, there are relevant discussions in the legislative branch to establish guidelines for corporate responsibility in relation to human rights, as mentioned at **4.1 Soft Law Becoming Hard Law**.

Moreover, EU companies which are subject to the CSDDD and use acquisitions as a means of expanding their operations in Brazil shall evaluate the sustainability-related risks associated with their acquisitions. This could directly impact Brazilian companies with whom they do business.

5. Transparency and Reporting

5.1 Key Requirements

In Brazil, the following categories of companies are required to disclose ESG-related information, consolidated in sustainability reports, integrated reports or through other means.

- Federal Law No 13.303/2016: requires public companies and mixed-capital companies to observe transparency requirements. Article 8, item XI, requires the annual disclosure of an integrated or sustainability report.
- Resolution No 139/2021 and Normative Instruction 153/2021 of the Central Bank of Brazil: regulates the annual preparation of a Report on Social, Environmental, and Climate Risks and Opportunities by financial institutions, based on the Task Force on Climate-Related Financial Disclosures (TCFD).
- Superintendence of Private Insurance (SUSEP, by its acronym in Portuguese) Ordinance No 666/2022: outlines sustainability requirements to be observed by insurance companies, open pension entities, capitalisation companies, and local reinsurers. Among the provisions of the circular, Article 15 requires companies supervised by SUSEP to annually disclose a sustainability report.
- Resolutions No 59 and 193 by CVM: in December 2021, CVM published Resolution No 59, which required publicly traded companies to indicate in their CVM reference forms data on corporate governance, human rights and the environment. In October 2023, CVM published Resolution No 193, which requires the disclosure by public companies, investment funds, and securitisation companies of a report on financial information related to sustainability, based on the international standard issued by the International Sustainability Standards Board (ISSB), starting in 2027 (for the 2026 fiscal year). This Resolution positions Brazil as the first country in the world to adopt the ISSB's report on financial information related to sustainability.

Furthermore, Bill of Law No 412/2022 aims to regulate the carbon market in Brazil and may require companies with emissions exceeding 10,000 tons of CO_2 per year to submit a report on emissions and removals of greenhouse gases. The Bill passed in the Federal Senate in October 2023 and is currently awaiting review by the House of Representatives.

5.2 Transition Plans and ESG Targets

According to CVM Resolution No 193, reporting must be conducted in accordance with the guidelines of the IFRS S1 "General Requirements for Disclosure of Sustainability-related Financial Information" and IFRS S2 "Climate-related Disclosures" issued by the ISSB. Specifically, the latter recommends disclosing information on:

- climate transition plans companies may have, action plans to achieve them, and their associated risks; and
- the strategies defined to achieve the proposed climate targets.

As mentioned in **5.1 Key Requirements**, the adoption of ISSB standards by publicly traded companies, investment funds and securitisation companies is voluntary starting in 2025 and will become mandatory starting in 2027. The period of voluntary reporting is being used by CVM to analyse the need for adjustments in the regulations. Organisations that choose to adopt voluntary reporting are required to disclose the fiscal year in which they will begin to comply with the standards.

5.3 Regulation of ESG Labels

The main programme for the certification of sustainably sourced products and services is the Green Seal Brazil Program, established by the federal government in June 2024, through Federal Decree No 12,063/2024. The programme aims to develop a national strategy for the certification and compliance assessment of Brazilian products and services that demonstrably have a social and environmentally responsible lifecycle.

Regulation by the Ministry of Development, Industry, Commerce, and Services will establish the programme's management and advisory committees, which will be responsible for:

- facilitating dialogue between the public and private sectors to jointly build initiatives;
- developing guidelines; and
- establishing priority products and services for certification.

The expectation is that the first standards will be published by the first half of 2025.

5.4 Supervision

As mentioned above (see **5.1 Key Requirements**), the main regulators monitoring the reporting of ESG-related information in Brazil are the CVM, the Central Bank of Brazil and SUSEP.

With the establishment of the Green Seal Brazil Program, new entities responsible for monitoring ESG matters will be appointed. Article 5 of Federal Decree No 12,063/2024 states that the seal will be granted by assessment bodies accredited by the National Institute of Metrology, Quality and Technology (INMETRO, by its acronym in Portuguese) to those products and services that demonstrably meet the sustainability requirements defined in Brazilian technical standards issued under the Green Seal Program.

5.5 Enforcement

The penalties for companies that fail to comply with ESG reporting obligations and fail to submit sustainability reports can vary depending on the applicable regulations and the sector in which the company operates.

In the case of the Central Bank of Brazil, which supervises and enforces penalties for financial institutions, the types of penalties vary based on the economic capacity of the offender and the degree of reprehensibility of the conduct. The following penalties may be applied:

- fines;
- disqualification or prohibition from exercising certain activities; and
- in very serious cases, revocation of the authorisation to operate.

Additionally, publicly traded companies, investment funds and securitisation companies may face administrative fines imposed by CVM for non-compliance with Resolution No 59 and, starting in 2027, for non-compliance with Resolution No 193. Article 11 of Law No 6,385/1976, which regulates the capital markets in Brazil, specifies the penalties applicable by CVM, which can range from fines and warnings to the suspension of trading of the shares of the supervised companies, depending on the severity of the non-compliance.

5.6 Expected Progress

In the coming years, Brazilian companies are expected to make significant progress regarding ESG reporting obligations, driven by local regulations and demands from other jurisdictions with which Brazilian companies maintain trade relationships. Some of these include the following.

- The aforementioned regulations indicate that Brazilian companies must adopt international ESG reporting standards, such as those from the ISSB, the Sustainability Accounting Standards Board (SASB), the Global Reporting Initiative (GRI), and the recommendations from the TCFD. As a result of adopting these standards, the trend is toward greater transparency in companies' ESG practices, as they seek to meet stakeholder expectations.
- The integration of ESG topics into business strategies, a movement that is already present in companies that go beyond mere regulatory compliance.
- Training and qualification of professionals, particularly within compliance and sustainability teams, as well as investment in third-party specialists for ESG information reporting.

The following challenges should be highlighted:

- the need for investment to implement sustainable practices;
- the complexity of data collection and standardisation;
- the need to revise budgets to implement efficient ESG information collection systems;
- increasing regulatory pressure; and
- the risks of greenwashing arising from the growing regulatory pressure.

6. Climate and ESG Litigation

6.1 Instruments for ESG Litigation

In Brazil, there are several mechanisms available to private parties and enforcement authorities to initiate ESG-related cases against companies, which vary depending on the nature of the case and the type of offence. Below are a few common examples.

- Complaints to CVM: when irregularities occur involving publicly traded companies that may impact investors or the financial market, particularly regarding ESG information disclosure, as stipulated in CVM Resolution No 193.
- Environmental criminal actions: this is the sole basis for corporate criminal liability in Brazil. The Public Prosecutor's Office may pursue cases under the Environmental Crimes Law. Entities convicted of environmental crimes are typically subject to severe fines.
- Popular actions: any citizen has the right to file a lawsuit to challenge administrative acts that infringe upon public assets, environmental integrity or administrative morality.
- Public civil actions: these civil actions fall under the jurisdiction of the Public Prosecutor's Office and aim to protect the environment, consumer rights and other collective interests.
- Complaints to the National Consumer Protection Agency and to the National Council for Advertising Self-Regulation: these are appro-

priate for addressing advertising practices that violate consumer rights or involve misleading claims, such as greenwashing.
- Labour-related lawsuits: employees may file lawsuits in labour courts against employers in case of violation of labour rights and harassment. Depending on the severity of the offence, they may also give rise to criminal liability.

6.2 Climate Activism

In Brazil, NGOs and activists play an important role in the ESG landscape, particularly regarding environmental issues and social justice. They often lead oversight efforts, report violations and advocate for fairer and more sustainable public policies.

Environment and Climate Activism

Organisations such as WWF, the Socioenvironmental Institute (ISA, by its acronym in Portuguese), and Greenpeace are actively engaged in campaigns against deforestation, climate change and biodiversity conservation. These groups are well-known for their advocacy, monitoring and awareness-raising initiatives.

Additionally, local and regional NGOs are essential in promoting climate justice, including the Mapinguari Institute, Rede Jandyras, Engajamundo and Resama.

Indigenous, Quilombola and Other Vulnerable Communities

Social movements such as Casa Fluminense, COIAB (Coordination of Indigenous Organizations of the Brazilian Amazon, by its acronym in Portuguese), and CONAQ (National Coordination of Articulation of Quilombola Rural Black Communities, by its acronym in Portuguese) also play a vital role. These entities advocate for the rights of vulnerable populations, such as Indigenous and Quilombola communities ("Quilombolas" is the Portuguese term for members of communities in Brazil that are descendants of escaped enslaved people), and are key to advancing ESG agendas.

Moreover, Brazil is home to internationally recognised activists such as Alice Pataxó, Alessandra Korap and Samela Sateré, all of whom champion Indigenous and environmental causes. They serve as important voices in the fight against environmental and social violations perpetrated by large corporations.

6.3 Greenwashing v Greenbleaching

Enforcement Actions Against Irregularities in the Carbon Credit Market

In 2024, the Brazilian Federal Police launched "Operation Greenwashing" to investigate the illegal sale of carbon credits of illegal projects in the state of Amazonas. This operation dismantled a criminal organisation suspected of selling approximately BRL180 million in carbon credits from illegally occupied areas.

Moreover, in 2023, the State of Pará's Public Defender's Office filed civil lawsuits against a group of companies from Brazil, Canada, USA and the UK that allegedly irregularly sold carbon credits to large Brazilian and foreign companies. The carbon credits were certified by the largest certifier in the voluntary carbon credit market and were validated by third-party auditors. These cases represent examples of the increasing involvement of authorities in identifying and combating greenwashing practices, especially in the carbon credit market, given Brazil's potential in this market.

Increase in Scrutiny by Advertising Regulators

Another example of regulators taking action against misleading ESG information involved an advertising campaign. A well-known matchstick company claimed that its products were made from "100% reforested" wood and included said information in the products' packaging. However, there was no official certification or any other available evidence to substantiate the advertisement. After receiving a complaint against the campaign, the National Council for Advertising Self-Regulation (CONAR, by its acronym in Portuguese) required the company to remove this information from its packaging, reinforcing the increased scrutiny on sustainability campaigns and reporting in general.

Investors Disbelief and Regulation on Sustainability Reports

Moreover, a survey conducted by PwC in 2024 found that 98% of investors believe there is greenwashing in the sustainability reports published by companies. This underscores the growing vigilance among investors, who are carefully assessing the disclosed ESG information. CVM's new regulations demanding the adoption of international standards in sustainability reports are a first step towards combating greenwashing in these reports.

These cases indicate that while Brazil is still maturing in its approach to hold companies liable for greenwashing, there is a rising demand for greater transparency in ESG practices from both investors and regulatory bodies.

6.4 A Turbulent Future Ahead

Although Brazil has adopted significant measures to include ESG matters in governmental agendas, it still has a long path towards incorporating ESG-related principles in business strategies and in the public agenda. In this context, it is likely that the number of ESG-related lawsuits will increase as international pressure and investor demands grow. With the rising global awareness of environmental, social and governance issues, Brazilian companies and regulatory bodies will face stricter requirements to implement transparent and sustainable practices.

Examples of this shift include:

- the Central Bank's new sustainability agenda, which prioritises the management of environmental and climate risks;
- the 2023 CVM Resolution, which requires the disclosure by public companies, investment funds and securitisation companies of a report on financial information related to sustainability, based on the international standard issued by the ISSB, starting in 2027 (for the 2026 fiscal year); and
- the classification of "green actions" by B3, which highlights companies' alignment with the green economy.

These initiatives indicate a movement towards greater transparency and corporate accountability in Brazil.

Trends and Developments

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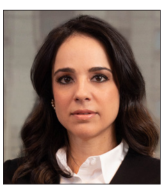

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Human Rights Due Diligence as a Framework for Implementing Responsible Business Practices: Key Guidelines and Challenges in Brazil

Introduction

The roles and responsibilities of companies in protecting human rights have increasingly been a topic of international debate. Companies are now required to implement mechanisms and processes to identify, prevent and mitigate risks related to negative impacts on human rights. In this context, human rights due diligence (HRDD) emerged as a tool to provide visibility to companies (and their stakeholders) regarding human rights-related risks of their operations and supply chains, allowing for the identification of gaps and the implementation of prevention and mitigation mechanisms to address those risks.

In Brazil, Bill of Law No 572/2022 ("Bill 572/22"), which is currently being discussed in the House of Representatives, establishes that HRDD shall be mandatory for companies domiciled or economically active in Brazil. Article 7 of Bill 572/22 sets forth that HRDD must "identify, prevent, monitor, and remediate human rights violations, including social, labor, and environmental rights" (Article 7, caput) and shall, at least:

- "encompass those [violations] that the company may cause or contribute to, through its own activities, or that are directly related to its activities and operations, products, or services through its business relationships" (Article 7, item I); and
- be a continuous process, "recognizing that the risks of human rights violations may change over time as the company's activities and operations develop and its operational context evolves." (Article 7, item II).

Bill 572/22 will establish the National Framework on Human Rights and Businesses in Brazil and will provide guidelines for the application of national and international human rights protection standards and for implementation of public policies.

This article explores the guidelines and challenges for conducting HRDD in Brazil, highlighting its importance as a fundamental step towards promoting a more responsible business environment.

Why should companies conduct HRDD in their own operations?

HRDD is one of the tools available for companies to identify, prevent and mitigate risks related to human rights, as well as to provide information to their stakeholders on how identified impacts and risks are addressed.

Conducting a HRDD may result in significant benefits. For the company, understanding and addressing its human rights-related risks can:

- maximise positive contributions to society;
- improve relationships with stakeholders;
- protect its reputation;
- ensure compliance with legal obligations; and
- add greater value to the business.

It also enables companies to identify risks associated with suppliers and business partners, which can significantly impact access to important foreign markets, such as the United States.

Moreover, identifying human rights risks allows for the implementation of preventive and mitigative actions aimed at fostering a safer, healthier, more diverse and inclusive work environment. This can promote talent retention and lead to lower rates of turnover, harassment and discrimination. In addition, studies indicate that companies that focus on diversity and inclusion and maintain a good relationship with employees can reduce litigation.

Lasty, Bill 572/22 sets forth that companies may be held liable for human rights violations caused directly or indirectly by their activities (Article 5, caput). In cases of indirect violations, Bill 572/22 provides for joint liability throughout the entire production chain (Article 5, paragraph 1) and requires companies to implement "control, prevention, and remediation mechanisms capable of identifying and preventing human rights violations (...)" (Article 5, paragraph 2).

How should companies conduct HRDD?

In Brazil, there is no law or regulation outlining the methodology or the criteria to be adopted in a HRDD. As mentioned before, this is a relatively new topic, and legislators are still discussing the framework that will be enforced in the country. Nonetheless, many companies have begun to conduct HRDD, whether voluntarily or as a result of demands from business partners who are more mature in human rights-related topics.

Conducting HRDD requires hiring specialists with the appropriate skills and qualifications to independently assess:

- what the company has already put in place to comply with applicable laws and respect internationally recognised human rights;
- whether the company has adequate mechanisms in place to prevent, mitigate, monitor and remedy negative impacts on human rights and specific risks associated with its business practices; and
- what additional mechanisms and policies may be necessary for managing and mitigating human rights-related risks and negative impacts.

The scope can be defined in stages. First, it is important for companies to focus on their own activities and operations, prior to assessing their supply chain. Also, depending on the size of the company, it is not necessary to conduct HRDD on all activities and operations at once. Similar to the management of other types of risks, the company may take a risk-based approach to managing human rights-related risks, where preliminary findings guide the subsequent activities to be undertaken, in a highly dynamic process. Being able to differentiate between what is urgent and requires immediate action and what requires further reflection for implementation in the medium or long term makes the process more sustainable.

In the authors' experience, the United Nations Guiding Principles on Business and Human Rights and the methodology, outlined in the Organisation for Economic Co-operation and Development Due Diligence Guidance for Responsible Business Conduct (the "OECD Guidance"), can serve as a basis for conducting HRDD.

The OECD Guidance recommends that the assessment should be proportional to the risk and tailored to the company's specific circumstances and context. It outlines measures to:

- embed responsible business conduct into the company's policies and management systems;
- undertake due diligence by (i) identifying actual or potential adverse impacts associated with the company's operations, products or services; (ii) ceasing, preventing or mitigating them; (iii) tracking implementation and

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results; (iv) communicating how impacts are addressed; and
- enable remediation when appropriate.

What should companies evaluate when conducting HRDD?

The issues assessed in a HRDD vary based on the sector and location of the company, its size, and the quantity and profile of its suppliers.

For companies operating in Brazil, in addition to specific issues related to the applicable legislation, when conducting a HRDD, companies should also consider the socioeconomic characteristics of the region where they operate, considering the country's continental dimensions and the cultural and socioeconomic differences among regions.

This is a comprehensive and complex activity that requires a deep dive into the specifics of the company's operations, its relationships with employees and other stakeholders, and how the company and its third parties interact with communities or affect them.

Moreover, in a HRDD it is essential to assess whether the company has a specific channel for receiving complaints (hotline) and whether this channel:

- is widely communicated to employees, third parties and other stakeholders;
- is offered through accessible means; and
- is effectively used for reporting human rights-related issues.

In this regard, it is important to analyse the channel's statistics, including the content, handling and resolution of human rights-related complaints, as well as the existence and effectiveness of any training provided to employees and other stakeholders on human rights issues.

Below are some examples of topics that, based on the authors' experience, can be analysed in the context of HRDD.

Labour practices

HRDD should facilitate a deep understanding of the conditions to which workers are subjected to and overall compliance with applicable labour laws. Depending on the industry in which the company operates, HRDD should also take into account specific local regulations established in legislation for workers engaged in certain activities, in addition to general labour laws, such as in Brazil, Federal Law No 5,811/1972, which governs the regime for employees in activities related to oil and gas, and Federal Law No 5,889/1973, which regulates labour relations in rural areas.

Health, well-being and workplace safety

Healthy and safe working conditions are recognised in the Brazilian Consolidation of Labor Laws and are stipulated by the International Labour Organization Convention (ILO) as a human right. They are also one of the United Nations Sustainable Development Goals.

Brazilian labour legislation establishes obligations, rights and duties for employees and employers aimed at ensuring safe and healthy work conditions to prevent occupational diseases and accidents. Definitions regarding health and safety in the workplace have consistently evolved. Beyond the requirements related to the use of personal protective equipment, safety trainings and inspection procedures, issues related to mental health, have also come to be regarded as topics that employers must pay attention to. In this sense, it is important to explore in a HRDD the programmes and policies in place – or the possible absence of such policies – aimed at the well-being and health (in a broad sense) of employees and third parties. Companies operating in high-risk environments, dangerous work, or assigning people to hazardous areas or job sites bear a greater burden in implementing these programmes and policies.

Equality of opportunities, prevention of discrimination and harassment, and promotion of diversity, equity and inclusion

Beyond its potential positive impact on profitability, promoting diversity also contributes to creating a more inclusive and respectful workplace environment, enhancing employees' sense of belonging, psychological safety, and inspiration. Furthermore, companies that prioritise maintaining harassment-free and discrimination-free environments tend to have higher productivity rates and lower absenteeism and turnover rates.

Thus, in conducting HRDD, it is important to assess the percentage of employees who meet diversity criteria related to race, ethnicity, national origin, gender, age, marital status and family situation across different hierarchical levels of the company. This assessment enables the company to implement actions to promote diversity at all levels.

In Brazil, there are various laws and regulations addressing:

- equality of opportunities without distinction based on gender, race, colour, ethnicity, national origin, marital status, family situation or age;
- the prevention of discrimination and harassment; and
- the promotion of diversity and inclusion.

Among these, it is worth highlighting the following.

- Federal Law No 7,716/1989: defines as crimes actions involving discrimination or prejudice based on race, colour, ethnicity, religion or national origin in Brazil, and prohibits the denial of access to positions or employment due to racial discrimination.
- Federal Law No 9,029/1995: forbids discriminatory practices in labour relations and forbids the adoption of exclusionary criteria for hiring, retention or termination of workers based on personal characteristics.
- Federal Law No 14,457/2022: created the "Employ More Women" programme, aimed at promoting the inclusion and retention of women in the workplace, combating violence and discrimination, promoting gender equity in the workplace, and encouraging fatherhood in early childhood. An important measure introduced by Federal Law No 14,457/2022 is the obligation for companies with Internal Commissions for Accident and Harassment Prevention to adopt preventive and combative measures against sexual harassment and other forms of violence, as well as to conduct training, guidance and awareness-raising activities on violence, harassment, equality and diversity for all employees.
- Federal Decree No 11,430/2023: regulates Federal Law No 14,133/2021 (the Public Procurement Law) and sets forth the requirement for a minimum percentage of the workforce composed of women who are victims of domestic violence in public contracts. Additionally, it introduces the development of actions promoting equity between women and men in the workplace as a tie-breaking criterion in federal public procurement bids.

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- Federal Law No 14,611/2023, Federal Decree No 11,795/2023 and Ministry of Labor and Employment Ordinance No 3,714/2023: govern salary equality and remuneration criteria for men and women. They jointly require private companies with 100 or more employees to submit a Semiannual Salary Transparency and Remuneration Criteria Report, under penalty of fines. The obligation for transparency of these data reinforces the need for salary equality and remuneration criteria in a context where women earn, on average, 20.4% less than men, with the disparity for Black women being 39.2%, according to a research study published by the Brazilian Senate in 2024.

Modern slavery

According to the Amnesty International report "The State of Human Rights in the World", in 2023, Brazil's National Human Rights Ombudsman received reports of 3,422 cases of slavery, 3,925 cases of labour exploitation and 1,443 human rights violations.

Companies play a central role in combating modern slavery not only in their operations but also in managing their supply chains. In this regard, HRDD should encompass:

- an analysis of working hours of employees and third parties;
- whether the location and conditions in which employees and third parties work are appropriate; and
- whether employees and third parties are being adequately compensated.

Some reference sources can also be useful in mapping risks related to modern slavery, especially in third-party management. For example, in Brazil, the Ministry of Labor and Employment updates the List of Employers who have subjected workers to slavery on a semiannual basis (a document known as the "Dirty List"). The purpose of the List is to provide transparency to the enforcement efforts to combat modern slavery. The List was last updated in October 2024 and included 176 employers. Joint Ordinance No 18/2024 by the Ministries of Labor and Employment; Human Rights; and Racial Equality allows employers included in the List to enter into plea agreements to mitigate their blacklisting status, provided that they conduct HRDD in their supply chains.

Freedom of association and collective bargaining

Freedom of association and collective bargaining are fundamental rights enshrined in Article 8 of the Brazilian Federal Constitution and in ILO Conventions No 154 and No 98, which have been ratified in Brazil. The Consolidation of Brazilian Labor Laws also establishes penalties for employers who prevent their employees from joining unions or exercising the rights of union members, and it prohibits hindering the functions of employees elected to union administration or professional representation positions.

When conducting HRDD, it is necessary to assess whether these rights are guaranteed to workers and whether the company provides the necessary means for the exercise of these rights.

Impact of operations on stakeholders: local communities, indigenous peoples, children and teenagers

Assessing the impact of companies' operations on their stakeholders is crucial to ensure a responsible approach to human rights. Local communities and indigenous peoples often face consequences from business activities, which can include environmental degradation, violations of cultural rights, child labour and the need for resettlement. Therefore, it is essential for companies not only to identify these impacts but also to actively engage with these groups to understand their concerns and needs prior to implementing mitigation measures. In other words, it is important to give a voice to these communities and create spaces to listen to them.

Assessing the impacts of operations on this type of stakeholder involves a series of activities, such as conducting interviews with representatives of local communities, and engaging with associations, professional entities and other organisations related to local communities.

As mentioned previously, the accessibility and the effectiveness of the hotline is crucial when assessing the impact of a company's operations on stakeholders. For instance, the HRDD should investigate whether the access methods to the hotline are appropriate for the realities of those communities (eg, if the hotline can only be accessed online but the impacted communities have limited internet access, it is not easily accessible to them) and if the communities have been appropriately informed of the hotline and received appropriate training.

As a result of this process, investments in social responsibility initiatives can help mitigate negative impacts and promote active citizenship. By implementing programmes that address the needs of affected communities, companies not only fulfil their ethical obligations but also build relationships of trust and collaboration that can lead to mutual benefits.

Expanding the scope of the HRDD to the supply chain

As mentioned previously, the first step in implementing a human rights risk management process typically focuses on the company's own operations. As a second step, the expectation is that companies will turn their attention to their supply chains, spreading a responsible corporate culture regarding human rights among their business partners.

The logic behind conducting HRDD in the supply chain is similar to the approach taken in integrity matters and corporate anti-corruption efforts: companies that have responsible corporate cultures seek to associate only with partners who share the same values. Beyond reputational concerns, requiring partners to adhere to high standards of respect and protection for human rights mitigates risks throughout the supply chain and strengthens the protection of human rights on a larger scale.

In Brazil, this topic is gaining momentum with the progress of Bill 572/22. The proposal establishes that companies domiciled or economically active in Brazil may be held liable for human rights violations caused directly or indirectly by their activities, and that liability may extend throughout the supply chain. According to Article 5, paragraph 1, the following entities may be jointly liable: parent companies, controlled companies, public and private investors, branches, and subsidiaries, even without a formal contractual relationship. Therefore, it is important that HRDD in the supply chain be conducted not only prior to the hiring of third parties or the sale of goods or provision of services to clients but also periodically throughout the entire contract execution.

Conclusion

There are numerous challenges in implementing HRDD processes and routines. This is a relatively new topic in Brazil, and most companies are just beginning to take their first steps on this journey.

Based on the firm's experience in this type of work, the authors recognise that an important challenge lies in defining who should be responsible internally for co-ordinating these efforts, which will be multidisciplinary and involve various areas of the company. In many cases, these activities fall under the compliance department, which is also responsible for preventing, detecting and mitigating risks of other natures. There are also instances where the sustainability department may take the lead. Involving an external specialist can be a good way for the company to ensure independence and comprehensiveness of the HRDD. There is no one-size-fits-all solution, but it is crucial to allocate sufficient resources and personnel, as this is a complex and challenging task that must remain up to date with changes in the company's activities, the hiring of new suppliers, operational expansions, etc.

Another challenge is identifying priorities. In many cases, clients report difficulties in knowing where to start and feeling overwhelmed by the many tasks at hand. The truth is there's no secret: the important thing is to take the first step. From there, various prioritisation exercises can be conducted to make the challenge manageable, whether because a particular operation or line of business presents more risk than others, or because a group of suppliers has activities with greater potential for risk.

In terms of the supply chain, what the authors have observed is that companies with greater experience in managing human rights risks play an educational role. In some cases, they even finance the training and enhancement of their business partners' practices related to human rights, fostering a responsible corporate culture of respect for human rights in their supply chain.

Despite the challenges, HRDD is an effective tool for preventing, identifying and mitigating the risks of negative impacts on human rights from business activities. As detailed throughout this article, even though there is currently no legal requirement in Brazil for conducting HRDD, employing this tool brings benefits to the company itself, its employees and third parties, the communities affected by business activities, and to investors and shareholders.

CANADA

Law and Practice

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Contents

McMillan LLP is a leading business law firm serving public, private and not-for-profit clients across key industries in Canada, the United States and internationally. With recognised expertise and acknowledged leadership in major business sectors, the firm provides solutions-oriented legal advice through its offices in Vancouver, Calgary, Toronto, Ottawa and Montréal. The team advises clients on key environmental, social and governance aspects of their business, from M&A in the clean energy space (and M&A opportunities driven by environmental considerations) to EDI and sustainable investment strategies. The firm believes in the importance of doing business differently and help its clients to understand not only the risks of environmental, social and governance inaction but the opportunities available for growth and differentiation.

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1. Introduction

1.1 General ESG Trends

Key ESG Developments in 2024

2024 continued the trends of hard law on ESG coming into force, more legal frameworks being developed and greater scrutiny on previously unregulated ESG-related disclosures.

Two significant ESG-related laws came into force in 2024. First, the passing of Bill C-59 amended the Competition Act, among other objectives, explicitly targeting greenwashing. Second, the Fighting Against Forced Labour and Child Labour in Supply Chains Act (the "Modern Slavery Act") implemented requirements for certain entities to report on their efforts to prevent and reduce the risk of child or forced labour in the entity's supply chain. These developments are delved into in the Trends and Developments article.

There continues to be development in voluntary reporting standards. On 13 March 2024, the Canadian Sustainability Standards Board (CSSB) released exposure drafts of its first Canadian Sustainability Disclosure Standards, comprised of the General Requirements for Disclosure of Sustainability-related Disclosure Standard (CSDS 1) and the Climate-related Disclosures (CSDS 2 and, together with CSDS1, the CSDS).

These standards are based on the International Sustainability Standards Board's (ISSB) International Financial Reporting Standards (IFRS) Sustainability Disclosure Standards, released on 26 June 2023, but updated for the Canadian context. This is discussed further in **3.1 Progress in Green Financing**.

Voluntary action by companies is also driving ESG developments in Canada. For example, companies are addressing board diversity in response to voting guidelines published by Institutional Shareholder Services (ISS) and Glass Lewis, who publish voting policies for security-holder meetings. For companies listed on the S&P/TSX Composite Index, ISS recommends voting against or withholding support from the chair of the nominating committee or the board of directors if no racially or ethnically diverse members are present and no formal commitment to add such diversity has been publicly disclosed. Glass Lewis generally recommends voting against the chair of the nominating committee if the board of a TSX listed company is not at least 30% gender diverse, or the entire nominating committee if there are no gender diverse directors. Changes adopted according to the ISS and Glass Lewis are done so on a voluntary basis.

ESG and Indigenous Communities

As part of the Canadian government's 2024 budget, the government provided details on the federal Indigenous Loan Guarantee Program (the "ILG Program"), which was first announced in the government's 2023 Fall Economic Statement. The federal government will provide up to CAD5 billion in loan guarantees to Indigenous communities as part of the ILG Program. This means that loans provided to Indigenous communities by financial institutions and other lenders will be guaranteed by the Canadian government, which will allow these communities to benefit from the government's AAA credit ratings and consequently receive lower interest rates than they may otherwise have received. This is intended to create economic opportunities and to support Indigenous communities in developing their own economic priorities.

Under the ILG Program, applicant eligibility would recognise Indigenous governments and their wholly owned subsidiaries. The ILG Program will also be sector-agnostic for natural resource and energy projects, which means that oil and gas and mining projects are eligible under the Program.

The federal government still must provide further details on the ILG Program. For example, when it will become effective, how long it will run for, its requirements and regulations, its specific rules, the term of the guarantees, and how exactly it will be administered. That said, this year's update shows a strong commitment by the government to provide increased opportunities for the economic development of Indigenous communities.

It is important to note that the ILG Program comes on the heels of various existing and proposed provincial Indigenous loan guarantee programmes, such as Ontario's Aboriginal Loan Guarantee Program, the Alberta Indigenous Opportunities Corporation, British Columbia's First Nations Equity Financing Framework, and the Saskatchewan Indigenous Investment Finance Corporation. Although there are important differences between these provincial programmes and the ILG Program, they show how Canada, both federally and provincially, is using equity loan guarantees as a tool for economic reconciliation with Indigenous communities.

AI Code

In 2023, Canada launched the Code of Conduct on the Responsible Development and Management of Advanced Generative AI Systems (the "AI Code") to achieve accountability, safety, fairness and equality, transparency, human oversight and monitoring, and validity and robustness in the development of AI. This is intended to help address risks associated with AI such as spreading bias, compromising health and safety, and crafting large-scale fraud. To mitigate these risks, companies (particularly developers and managers of AI systems) that sign the AI Code commit to working towards achieving the goals noted above by following measures to be undertaken pursuant to the AI Code, such as implementing a comprehensive risk management framework proportionate to the nature and risk profile of activities being undertaken, and implementing proportionate measures to mitigate risks of harm, such as by creating safeguards against malicious use. The AI Code is voluntary. As of 27 May 2024, 30 companies, including Lenovo, Mastercard, Blackberry and Telus, have signed the AI Code.

The AI Code is not the only governmental initiative to promote safe use and development of AI. The Artificial Intelligence and Data Act (AIDA) was proposed under Bill C-27 and is currently in consideration in committee in the House of Commons. AIDA has similar goals to those of the AI Code and, if passed, would codify AI regulation in Canada.

1.2 Environment Trends

There were developments in the E of ESG in a variety of areas, including regulation of plastics, clean electricity and the right to repair.

Plastic and "Forever Chemicals" Regulations

Plastic regulations

On 4 July 2024, the government of Canada launched a consultation process for its Draft Roadmap aimed at addressing plastic waste and pollution in the textile and apparel industry, which is the fifth largest contributor to plastic waste in the country. The Draft Roadmap seeks to develop solutions for managing plastic waste, enhancing recycling efforts, extending product life and reducing microfiber pollution. The consultation process, which concluded on 1 September 2024, aims to gather industry insights to inform government action, with the finalised roadmap expected by the end of the year.

Of note, the federal government already has a Federal Plastics Registry that mandates annual reporting on plastic production, importation, diversion and disposal, which, unlike the Draft Roadmap, applies to all plastic producers and is not limited to the textile sector.

Forever chemicals regulations

On 12 July 2024, the government of Canada announced new measures to address concerns about per- and polyfluoroalkyl substances (PFAS), commonly known as "forever chemicals," including the publication of the Updated Draft Report on the state of PFAS (the "Updated PFAS Report") and the Revised Risk Management Scope for PFAS (the "Revised Risk Management Report"). The Updated PFAS Report concluded that PFAS (excluding fluoropolymers) may cause harm to human health and the environment and proposed that all substances in the defined PFAS class (excluding fluoropolymers) meet the "toxic substance" criteria set out in Section 64 of the Canadian Environmental Protection Act (CEPA). Fluoropolymers would be moved to a "Watch List." A timeline for a final version of the Updated PFAS Report has not yet been set.

The Revised Risk Management Report sets out risk management options to address PFAS. It proposes a phased approach, beginning with restricting PFAS not currently regulated in firefighting foams. Next, the PFAS class would be recommended for addition to the List of Toxic Substances in Schedule 1 of CEPA, which would empower the federal government to create regulations that restrict the use, manufacture, import and release of the listed substances. Together with the Updated PFAS Report this constitutes a class-based approach to the regulation of PFAS that would apply to all substances within that class. This is different from the current federal regulation that regulates specific varieties of PFAS.

The federal government also requested mandatory survey under CEPA that requires certain manufacturers and importers to report their use of PFAS by 29 January 2025. The information gathered from the survey will be used to assess whether a substance is or can become toxic and how it should be controlled.

PFAS is currently regulated federally by the Prohibition of Certain Toxic Substances Regulations, 2012, under CEPA. These Regulations prohibit the manufacturing, use, sale and importation of some PFAS and their precursors. In 2022, the federal government proposed replacing the 2012 Regulations with the draft Prohibition of Certain Toxic Substances Regulations, 2022, which would remove existing PFAS exemptions for certain uses. The government of Canada is expected to publish a final version of this draft regulation in the autumn of 2024 that will significantly tighten the existing regulations.

PFAS is regulated both federally and provincially. Businesses are advised to be aware of both federal and provincial regulations impacting their operations related to PFAS, as these changes may heighten litigation risks and public scrutiny.

Clean Energy Regulations

The Clean Energy Regulations are a key component of Canada's 2030 Emissions Reduction Plan, aimed at achieving net-zero emissions by 2050. In February 2024, the government released an update (the "CER Update") based on stakeholder feedback, revising the Draft Clean Energy Regulations initially published in August 2023. The proposed changes aim to enhance flexibility for provinces and electricity providers while ensuring significant emission reductions. Key modifications include shifting from a fixed emissions intensity standard to an annual emissions limit tailored to each unit's capacity, introducing a new formula for calculating emission limits, allowing pooling of limits for operators with multiple units, and permitting limited excess emissions if offset by greenhouse gas credits. Additionally, the CER Update narrows exemptions for generating units with no net exports to the grid. How these changes will be implemented in the final Clean Energy Regulations is yet to be determined.

Right to Repair

In Budget 2024, the government of Canada committed to launch consultations on a right to repair (RTR) policy for home appliances and consumer electronics. The goal of this policy is to improve product durability and repairability so that devices work longer and harmful electronic waste is reduced. There is no specific RTR policy proposal yet because of the complex and interconnected nature of repairability and the vast array of consumer products and stakeholder considerations related to it. Instead, this consultation period is one part of a process to develop a fulsome federal approach to the RTR.

The federal government intends the RTR policy be based on the principles of repairability, interoperability and durability. While a specific RTR regulatory framework has yet to be developed, some legislative steps have already been taken to ensure Canadians have a RTR. The Copyright Act was amended to remove a barrier to repair by allowing the circumvention of technological protection measures to diagnose, maintain or repair a product. The Competition Act was also amended to expand the refusal to deal provisions to include a "right to repair," meaning a supplier may be ordered to provide a means of diagnosis or repair to a person.

The public consultation period on the RTR policy ended on 26 September 2024. Further consultation with representatives from consumer and industry stakeholders will take place this autumn. It is unclear when a complete RTR policy framework proposal will be presented, but it will likely take some time given the complex nature of RTR.

1.3 Social Trends

Modern Slavery Act

A key development in the social aspect of ESG stems from Bill S-211, which brought about the Modern Slavery Act and amends the Customs Tariff Act. Although the Bill received royal assent in 2023, its provisions took effect on 1 January 2024.

The Modern Slavery Act targets forced labour and child labour by mandating certain entities to report on the measures they are taking to prevent and mitigate the risks of forced and child labour in their supply chains.

Bill S-211, which introduced the Modern Slavery Act, also introduced changes to the Customs Tariff Act prohibiting the import of "goods that are mined, manufactured or produced wholly or in part by forced labour or child labour as those terms are defined in Section 2 of the [Modern Slavery Act]." This prohibition along with the reporting obligations imposed by the Modern Slavery Act show a concerted effort on the part of the Canadian government to address the persistent problem of forced and child labour in supply chains.

For a more in-depth discussion of the Modern Slavery Act, the takeaways from its first reporting period, the import prohibition and potential issues with Canada's approach to tackling modern slavery, please refer to our analysis of these matters in the Trends and Developments article.

Human Rights Due Diligence

In addition to the Modern Slavery Act, the federal government is considering developing human rights due diligence (HRDD) legislation. The intention to introduce such legislation was first announced in Budget 2023 and was reiterated in Budget 2024. The federal government is currently consulting on how to develop HRDD legislation.

Generally, HRDD legislation tackles human rights abuses by creating a legislative framework that requires business to take proactive steps to identify, prevent, mitigate and address their impacts on human rights. HRDD legislation usually only applies to entities that meet the legislative requirements in the relevant jurisdiction, but it can have trickle down effects as those entities request HRDD in contracts. Examples of this can be seen in increasingly common supply chain codes of conduct that require some HRDD.

Canada has not yet announced its timeline for HRDD legislation and what approach it intends to take.

Federal UNDRIP Action Plan

In 2023, the federal government launched the 2023-2028 Action Plan (the "Action Plan") to implement the United Nations Declaration of the Rights of Indigenous Peoples (UNDRIP). The Action Plan "outlines a whole government roadmap for advancing reconciliation with Indigenous Peoples through a renewed, nation-to-nation, government-to-government, and Inuit-Crown relationship based on recognition of rights, respect, cooperation, and partnership as the foundation for transformative change." Importantly, the plan is not a static document but must continue to develop in consultation with First Nations, Inuit and Métis.

Developed over two years of consultation with First Nations, Inuit, and Métis, the Action Plan outlines 181 measures organised into five chapters that address shared and specific priorities of Canada's Indigenous Peoples. The Action Plan stems from the UNDRIP Act, which mandates alignment of Canadian laws with UNDRIP and requires annual progress reports. The federal government is considering using a variety of new and existing mechanisms to achieve the priorities set out in the Action Plan, such as permanent bilateral mechanisms, national and regional committees to co-develop implementation plans, and possible federal-provincial-territorial-Indigenous fora.

The first of the annual reports, released on 18 June 2024, indicated that actions have been taken on 178 measures, with some funding allocated to 128 of them. However, many departments faced challenges due to limited funding.

How the federal government continues to collaborate with Indigenous communities to achieve the goals of the Action Plan remains to be seen. The annual progress reports are valuable documents that show what progress is being made and what roadblocks remain. Given the importance of Indigenous matters to ESG in the Canadian context, readers should review how the federal government is working towards reconciliation through the Action Plan and the annual progress reports.

1.4 Governance Trends

A key development in terms of governance started in 2022, when Corporations Canada updated requirements for businesses incorporated under the Canada Business Corporations Act (CBCA) to disclose information to shareholders and Corporations Canada on the diversity of their boards of directors and senior management teams. Corporations must specifically report on the four designated groups defined in the Employment Equity Act, which includes:

- women;
- Indigenous Peoples;
- persons with disabilities; and
- members of visible minorities.

The introduction of new guidelines around climate risk management published by the Office of the Superintendent of Financial Institutions (OSFI) enhance the governance aspect of ESG. As of 2024, Canadian banks, insurance companies and federally regulated financial institutions (FRFI) are required to disclose climate-related risks and opportunities. Board members are now also charged with ensuring that management's approach to climate-related risks is both precise and effective.

In addition to disclosure obligations already in place, the federal government announced on 9 October 2024 that it intends to amend the CBCA to mandate climate-related financial disclosure for large, federally incorporated private companies. A regulatory process will be launched to determine the substance of these disclosure requirements and the size of corporations that will be subject to them. The federal government is also considering ways to encourage small- and medium-sized businesses to voluntarily disclose climate-related information. It further indicated its readiness to work with provincial and territorial governments to ensure consistent disclosure obligations across Canada.

1.5 Government and Supervision

The ESG transition in Canada is propelled by all levels of government, as well as various regulatory bodies. The Canadian Securities Administrators (CSA) is the umbrella organisation of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonise regulation of the Canadian capital markets. To date, the CSA has been primarily responsible for the development of ESG regulations applicable to reporting issuers wishing to access the Canadian capital markets.

The CSA has established several regulations for reporting issuers related to ESG disclosures and practices, including:

- National Instrument 51-102, which mandates disclosure of environmental risks which are material to an issuer;
- National Instrument 52-110, which sets independence requirements for audit committees; and
- National Instrument 58-101, which requires disclosure of corporate governance practices, including diversity metrics.

The CSA has also previously published for comment proposed National Instrument 51-107 – Disclosure of Climate-related Matters (NI 51-107), which sets out a proposed framework for Canada's first mandatory climate-related disclosure rules. The CSA released a statement on 13 March 2024, indicating that the feedback provided to the CSSB in connection with the consultation on the CSDS may help inform potential revisions to NI 51-107 and the CSA reaffirmed its commitment to developing "disclosure requirements that support the assessment of material climate-related risks." It is expected that the CSA will publish a revised version of NI 51-107 for comment shortly after the review process is completed.

The CSA has also issued guidance to reporting issuers over the years regarding ESG disclosure obligations. This includes guidance on environmental reporting (CSA Staff Notice 51-333), climate-related risks (CSA Staff Notice 51-358), and on the concerns of overly promotional ESG disclosure (CSA Staff Notice 51-364). Importantly, the guidance provided by the CSA did not impose any new standards with respect to ESG disclosure but were published to clarify existing disclosure obligations of issuers in the context of a growing focus on ESG-related issues.

Further, in March 2024, the CSA released Revised ESG-Related Investment Fund Disclosure Staff Notice (originally published in January 2022), which sets out guidance for investment funds on disclosure practices as they relate to ESG. The guidance does not modify existing disclosure requirements, but sets out best practices regarding investment objectives, fund names, investment strategies, risk disclosure, continuous disclosure and sales communications. It also covers the types of investment funds that may market themselves as focusing on ESG or as considering ESG factors as part of their investment process.

Stock exchanges in Canada may also impose additional ESG requirements with respect to listed issuers. See **2.2 Differences Between Listed and Unlisted Entities** for further discussion.

Other regulatory bodies, such as OSFI, which oversees and regulates federally registered banks, insurers, pensions plans, and trust and loan companies, play an important role in regulating ESG in Canada. OSFI's climate reporting regulations require FRFIs to report GHG emissions, including Scope 3 emissions.

Additionally, a variety of recommendations, guidelines and standards have been or are being developed by government agencies, such as the Competition Bureau, which is in the process or preparing guidelines regarding environmental representations to mitigate the risk of greenwashing. These guidelines and standards are being implemented to ensure transparency and accountability in environmental claims made by companies, protect consumers from misleading information and promote genuine sustainability practices across industries and compliance with these evolving regulatory regimes. These guidelines are discussed further in the Trends and Developments article.

Lastly, supervisory authorities, such as the Canadian Association of Pension Supervisory Authorities' (CAPSA) play a significant role in this transition. CAPSA is a national organisation of pension regulators dedicated to promoting an efficient and effective pension regulatory framework in Canada.

On 9 September 2024, the CAPSA sub-committee on Integrating ESG in Pension Plan Supervision published a general Guideline for Risk Management for Plan Administrators (the "Risk Management Guidelines") that incorporates ESG considerations. A draft of these ESG considerations was first developed in 2022 and, following a comment period, have been incorporated into the Risk Management Guidelines. The Risk Management Guidelines establish three principles related to ESG in pension plan administration.

First, administrators should assess how ESG factors may impact the financial risk-return profile of their funds. Second, they must integrate ESG risks and opportunities into their investment decision-making and risk management processes as part of their standard of care. Third, they are required to publicly disclose how they consider material ESG information in their plan designs and investment policies.

The Risk Management Guidelines are guidance and are not binding.

1.6 Market Participants

All sectors and industries will be affected by ESG laws and regulations, as they are wide ranging and incorporated in many legal and regulatory frameworks federally and provincially. This section will focus on the sectors and industries that will be most affected by ESG laws and regulations in the coming years, including:

- energy;
- financial services;
- mining; and
- real estate.

Energy

The energy sector is likely to be significantly impacted by new ESG regulations, with Canada's commitment to a future free from carbon emissions by 2050. For example, the federal government carbon tax scheme significantly impacts the energy sector. This scheme was established through the Greenhouse Gas Pollution Pricing Act (GGPA), which came into force in 2018. The initial price on carbon was set at CAD20 per tonne in 2019. This price has steadily increased to CAD80 per tonne this year and is expected to continue to increase by CAD15 per year until 2030 when it reaches CAD170 per tonne. The goal of the carbon tax scheme is to reduce GHG emissions by creating a financial incentive for people and businesses to pollute less.

An important part of the carbon tax scheme is the Output-Based Pricing System (OBPS) for industries. This was established through the Output-Based Pricing System Regulations under the GGPA. The OBPS creates a price incentive for industrial emitters (such as those in the energy sector) to reduce their GHG emissions, spur innovation, maintain competitiveness within the industry and protect against the risk of industrial facilities moving from one region to another to avoid paying a price on carbon pollution.

In addition to the OBPS, there is the OBPS Proceeds Fund, which is a programme that assists Canada in returning proceeds from the OBPS strain of the carbon tax scheme to their jurisdiction of origin.

Notably, the federal carbon tax does not apply in provinces like British Columbia and Quebec that have their own carbon pricing systems. Further, some provinces and territories have their own industry pricing systems (ie, schemes like the OBPS), which means that the OBPS applies in Manitoba, Nunavut, Prince Edward Island, Yukon, unless other provinces and territories wish to voluntarily ascribe to it.

The carbon tax scheme has been very controversial and this year the leader of the federal opposition along with seven provincial premiers called for this year's tax increase to be cancelled. It was not cancelled, but a potential change in the federal government could impact the continued development of the carbon tax scheme.

Canada's Methane Strategy is a key initiative aimed at significantly reducing methane emissions in the energy sector, originally introduced in the 2030 Emissions Reduction Plan and updated in 2023 with a regulatory framework. The draft Enhanced Oil and Gas Methane Regulations, released in December 2023, target a 75% reduction in methane emissions from oil and gas operations compared to 2012 levels by 2030. These Regulations propose stricter emissions monitoring, risk-based inspection schedules and mandatory annual third-party audits, with the first requirements set to take effect in January 2027. Additionally, the Investment Tax Credit (ITC) for Carbon Capture, Utilization and Storage (CCUS), revised in Budget 2023, offers significant tax incentives for carbon capture technologies, further promoting investment in emissions-reducing technologies. While the carbon tax serves as a regulatory "stick," the ITC acts as a "carrot," collectively encouraging the energy sector to align with Canada's net-zero emissions goals.

Financial Services

The Financial Services industry will also face considerable changes. Proposed legislation, including the Act to Enact the Climate-Aligned Finance Act, would mandate large companies to disclose climate-related risks, compelling financial institutions to incorporate considerations of environmental risk into their investment strategies and risk assessment processes. The Bill for this Act is currently in consideration in committee in the House of Commons.

Mining

The mining industry is expected to face significant challenges as companies are charged with enhancing their sustainability practices and minimising their carbon footprints to align with the government's net-zero targets. Some of these challenges include limiting emissions, minimising impacts on water and biodiversity, and impacts on Indigenous rights.

That said, there is also an opportunity for the Canadian mining industry to be a leader in sustainably developing the critical minerals required to meet the transition to a low carbon economy. The mining industry also has an opportunity to collaborate with Indigenous communities to ensure that not only their rights are respected, but even to enter equity ownership partnerships that can further economic reconciliation.

The Canadian Critical Minerals Strategy (the "Critical Minerals Strategy"), released in December 2022, is highly relevant for the mining industry, aiming to promote climate action, environmental protection and reconciliation with Indigenous Peoples. Recognising Canada's unique abundance of critical minerals like aluminium, lithium and zinc, the Critical Minerals Strategy highlights the mining sector's essential role in providing materials necessary for clean energy technologies, electric vehicles and batteries, which are vital for achieving net-zero emissions by 2050. It also notes the applications of other critical minerals, such as niobium and indium, in sectors like aerospace and IT.

In response to growing scrutiny over the environmental and social impacts of mining, particularly on Indigenous communities, the Mining Association of Canada has implemented the Towards Sustainable Mining initiative, which focuses on key performance indicators to ensure compliance with ESG initiatives and strengthen Indigenous and community relationships.

Real Estate

Building retrofits and energy efficiency will prove to have a great impact on the real estate sector. Both historic and contemporary properties are expected to undergo a series of improvements, signalling a shift towards more environmentally sustainable buildings. This change is driven in part by the government of Canada through the Canada Greener Homes Affordability Program announced in Budget 2024.

1.7 Geopolitical Developments

The progression of Canada's ESG movement is significantly influenced by the country's political landscape and geopolitical considerations. For example, national political considerations like energy security, developing a green economy (as shown by major governmental investments in electric vehicles and battery plants) and Indigenous reconciliation are driving both the development of mandatory ESG regulation and voluntary ESG progress.

Acts like the Modern Slavery Act, amendments to the environmental claims provisions in the Competition Act, Bills like the proposed Act to Enact the Climate-Aligned Finance Act and commitments to develop HRDD show that ESG is being considered by a variety of political actors throughout Canada. As regulatory frameworks continue to evolve, a further integration of ESG considerations within Canada's legislative framework can be expected.

Geopolitics is increasingly influencing the landscape of ESG initiatives in Canada, particularly in the context of investment decisions related to international conflicts, such as those in Ukraine and the Middle East. Despite the absence of legislative or regulatory transformations, major financial institutions are currently facing reputational risks due to accusations of unethical practices related to these conflicts. For example, in response to public pressure from the Boycott, Divestment and Sanctions movement for Palestine, one major financial institution halved its stakes in an Israel-based weapons manufacturer.

In response to Canadian sanctions policies, major financial institutions have developed their own sanctions policies to ensure that they do not facilitate or conduct business activity or transactions with sanctioned countries or individuals. For example, one major financial institution has specific sanctions policies to avoid doing business with the Russian government and sanctioned Russian individuals, as well as the Iranian government and companies at least 50% owned by the Iranian government.

These efforts reflect a recognition by financial institutions that responding to public pressure on geopolitical issues is important for maintaining public trust and investor confidence.

Given the expansive nature of ESG and the interconnected reality of geopolitics, the Canadian government and Canadian business can be expected to adapt their practices and policies in accordance with national political developments and geopolitical considerations.

2. Corporate Governance

2.1 Developments in Corporate Governance

The CBCA added a new requirement to increase transparency to fight money laundering and tax evasion. As of 22 January 2024, corporations created under the CBCA are required to provide information regarding Individuals with Significant Control (ISC) over the business to Corporations Canada. This disclosure is mandatory upon the inception of the company and must be updated annually in conjunction with the submission of annual reports. Certain other corporate statutes in various provinces and territories have also implemented requirements to produce transparency registers, subject to varying disclosure requirements.

These developments are in addition to the previously enforced requirements under Section 172.1 of the CBCA that promote accountability regarding diversity of boards of directors and senior management, which have been in effect since 2020. These previously existing requirements are further discussed in **1.4 Governance Trends** and **5.1 Key Requirements**.

Bill S-285

Bill S-285 – an Act to amend the CBCA ("Bill S-285") – aims to amend the purpose of modern corporations by requiring them to operate in a manner that benefits society and the environment, while minimising any harm resulting from running their business. In addition to this, directors' and officers' fiduciary duty and duty of care would include a requirement to act in the best interests of society and the environment. If enacted, Bill S-285 would also introduce disclosure requirements to highlight the actions taken by companies to positively impact society and the environment.

Bill S-285 has the potential to significantly reshape corporate governance in Canada by embedding double materiality into corporate mandates. While this legislative shift could position Canada as a leader in corporate responsibility, it may also generate resistance from businesses due to the additional fiduciary duties placed on directors. There is no timeline for Bill S-285's potential implementation as it has only completed its first reading at the Senate.

2.2 Differences Between Listed and Unlisted Entities

Corporate governance requirements in Canada differ for listed and unlisted companies. Many unlisted companies are not "reporting issuers" in Canada and are not subject to the corporate governance requirements imposed by the CSA for listed entities and other reporting issuers. For example, listed entities are required under NI 58-101 to make diversity-related disclosure in their annual disclosure documents on a comply or explain basis and are also subject to certain independence requirements imposed by the CSA.

Further, listed entities are subject to the policies and rules of the applicable stock exchange in which they are listed and may be subject to different corporate governance rules and standards depending on the stock exchange in which they are listed. For example, NI 58-101 imposes different reporting standards for companies listed in senior stock exchanges (such as the TSX and Cboe Canada) than those listed on junior exchanges (such as the TSX-V and the CSE).

Stock exchanges can also impose additional disclosure requirements. For example, the TSX and TSX-V policies require the timely disclosure of material information, which encompasses both material facts and material changes relating to a company, which (as noted above in **1.5 Government and Supervision**) can include ESG considerations such as environmental matters and climate-change-related risks. The timely disclosure obligations in the exchanges' policies exceed those found in securities legislation.

2.3 Role of Directors and Officers

Directors have an obligation to consider any issue that may impact the best interests of a corporation. ESG developments in corporate law are expanding what constitutes the best interest of a corporation beyond simple financial considerations. For example, Section 122(1.1) of the CBCA, which has been in place since

21 June 2019, states that directors and officers may consider the interests of stakeholders, such as employees, consumers and the environment, when exercising their powers and performing their duties. This builds on significant Supreme Court of Canada decisions, BCE Inc. v 1976 Debentureholders from 2008 and Peoples Department Stores (Trustee of) v Wise from 2004 that affirmed the notion that, "although directors must consider the best interests of the corporation, it may also be appropriate, although not mandatory, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders," including "the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment."

Bill S-285, discussed in **2.1 Developments in Corporate Governance**, would significantly expand the fiduciary duty and duty of care of directors and officers, so that they would be obliged to consider the best interests of society and the environment as part of their duties. This would expand their duties well beyond their current state, which only holds that directors and officers may make these types of considerations.

Under Canadian securities laws, directors and officers of a reporting issuer are responsible for the issuer's compliance with timely and continuous disclosure rules and must approve certain documents filed with the securities regulator(s). Attention must be paid the preparation of issuer disclosure documents, including the ESG-related disclosures therein, as Canadian securities laws in certain provinces and territories provide a right of damages or rescission against directors and certain officers, among others, for misrepresentations in certain disclosure documents.

Under CEPA and the federal Fisheries Act, directors have positive obligations to take reasonable steps to ensure compliance with environmental standards by reporting to relevant authorities and informing the public about measures taken to minimise environmental damage.

The Modern Slavery Act, as discussed in **1.3 Social Trends**, mandates specific Canadian entities to report their efforts to eliminate forced and child labour within their corporate structure and supply chains. It also requires that a director or officer approve these reports. The Modern Slavery Act also provides for severe monetary penalties for failure to file, including possible personal liability on the directors of the entity.

2.4 Social Enterprises

Canadian companies can be incorporated both federally and provincially (or territorially). British Columbia is the only Canadian jurisdiction that has adopted the business form of a "benefit company," which was created in June 2020 through an amendment to the British Columbia Business Corporations Act. Benefit companies are for-profit companies that must include a "benefit statement" and a "benefit provision" in its incorporation documents. In these documents, the company must specify the public benefits the company will promote, as well as declare its commitments to conduct its business in a "responsible and sustainable manner" and to promote the specified public benefits it has committed to. Benefit companies in British Columbia must submit benefit reports that measures the company's performance in implementing their social responsibility commitments against a third-party standard of its choice.

Bill S-285, discussed in **2.1 Developments in Corporate Governance** and **2.3 Role of Directors and Officers**, would not specifically turn Canadian businesses into benefit companies per se, but it would mandate that corporations federally incorporated under the CBCA have a purpose to benefit society and the environment.

Each province has its own legislation governing the incorporation and regulation of not-for-profit corporations. A not-for-profit may also be incorporated federally under the Canada Not-for-profit Corporations Act.

The law concerning charities and not-for-profits has not often been considered by Canadian courts. However, it is generally accepted that a not-for-profit must fall into one of the four "heads" of charitable purposes to benefit from certain tax advantages. Those heads were originally set out in Tax v Pemsel, an 1891 House of Lords case, and confirmed by the Supreme Court of Canada in Vancouver Society of Immigrant and Visible Minority Women v M.N.R., [1999] 1 S.C.R. Those four heads are:

- the relief of poverty;
- the advancement of education;
- the advancement of religion; and
- other purposes beneficial to the community and not falling under any of the preceding heads.

2.5 Shareholders

There is increasing expectations for directors of corporations to consider a broader group of stakeholders, rather than focusing only on value maximisation for shareholders.

At the same time, the increase in ESG-focused shareholder activism shows that some shareholders are pushing for further ESG action by companies. For example, in 2022, 88% of shareholder proposals were concentrated on ESG matters (environmental and social matters, in particular). Further, average support for such shareholder proposals increased from 15.8% in 2022 to 16.4% in 2023 indicating shareholder support for ESG initiatives, showing growing support for voluntary development of ESG within companies by shareholders.

3. Sustainable Finance

3.1 Progress in Green Financing

As briefly noted in **1.1 General ESG Trends**, in March 2024 the CSSB released a draft of the first Canada-specific ESG reporting standards – the CSDS. The proposed CSDS 1 and CSDS 2 mirror the disclosure standards released by the ISSB, with minor modifications relating to implementation timelines. Specifically, the CSDS 1 mirrors IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information, which requires disclosure about sustainability-related risks and opportunities that could reasonably be expected to affect an issuer's cash flows, access to finance or cost of capital over the short, medium or long term. CSDS 2 mirrors IFRS S2 Climate-related Disclosures, which requires disclosure of material information about an issuer's climate-related risks and opportunities that could reasonably be expected to affect issuer's cash flows, access to finance, or cost of capital over the short, medium or long term.

The CSDS were developed as a way to implement the ISSB standards with modifications appropriate to the Canadian context. The primary modification at this point relates to the implementation timeline. The ISSB standards have an implementation date of 1 January 2024, while the CSDS implementation date is 1 January 2025. The CSDS also have a two-year transition period, compared to the ISSB's one-year transition period. This gives companies more time to adjust to the voluntary reporting requirements of the CSDS.

Importantly, the ISSB standards require Scope 3 GHG disclosure and scenario analysis. The CSDS also requires Scope 3 disclosure, but the CSDS provides certain relief related to this disclosure for the first two annual reporting periods that an organisation applies the CSDS, as opposed to the ISSB standards, which only provide certain relief for the first annual reporting period. The CSDS does not vary from the ISSB standards in that CSDS 2 requires scenario analysis to assess climate resilience and provide quantitative disclosure on this matter.

The CSSB also recognises the importance of Indigenous Peoples in Canada by acknowledging that they have inherent rights, which must be respected and considered in the development of the CSDS.

The CSDS are not mandatory. The CSSB is a standard setting organisation that works to advance the adoption of its disclosure standards in Canada, but which does not have the authority to mandate disclosure requirements. The CSA has yet to incorporate the CSDS into its rules and are monitoring the CSSB consultation process before determining any proposed changes to the regulatory framework for climate-related disclosures. The CSA issued a statement in March 2024, stating that it expects to adopt only the CSDS provisions that "are necessary to support climate-related disclosures."

The comment period for the CSDS drafts closed on 10 June 2024, and the CSSB is currently deliberating feedback on the CSDS drafts. A release date for the final version of the CSDS has not yet been set, though the CSSB states that they are proposed to be effective for annual periods beginning on or after 1 January 2025.

Once the CSSB consultation process is completed, it is expected that the CSA will publish a proposed regulatory framework for comment, which framework may also be guided by international developments, including the United States' Securities and Exchange Commission's (SEC) final climate-related disclosure rules released in March 2024 and discussed further in **5.6 Expected Progress**.

In addition to the CSSB, the federal government announced on 9 October 2024, its plan to establish a sustainable investment taxonomy (the "Taxonomy"). At a high level, the Taxonomy will be a set of guidelines that categorise sustainable economic activities with the goal of facilitating sustainable financing and investment. This "made-in-Canada" Taxonomy will be an important voluntary tool for investors, lenders and other stakeholders to credibly identify sustainable economic activities, and it is intended to help Canada reach its sustainability targets of net-zero emissions by 2050 and limiting global temperature rise to 1.5°C.

3.2 Sustainable Finance Framework

To access the Canadian capital markets and raise capital in Canada, Canadian public companies who are not "venture issuers" are required to disclose matters such as the composition of the board (including the number of independent directors), any ethical business mandates on the board and matters related to the number of women on the board of directors in executive positions under Form 58-101F1 - Corporate Governance Disclosure. Lesser standards are applicable to those companies who are "venture issuers" under Canadian securities laws.

In April 2023, the CSA published two variations of proposed amendments to Form 58-101F1. Both proposals aim to include diversity metrics beyond gender. The first proposed approach requires disclosure metrics of "identifiable groups," where companies would be given flexibility in choosing the marginalised group metrics they would like to disclose. The second proposed approach requires companies to disclose diversity metrics on enumerated groups, such as racialised persons, Indigenous Peoples, persons with disabilities, and LGBTS2SI+ persons. The comment period for these proposals closed in September 2023. No further updates on the status of these proposals have been provided by the CSA.

3.3 Access to Green Financing

Access to green financing is still limited in Canada. One method of green financing is Canada's Green Bond programme, which began in March 2022 to mobilise capital in support of its climate and environmental objectives. In its initial release, the programme saw extensive demand, which led to a final book order of over CAD11 billion.

In November 2023, the government updated its Green Bond Framework to align with Canada's 2030 Emissions Reduction Plan, with updated priorities in terms of expenditures. Despite government green bonds being popular, corporate green bonds have yet to make as significant an appearance in Canada, as they have in other major financial jurisdictions.

3.4 Stranded Assets and Non-bankables

The evolving ESG landscape provides significant challenges but also significant opportunities to the Canadian oil and gas sector, noting that the Canadian oil and gas sector has in recent years made significant investments and taken action to meet these challenges. The recent greenwashing amendments to the Competition Act and the political landscape, however, have created an uncertain regulatory standard.

The Canadian oil and gas sector is a global leader in investments and action in respect of the transition towards ESG goals, including investing in methane reduction, carbon capture technology and other technologies. For example, businesses are engaged in Canada's Hydrogen Strategy (announced in 2020), which is one of the ways in which the country aims to achieve net zero by 2050. The strategy includes a vision of growing the hydrogen sector up to a revenue over CAD50 billion. According to the federal government, low-carbon hydrogen has attracted over CAD100 billion in potential investments as of May 2024.

The uncertainty about the scope and enforcement of the amendments to the Competition Act to combat greenwashing (as discussed further in the Trends and Developments article) raise significant challenges to the oil and gas industry's ability to communicate publicly about ESG plans, objectives and initiatives. In June 2024, Pathways Alliance, a consortium of Canada's largest oil sands producers with a goal of achieving "net zero by 2050," (among other oil and gas companies) removed statements about environmental goals and plans from its website and social media pages. Pathways cited concerns over the amendments to the Competition Act, which it said makes it difficult for all Canadian companies who "want to communicate publicly about the work they are doing to improve their environmental performance," due to the "significant uncertainties" around the requisite methodology that must be used to substantiate public statements regarding actions that improve the environment or mitigate the effects of climate change, as it is not a defence that the claim is in fact true.

The federal government's evolving policy has supported the oil and gas sector's active participation in achieving ESG goals (eg, Canada's Hydrogen Strategy) but significant challenges remain including a lack of certainty with respect to a holistic regulatory regime to support such innovation and transparency (eg, the greenwashing amendments to the Competition Act). What will prevail remains to be seen.

3.5 Challenges Ahead

As ESG policy increasingly becomes regulated, businesses face new challenges in keeping pace with both mandatory and other standards. Similarly, reputational pressures are forcing businesses to address ESG concerns.

Greenwashing and ESG Messaging

For example, as discussed in **3.4 Stranded Assets and Non-bankables**, the uncertainty as to scope and enforcement of the recent "greenwashing" amendments to the Competition Act has made it difficult for businesses to communicate their environmental efforts and programmes without risking scrutiny from the Competition Bureau and private parties who will have the right (effective June 2025) to seek leave to challenge conduct under the new greenwashing provisions.

Scope 3 Emissions

Albeit voluntary, the emergence of the new CSDS standards (as discussed at **1.1 General ESG Trends** and **3.1 Progress in Green Financing**) also creates challenges. Even when businesses are willing to ascribe to the voluntary standards, the broad scope and frequency of disclosure, which includes Scope 3 emissions would require technical expertise and data collection which could impose major cost concerns.

Anti-ESG Movements

Canada has not seen aggressive anti-ESG movements that has occurred in other jurisdictions, such as the USA. As a result, anti-ESG sentiment is not a major consideration for businesses in Canada. According to a recent study published in September 2024, 94% of institutional investors surveyed replied that they had not changed their investment process as a result of ESG pushback in the USA. However, almost a third replied that the ESG pushback had contributed to changes in their public communications. This pushback, along with the greenwashing amendments, may lead to more limited ESG communications moving forward. It is unclear how this may affect ESG initiatives by investors and companies.

4. ESG Due Diligence

4.1 Soft Law Becoming Hard Law

There is an increase in soft law becoming hard law in Canada. Namely, the greenwashing amendments to the Competition Act, the coming into force of the Modern Slavery Act and developments in plastics regulations were major examples in which soft law became hard law.

Moving forward, this trend can be expected to continue. For example, the potential publication of a revised draft of NI 51-107 and its mandatory climate-related disclosure rules for reporting issuers would be a major introduction of hard ESG law in Canada. The CSA has consistently indicated its commitment to developing such rules but has not yet indicated a formal timeline for the introduction and adoption of such rules.

4.2 Towards Vertical Responsibilities

The Modern Slavery Act's reporting requirements have led to businesses implementing supply chain codes of conduct that are increasing due diligence requirements throughout the value chain. Similarly, the potential development of mandatory human rights due diligence legislation in Canada would create hard law due diligence requirements throughout the value chain. This indicates that due diligence requirements are likely to continue to increase moving forward.

4.3 Partner Selection

The combination of recent supply chain disruptions and regulatory ESG developments have likely placed ESG considerations at a higher priority when companies review supply chain partners.

It is likely that recent supply chain disruptions, some of which are caused by geopolitical tensions, have caused businesses to turn their minds to human rights and geopolitics when working with their supply chain partners. This is especially the case when enforcement actions against human rights violations in the supply chain are becoming prevalent. For example, in March 2024 the Canadian Ombudsperson for Responsible Enterprise released its final report on its investigation into a Canadian mining company's operation in Xinjiang, China. The report, which found that the company was involved in forced labour, recommended that the government of Canada not provide support for the company in its trade initiatives. Similar enforcement actions can be expected in the future as Canada increases enforcement of human rights within supply chains. In response to such actions, it can be expected that companies will increasingly choose supply chain partners that protect human rights and therefore do not open the companies up to enforcement actions.

Looking ahead, the emergence of voluntary Scope 3 GHG emission reporting requirements in the CSDS may make businesses further consider the amount of emissions of their supply chain partners and whether these partners engage in any carbon capturing activities. Businesses may also consider whether their supply chain partners are able to provide data of their own GHG emissions in the first place.

4.4 ESG in M&A Due Diligence

Specific ESG considerations that simultaneously carry legal liability risks are increasingly included in the M&A due diligence process. Consequently, ESG considerations are often addressed in representation and warranty clauses. However, this does not necessarily extend to all ESG considerations, especially not to those that do not create a material risk.

In Canada, representations and due diligence analyses regarding the existence of disputes with Indigenous groups or First Nations is particularly prevalent in the natural resource sector, specifically with respect to Indigenous land and rights claims associated with land.

Matters related to data and privacy considerations, which were considered one of the more "traditional" ESG considerations in M&A due diligence, continue to be prevalent. Social considerations, such as workplace-related representations, also face scrutiny in M&A due diligence.

On the other hand, a recent review of M&A circulars in Canadian public companies suggests that ESG considerations only appear in a small minority of circulars, suggesting that broader ESG considerations are not yet considered material risks for shareholders.

5. Transparency and Reporting

5.1 Key Requirements

Companies can be incorporated in Canada either federally through the CBCA or provincially through the province's (or territory's) business corporation act. Different jurisdictions have different requirements, including ESG requirements. Companies incorporated federally under the CBCA have important ESG obligations that not all provincially or territorial incorporated companies have.

There are a variety of disclosure obligations applicable to reporting issuers (generally, public companies/entities) in Canada. There are various ways to become a reporting issuer and having securities listed on a Canadian exchange is one method. There is no national securities regulator in Canada; rather, each province and territory has its own securities laws. Certain disclosure requirements are harmonised across jurisdictions in the form of National Instruments.

The CSA's current regulatory framework is largely silent on environmental and social disclosure. However, National Instrument 51-102-Continuous Disclosure Obligations requires reporting issuers to disclose any "material" information in their continuous disclosure documents. Material information includes information that, if omitted or misstated, would influence a reasonable investor's decision to buy, sell or hold a security. ESG-related information, to the extent that it is "material," must be disclosed. This sort of disclosure often includes disclosure concerning environmental liabilities that might have a financial impact on the issuer.

In November 2022, the CSA published Staff Notice 51-364 (see **1.5 Government and Supervision**), which discussed the results of the CSA's review respecting continuous disclosure of ESG-related information. The CSA noted an increase in issuers making potentially misleading ESG-related claims and expressed their view that issuers must be careful to avoid misleading promotional language in both voluntary and required public disclosure documents: a failure to do so could breach the deceptive marketing (including greenwashing) provisions set out in the Competition Act.

NI 58-101, which is discussed above in **2.2 Differences Between Listed and Unlisted Entities**, and National Policy 58-201 Corporate Governance Guidelines (together with NI 58-101, the "Corporate Governance Disclosure Rules") impose certain corporate governance disclosure obligations on reporting issuers. The Corporate Governance Disclosure Rules require reporting issuers to disclose certain information about various corporate governance principles. Since their inception, the Corporate Governance Disclosure Rules have expanded for issuers that are not "venture issuers" to require disclosure of the number and proportion of directors and executive officers of the issuer who are women. Though disclosure for such issuers is required, issuers are not required to place a particular number of women in board or management positions. This approach is often characterised as a "comply or explain" model, which allows entities and their shareholders to satisfy themselves that their company has adopted an appropriate governance approach.

As indicated in **3.1 Progress in Green Financing**, the CSSB's development of the CSDS is a significant step forward in terms of Canada-specific voluntary disclosure, while also closely aligning such disclosures with the ISSB's disclosures that are intended to be a global baseline for voluntary reporting.

The CSA is ultimately responsible for deciding whether the CSDS (or another standard) will be mandatory in Canada and, if so, which entities will need to comply with the standards and over what time period.

Lastly, as noted in **1.4 Governance Trends**, the federal government has indicated an intention to amend the CBCA to mandate climate-related financial disclosure for large, federally incorporated private companies. It is expected that these obligations will be harmonious with disclosure obligations required from public companies by securities regulators.

5.2 Transition Plans and ESG Targets

There is currently no obligation for Canadian companies to publish transition plans or commit to targets. However, there are frameworks in place to encourage voluntary actions in this respect. For example, any business operating in Canada may voluntarily join the government of Canada's Net-Zero Challenge (the "Net-Zero Challenge"), which has the following objectives:

- normalising net-zero planning so that this becomes the default business practice;
- building momentum by providing net-zero planning guidance to both the public and private sectors; and
- reducing GHG emission from industry and other sectors on the journey to net-zero emissions by 2025.

Net-Zero Challenge participants agree to set a target of net-zero emissions by 2050 for their Scope 1, Scope 2 and, if applicable, Scope 3 emissions. Participants further agree to establish two sets of sequential interim targets (eg, 2035 and 2045). Participants are required to report on progress annually. This annual progress reporting is meant to ensure that participants remain in compliance with the Net-Zero Challenge, to provide transparency and to assess progress in net-zero planning and implementation. As the programme is voluntary, the only penalty for a participant's failure to meet minimum requirements or timelines is removal from the programme.

5.3 Regulation of ESG Labels

Both the Competition Act and the Consumer Packaging and Labelling Act play a role in restricting certain sustainability claims and imposing certain conditions on ESG labels.

Recent amendments to the Competition Act, which came into force on 20 June 2024, expressly tackle greenwashing in addition to the Competition Act's existing, more general deceptive marketing provisions regarding false or misleading representations. A representation can take the form of a statement or claim regarding a product, business or business interests and can be made in written, oral, electronic or other form of media. This is discussed further in the Trends and Developments article.

The Consumer Packaging and Labelling Act does not specifically set out any conditions to ESG labels but does prohibit the sale, import or advertisement of any prepackaged product that has a label containing and false or misleading representation.

5.4 Supervision

As there are a variety of laws that require ESG disclosure in Canada, there are a variety of regulators in this regard. These regulators include, but are not limited to:

- each provincial and territorial securities regulator, which are responsible for the administration and enforcement of securities laws

in their respective jurisdiction and may bring enforcement proceedings against an issuer in breach of securities laws, including a breach resulting from failing to disclose material ESG-related information or making misleading ESG-related claims;
- the Minister of Public Safety and Emergency Preparedness, who is responsible for the administration and enforcement of the Modern Slavery Act;
- OSFI, which regulates FRFIs and monitors climate-related disclosures that are required by such institutions; and
- the Competition Bureau, which is responsible for the administration and enforcement of both the Competition Act (in addition to private rights of actions in respect of greenwashing claims) and the Consumer Packaging and Labelling Act.

5.5 Enforcement

Penalties for non-compliance with disclosure obligations are as broad and varied as the obligations themselves.

Enforcement action for a failure to make disclosure of material information in the manner and time required under relevant securities laws, or providing disclosure that contains a misrepresentation, can potentially be brought against the responsible issuer or any director or officer who authorised, permitted or acquiesced in the breach. Again, penalties are broad, but a monetary penalty is the most typical remedy.

An entity or individual that fails to submit and publish a satisfactory report as required under the Modern Slavery Act is guilty of a summary offence and liable to a fine of up to CAD250,000. Any director or officer who directed, authorised, assented to, acquiesced or participated in any of these offences may also be held personally liable.

Distributing corporations who fail to comply with diversity disclosure obligations under the CBCA, or who make false or misleading statements in these reports may be liable to pay a fine not exceeding CAD5,000. Any person who participates in making such a report may be held personally liable and ordered to pay a fine not exceeding CAD5,000, to imprisonment for a term not exceeding six months or both.

The Competition Act sets out the remedies for a breach of deceptive marketing practices, which include greenwashing claims. These remedies include that a court may order a business to pay an administrative monetary penalty (AMP) in an amount up to:

- CAD10 million, and for each subsequent order, CAD15 million; and
- three times the value of the benefit derived by the deceptive conduct, or, if that amount cannot be reasonably determined, 3% of the corporation's annual worldwide gross revenues.

5.6 Expected Progress

Canada can expect the trend in increasing voluntary ESG reporting to continue. Similarly, increased mandatory reporting requirements mean that more and more companies will be reporting on ESG matters. Nonetheless, challenges remain for both voluntary and mandatory reporting.

The proposed CSDS, if adopted, have the potential to pose significant challenges to Canadian companies. The proposed standards are somewhat burdensome, especially in comparison to the SEC's climate disclosure rules.

Though the SEC has stayed implementation of its rules pending completion of judicial review, its position continues to be that the rules are consistent with applicable law and within its authority. The CSDS contemplates more stringent requirements than the SEC rules. In particular, the SEC rules provide a safe harbour for certain forward-looking disclosures, namely protection from civil liability for transition plans, scenario analysis, internal carbon pricing, and targets and goals. Further, the SEC rules do not propose to require companies to disclose Scope 3 GHG emissions. In contrast, the CSDS does not provide any such safe harbours, and it proposes to impose Scope 3 disclosure obligations.

The cost of implementing these more stringent standards may be a barrier to Canadian entities in comparison to those operating in the US market. Given the interconnected markets in these regions, differences in reporting standards could lead to difficulties for businesses with operations in both countries.

It is important to note that the CSDS is voluntary and, unless it is adopted by the CSA and made mandatory, any differences between these standards and the SEC rules can be avoided by not reporting according to the CSDS. However, the CSA is expected to revise its proposed regulatory framework in response to the final CSDS, adopting those provisions of the sustainability standards that are necessary to support-climate related disclosures. Canadian reporting companies should pay particular attention to the revised framework to be published by the CSA.

What constitutes "adequate and proper testing" or "internationally recognised methodology" for the purposes of substantiating environmental claims has not yet been considered by any Canadian court. The Competition Bureau has issued some general guidance on what testing is considered "adequate and proper," but at this time any guidance relevant to environmental claims remains limited, and industry best practices vary widely. Companies will face challenges in determining what testing is required to substantiate environmental claims until further guidance either from the Competition Bureau or a relevant court decision is available.

6. Climate and ESG Litigation

6.1 Instruments for ESG Litigation

There are several tools in Canada that can be used to start ESG-related cases against companies, with a range of ease of access to parties who wish to rely on them.

The recent amendments to the Competition Act expand access to private parties seeking to bring deceptive marketing (including greenwashing) claims against businesses by allowing private parties to apply (with leave, based on a public interest test) for an order from the Competition Tribunal (the "Tribunal"), which right of access will be effective in June 2025.

Previously, only the Competition Bureau was permitted to bring an application for an order from the Tribunal and courts with respect to deceptive marketing practices. Effective 20 June 2025, private parties will also be permitted to bring an application to the Tribunal for an order, provided the Tribunal may grant leave where it is satisfied that it is in the public interest to do so.

Beyond use of the Competition Act, parties may commence civil suits, including class actions and derivate actions by shareholders to bring ESG-related claims. The scope of these potential claims is vast and could include claims concerning the environment, human rights, supply chains or workplace safety. A claim may also arise from a company's perceived failure to meet its ESG-related commitments.

Canadian companies may also face civil actions for their ESG-related actions in foreign jurisdictions. In 2020, the Supreme Court of Canada held in Nevsun Resources Ltd. v Araya that Canadian companies who operate abroad may be held liable for breach of customary international law. What exactly constitutes a breach of customary international law is not always clear, and bringing a claim rooted in this cause of action is not an easy process.

Derivative actions brought by shareholders are also a concern in this context. In Canada, a derivative action is a legal mechanism that allows shareholders to bring an action on behalf of a corporation against its officers or directors for an alleged wrongdoing. This sort of action addresses a harm done to the company rather than one particular shareholder.

6.2 Climate Activism

As further discussed in **6.4 A Turbulent Future Ahead**, NGOs and activists are an important party to consider in Canada. For example, as it relates to environmental claims by businesses, environmental organisations in Canada have relied on the mechanisms in the Competition Act that compels the Competition Bureau to commence an investigation into deceptive marketing. The initial complaint in 2019 focused on recyclability claims of a coffee business, which resulted in a settlement agreement providing for monetary penalties and corrective orders. Since that initial application, NGOs and activists have filed many other applications, most of which focus on the oil and gas sector, including claims in respect of:

- a certain carbon-neutral programme;
- a large financial institution claims of supporting net-zero emissions in light of its investments in the oil and gas industry; and
- claims by an oil and gas coalition that it is actively reducing emissions and helping Canada meet its climate targets.

In addition to regulatory action and litigation commenced by NGOs and activists, ESG-related shareholder activism appears to be on the rise in Canada. In 2023, a 145% rise in board activism and a 71% rise in transactional activism was reported in comparison to 2022.

6.3 Greenwashing v Greenbleaching

Greenwashing is understood in Canada to be the process of making false or misleading positive claims or downplaying negative qualities about the sustainability attributes of a product, service or business. In contrast, greenbleaching is used to describe an entity choosing not to make claims respecting the ESG features of its products or business to avoid regulatory scrutiny or other legal risks.

Greenwashing has been the subject of many investigations by the Competition Bureau, but with limited enforcement action under the Competition Act currently. Recent amendments to the Competition Act and statements by the Competition Bureau that greenwashing is a priority are expected to result in increased enforcement of claims of deceptive marketing as it relates to environmental claims, as explained in the Trends and Developments article.

In contrast, greenbleaching has not yet been addressed by Canadian regulatory authorities. Canadian companies may move towards greenbleaching to avoid regulatory action and penalties related to greenwashing, which have become stricter. Canadian regulatory bodies may have to create a framework to respond to this potential rise in greenbleaching.

6.4 A Turbulent Future Ahead

The amendments to the Competition Act to permit private parties (with leave, if found to be of public interest) to apply for order from the Tribunal in respect of deceptive marketing (including greenwashing), which will be in effect in June 2025, are expected to have a significant impact on the number of proceedings in Canada regarding deceptive marketing related to ESG claims, particularly greenwashing. Environmental activists in Canada have already used the Competition Act as a tool to compel the Competition Bureau to investigate environmental claims by businesses and the expanded access created by new amendments further reduces barriers to challenge greenwashing claims by businesses. In addition to activists, consumers and competitors may also apply to the Tribunal for orders to combat greenwashing under the Competition Act.

As noted above, ESG-related civil claims may arise from a company's perceived failure to meet its ESG-related commitments. To the extent that climate-related disclosure becomes mandatory in Canada, companies may run the risk of facing civil actions based on perceived failure to live up to commitments that have been set out in disclosure documents.

Shareholder activism is, to some extent, shaped by political trends. For example, the war in Ukraine and resulting energy crisis appears to have inspired a shift towards energy security related shareholder proposals. As the political landscape in Canada and abroad continues to shift in 2024 and beyond, companies across all sectors must be vigilant in assessing how shifts in political climate might affect trends in shareholder activism.

Overall, it is expected that ESG-related proceedings will grow with the increase in ESG disclosure (both mandatory and voluntary) and the creation of new avenues for proceedings.

Trends and Developments

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McMillan LLP is a leading business law firm serving public, private and not-for-profit clients across key industries in Canada, the United States and internationally. With recognised expertise and acknowledged leadership in major business sectors, the firm provides solutions-oriented legal advice through its offices in Vancouver, Calgary, Toronto, Ottawa and Montréal. The team advises clients on key environmental, social and governance aspects of their business, from M&A in the clean energy space (and M&A opportunities driven by environmental considerations) to EDI and sustainable investment strategies. The firm believes in the importance of doing business differently and help its clients to understand not only the risks of environmental, social and governance inaction but the opportunities available for growth and differentiation.

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Introduction

ESG continues to grow in importance in Canada as exemplified by two significant legislative developments that were introduced this year.

On 20 June 2024, the Canadian government implemented Bill C-59, amending the Competition Act (the "Act") to strengthen regulations regarding misleading environmental communications (including claims, representations, guarantees and statements) commonly referred to as greenwashing. This legislation enhances the Competition Bureau of Canada's (the "Bureau") enforcement capabilities by setting stricter standards for corporate environmental communications and expanding the Competition Tribunal's (the "Tribunal") accessibility to private parties. The amendments to the Act aim to combat the greenwashing that undermines consumer trust and hinders environmental initiatives.

The Fighting Against Forced Labour and Child Labour in Supply Chains Act (the "Modern Slavery Act") came into force on 1 January 2024 and addresses the critical issue of modern slavery. The Modern Slavery Act requires certain entities to disclose progress made to prevent and combat forced and child labour within supply chains. It also creates, through amendments to the Customs Tariff Act, a prohibition on the importation into Canada of goods made of such forced or child labour.

Collectively, these legislative changes highlight Canada's commitment to fostering a transparent, sustainable and ethical economic environment.

Bill C-59 Amendments to the Competition Act

Bill C-59 significantly amends merger review, abuse of dominance, non-merger collaboration and deceptive marketing provisions of the Act and added new rules relating to market studies of the Act as part of the "modernisation" of Canada's competition regime. These amendments include both substantive and procedural amendments that will materially expand the ability of the Bureau, which is responsible for the administration and enforcement of the Act, to combat deceptive marketing practices, including greenwashing.

The amendments set out in Bill C-59 expand the scope of deceptive marketing provisions to include two new provisions targeted at businesses making environmental communications, specifically: (i) representations (including claims and other statements) regarding a "a product's [environmental] benefits" must be supported by "adequate and proper test[s]" and (ii) representations regarding "[environmental] benefits of a business or business activity" must be supported by "adequate and proper substantiation in accordance with internationally recognized methodology."

In addition to these substantive amendments, Bill C-59 also included important procedural amendments to permit private parties' access to the Tribunal in respect of deceptive marketing claims, effective 20 June 2025. Previously, the Bureau was the only party permitted to bring a deceptive marketing application to the Tribunal (or courts).

These amendments strengthen the Bureau's ability to respond to alleged greenwashing claims, especially in light of amendments to the Act in 2022, which significantly increased the penalties against businesses upon a finding of deceptive marketing.

Even prior to these amendments, the Bureau had increased its scrutiny of business's environmental communications, in part fuelled by the Bureau's increased interest, but also by the recent strategy adopted by non-governmental and not-for-profit groups with environmental mandates. These groups have increasingly commenced applications under Section 9 of the Competition Act, which provides that six persons may apply to the Commissioner to commence a formal investigation (ie, an inquiry) into conduct that contravenes the advertising provisions of the Act.

Most notably, in response to an application by Ecojustice under the Act, the Bureau investigated claims by Keurig Canada Inc. ("Keurig") regarding the recyclability of its single-use coffee pods. In 2022, Keurig entered into a settlement agreement with the Tribunal to address the Bureau's concerns, agreeing to pay a CAD3 million penalty, donate CAD800,000 to an environmental charity, pay CAD85,000 for the Bureau's costs, and change its recyclable claims and packaging, publish corrective notices and enhance its corporate compliance programme.

Since this case, environmental activists have filed multiple applications with the Bureau, claiming misleading and false advertising by many businesses, with a focus on participants in the oil and gas industry. It is expected that this activism will increase with the inclusion of the new provisions focused on environmental claims and the expanded right of access by private parties to the Tribunal.

Substantive amendments – expansion of deceptive marketing targeting environmental claims

The Bill C-59 amendments to the Act build on the existing general deceptive marketing provisions, which have also been used to address greenwashing claims (eg, Keurig). The general deceptive marketing provisions are triggered if a person, for the purpose of promoting the supply or use of a product (which includes a service) or a business interest, makes a representation that is "false or misleading in a material respect" (Section 74.01(1) (a) of the Act).

The amendments add two provisions to the Act to address environmental claims, as follows.

"Misrepresentations to public 74.01 (1) A person engages in reviewable conduct who, for the purpose of promoting, directly or indirectly, the supply or use of a product or for the purpose of promoting, directly or indirectly, any business interest, by any means whatever,

(b.1) makes a representation to the public in the form of a statement, warranty or guarantee of a product's benefits for protecting or restoring the environment or mitigating the environmental, social and ecological causes or effects of climate change that is not based on an adequate and proper test, the proof of which lies on the person making the representation;

(b.2) makes a representation to the public with respect to the benefits of a business or business activity for protecting or restoring the environment or mitigating the environmental and ecological causes or effects of climate change that is not based on adequate and proper substantiation in accordance with internationally recognized methodology, the proof of which lies on the person making the representation."

The new provision in Section 74.01(1) (b.1) is similar to a current provision in the Act for representations of product performance, which requires that such representations must be supported by an "adequate and proper test." The new provision requires that a representation about a product's benefits to the environment must be based on an adequate and proper test. It is important to recognise that, even if the representation is true, it must be supported by an "adequate and proper test," which test must be conducted prior to the representation being made.

The new provision in Section 74.01(1) (b.2) is unrelated to the typical "product" related claims generally assessed under the Act. It significantly expands the current deceptive marketing provisions by requiring a business that makes a representation respecting the benefits of a business or business activity as it relates to the environment to be able to establish that such representation is based on "an adequate and proper substantiation in accordance with internationally recognized methodology."

These new environmental provisions differ from the general misleading and false advertising provision, which requires the Bureau establish that the conduct is a deceptive marketing practice. The amendments create a reverse onus: a business making climate claims, if challenged, bears the burden of proving that its claims are based on an "adequate and proper test" (in respect of products) or "adequate and proper substantiation" and "internationally recognized methodology" (in respect of business or business activity).

It is important to note that the phrases "adequate and proper substantiation" and "internationally recognized methodology" are broad terms that are not defined in the Act and have not been considered by the Tribunal or courts. Accordingly, their meanings are uncertain at this time. This lack of certainty is complicated by the fact that the legal framework and industry best practices regarding environmental practices continue to develop, and that the statements are not limited to those contained in businesses' marketing campaigns and likely apply to communications to the public made by a business in accordance with other regulatory regimes (such as securities laws, industry specific regulations).

This is especially troubling, as it is not a defence that the claim is in fact true, as the claim will be found to contravene the new environmental provision in Section 74.01(1) (b.2) if it is found that the claim was not substantiated in accordance with this new "internationally recognized methodology" standard.

The penalties for a finding that a business has engaged in deceptive marketing (including the two new environmental provisions) are significant, following a material increase in 2022. Upon finding a business has engaged in deceptive marketing practice, the Tribunal or court may issue an order for the person to:

- not to engage in the conduct;
- publish a notice that describes the misrepresentation;
- pay an administrative monetary penalty, in any manner that the court specifies, in an amount not exceeding the greater of:
  - (a) CAD10 million and, for each subsequent order, CAD15 million; and
  - (b) three times the value of the benefit derived from the deceptive conduct, or, if that amount cannot be reasonably determined, 3% of the corporation's annual worldwide gross revenues;
- pay an amount, not exceeding the total of the amounts paid to the person for the products in respect of which the conduct was engaged in, which amount is to be distributed among the persons to whom the products were sold (excluding wholesalers, retailers or other dis-

tributors), to the extent that they have resold or distributed the product.

The Bureau and the person may also enter into a "consent agreement" to resolve the Bureau's concerns, which agreement would be registered with the Tribunal and would have the force and effect of a court order.

Procedural amendments – private party access to the Tribunal

In addition to the inclusion of two new provisions discussed, Bill C-59 also amended the Act to allow third parties to seek leave to apply to the Tribunal for an order under the deceptive marketing provisions, effective 20 June 2025. Prior to the amendments, the Bureau was the only party permitted to bring an application to the Tribunal (or court) for an order in respect of deceptive marketing practices. The Tribunal may now grant leave to private parties to pursue an application for a remedy where it is satisfied that it is in the public interest to grant such leave.

This "public interest" standard for leave is new and is not defined in the Act. Presumably, the standard will be linked to the purpose of both the Act and the deceptive marketing practices provisions therein. The purpose of the Act does not extend to the environment, as the general purpose of the Act is to maintain and encourage competition in Canada in order to:

- promote the efficiency and adaptability of the Canadian economy;
- expand opportunities for Canadian participation in world markets, while at the same time recognising the role of foreign competition in Canada;
- ensure that small- and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy; and
- provide consumers with competitive prices and product choices.

Despite the lack of reference to the environment in the purpose of the Act, the Bureau has stated (when discussing the new environmental provisions in the Act) that: "The misleading advertising and deceptive marketing practices provisions of the [Act] exist to ensure that businesses do not deceive consumers making decisions in the marketplace. These decisions can include whether to buy a particular product, when to buy it, or if the product is something they want to buy at all." This statement is firmly rooted in consumer protection; however, the scope of the public interest test remains at this time uncertain.

Looking ahead – guidelines and enforcement

As noted above, the majority of (public) investigations by the Bureau into claims of environmental misrepresentations appear to have been initiated by non-governmental and not-for-profit groups with environmental mandates under Section 9 of the Act. None of these inquiries have yet to lead to an application by the Bureau for a remedy at this time, except for the Keurig settlement. These investigations continue to be conducted in private by the Bureau. Commencing in June 2025 (when the procedural provisions come into force), it is expected that these groups, in addition to competitors and customers, will make use of this new private right of enforcement in respect of the existing false and misleading representation provisions in addition to the two new environmental provisions.

Notwithstanding the limited enforcement action regarding greenwashing to date, the Bureau lobbied for these amendments to strengthen the Act. It is clear that greenwashing is a priority for the Bureau, and businesses should expect the

Bureau to scrutinise environmental communications by businesses.

In September 2022, the Bureau hosted the Competition Green Growth Summit to examine the interaction between competition law and sustainability. At the Summit, the Bureau indicated that it views "maintaining consumer confidence in the 'green economy' as part of its mandate." This commitment was reinforced through recent statements by the Bureau in its 2024–2025 Annual Plan, in which it stated its intent to "[c] ontinue to crack down on deceptive marketing practices in relation to environmental claims ('greenwashing')" and more recently in October 2024 at the CBA Competition Law Fall Conference where it made similar statements.

Accordingly, the Bureau is expected to investigate and take action against alleged greenwashing or environmental communications that are not adequately tested or substantiated. However, until the Bureau's guidelines are released, it is still uncertain exactly how the Bureau will interpret the new amendments and to what extent this will expand business's potential liability in making environmental representations.

Guidelines

On 22 July 2024, the Bureau launched a public consultation process, inviting parties to provide comments on the two new greenwashing provisions to develop guidelines to "offer transparency and predictability for the business and the legal communities in the enforcement of the law" to help businesses comply with these new environmental provisions. The comment period closed on 27 September 2024, with comments expected to be made public in October 2024, and draft guidelines expected to be released by the Bureau before the end of 2024.

Based on submissions made by parties to the Bureau as part of this consultation process that have been publicly disclosed by the parties at this time, it is clear that many parties support measures and actions to prevent greenwashing. However, there is a common recognition of the uncertainty of the meaning and application of these new provisions of the Act and the need for guidance to help businesses comply with these new provisions.

This uncertainty has led to a removal of or reduced public disclosure by many businesses, including by oil and gas companies, pending guidance from the Bureau, and, potentially, certainty from the courts. As noted by the Canadian Coalition for Good Governance: "It is therefore imperative that the Competition Bureau's guidance addresses these uncertainties in a timely manner and in such a way as to provide companies and investors with a clear path to assessing compliance such that companies are encouraged to make the truthful climate-related disclosures that investors have been requesting."

It should be noted that, while the guidelines will provide some level of certainty to businesses as to the Bureau's proposed approach, they will not be binding on private parties seeking to file applications regarding alleged environmental claims and, more importantly, these guidelines will not be binding on the Tribunal or courts. A better understanding of the scope and potential liability under these new provisions will develop slowly, as cases are heard by the Tribunal and courts. Judicial interpretation of the meaning of "adequate and proper substantiation in accordance with internationally recognized methodology," the standard for leave by private parties to the Tribunal and the penalties ordered will be crucial for solidifying the scope of these amendments.

General advice – environmental claims

Concurrent with the launch of the public consultation process, the Bureau published Volume 7 of The Deceptive Marketing Practices Digest in July 2024 to provide an overview of the issues around greenwashing and also "high-level business tips" for businesses to consider when making environmental claims (noting that this guidance specifically does not address the two new environmental provisions implemented by the amendments).

The Bureau also set out the most common kinds of complaints it receives, which generally fall into the following broad categories.

- Composition of products/products: for example, a claim that a product is made from 100% recycled paper or a claim that a product does not contain certain environmentally harmful components, such as microplastics.
- The production process of products: for example, a claim that a product was made with renewable energy or with a carbon neutral production process.
- Product disposal: for example, a claim that a product is fully compostable or recyclable.
- Comparison of products: for example, a claim that a product uses 25% less water than a previous model or than a competitor's product.
- Vague claims: for example, a claim that a product is "eco-friendly" or a similar "feel-good" message without any specification as to why or how the product is environmentally beneficial.
- Future claims: for example, a claim that a business will be carbon neutral by a certain date, especially if the business is making decisions that may move it away from its stated environmental goals.

This last category was indicated to be "one of the bigger trends" in greenwashing complaints.

Guidance from other jurisdictions

The approach in other jurisdictions may provide some insight regarding the potential treatment of environmental communications, given that Canada's largest trading partners, including the USA, the UK and the EU) are also tackling these issues. For example, in the EU, where greenwashing regulation is more advanced, regulators are considering banning the use of certain "green" terms such as "carbon neutral," because claims of this kind can be controversial and difficult to substantiate. There is further discussion of prohibiting any claims concerning specific emissions reductions targets, which tend to be aspirational. Given the Bureau's statement that claims about the future are one of the bigger trends in the Canadian context, it is possible that Canadian regulators will consider a similar approach to that of the EU.

In the meantime, while waiting for further guidance, businesses should review any environmental communications and analyse these communications for the legal risks related to making environmental representations.

Addressing Modern Slavery

Canada's Modern Slavery Act came into force on 1 January 2024, and aims to address issues around modern slavery by imposing reporting obligations on entities involved in manufacturing or importing goods.

The Modern Slavery Act applies to any entity traded on a Canadian stock exchange, as well as to any entities that do business, have assets or have a place of business in Canada and that meet the size thresholds, being two of the three of CAD40 million in revenues, assets surpassing CAD20 million, and employing a workforce exceeding 250 people. It mandates that entities report the actions taken to prevent and minimise the risk of forced labour and child labour in the previous financial year. The report must include specific information, including but not limited to:

- the entity's policies and due diligence processes concerning forced labour and child labour;
- measures implemented to mitigate the risk of such labour within the company's supply chain; and
- training provided to employees regarding these issues.

Reports must be approved by the entity's board of directors, and the statute provides for severe monetary penalties for failure to file, including possible personal liability on the directors of the entity.

The Modern Slavery Act has raised awareness regarding forced labour and child labour in supply chains, as evidenced by the 6,167 reports filed by Canadian and international businesses to date in this first year of reporting.

Clarifying reporting obligations

Before the deadline for the first round of required reports, Public Safety Canada (PSC) proactively released numerous clarifications to enhance technical guidelines. Amidst these updates, one notable adjustment was the removal of references to "selling" and "distributing" from the sections of guidance defining which parties are obligated to report. This important change narrows the scope of the Modern Slavery Act, ruling out companies that solely engage in retail or distribution of goods, unless they also manufacture or import products.

PSC also clarified that subsidiaries must gauge their reporting obligations independently from their overarching parent company. Joint reports are still available for affiliated entities if their internal policies, procedures and safeguards against risks are not only aligned but also in such harmony that their combined report does not result in any false or misleading information.

Lastly, PSC provided guidance to the effect that very minor dealings were excluded from the scope of the reporting obligation, thereby excluding entities that may have had only de minimis levels of imports into Canada.

PSC is actively consulting with industry and experts in the field to further augment and clarify the guidance provided.

Key takeaways from the initial reporting period

The first reports required under the Modern Slavery Act were submitted by 31 May 2024 and revealed valuable insights. Numerous companies affected by the Modern Slavery Act's criteria were unaware of their reporting obligations. A contributing factor to this struggle was the narrow window provided from the implementation of the Act to the submission of reports. The online portal remains open to accept delayed submissions.

In their reports, well-established entities such as Health Canada and the University of British Columbia seemed to focus on incentives such as creating awareness-raising materials and implementing codes of conduct to promote safe and healthy workplaces. Further, numerous Canadian and international businesses have committed in their reports to creating or improving procedures and policies, including supplier codes of conduct, and have stated that they will introduce contractual clauses aimed at ensuring their supply chain is free of forced labour or child labour. The ability to view reports online allows businesses to gain valuable insights and learn from one another's progress by examining these strategies.

Currently, the Modern Slavery Act only requires companies to report on their efforts to prevent and remedy forced and child labour practices within their supply chains. While there is not a legal mandate enforcing companies to implement specific actions to combat forced labour or child labour, there is speculation that a significant shift may be on the horizon. In France, Germany and the EU, mandatory human rights due diligence legislation is in place that mandates companies to conduct due diligence across their operations, subsidiaries and supply chains.

In its Budget 2024, the Canadian federal government re-affirmed its commitment to eradicate forced labour from Canadian supply chains and indicated its intention to introduce legislation to achieve this goal. The government of Canada has engaged with stakeholders and leading associations as it considers further actions and legislative changes. In the meantime, companies can look to the approach in the jurisdictions noted above for insight as to what future obligations might look like in Canada. To summarise, legislation in those jurisdictions imposes obligations to implement risk management plans, disclose policy statements respecting human rights strategies, engage in risk mapping and implement preventative measures, and provide continuous disclosure on due diligence activities. Canadian companies should consider how similar obligations might affect them if the federal government adopts similar legislation.

Import ban on goods made of forced and child labour

In addition to the reporting obligation, the Modern Slavery Act also introduces a prohibition on the importation into Canada of goods made of child labour, adding to the pre-existing prohibition on the importation of goods made of forced labour. The Modern Slavery Act itself does not prohibit the importation of goods made of child or forced labour, but the Bill that introduced it (Bill S-211) also amended the Customs Tariff Act so that Section 132(1) (m) (i.1) of that Act makes this prohibition. The Customs Tariff Act excludes "goods that are mined, manufactured or produced wholly or in part by forced labour or child labour as those terms are defined in Section 2 of the [Modern Slavery Act]." This is in addition to existing prohibitions on importing goods made with forced labour that was brought into effect on 1 July 2020, after the coming into force of the Canada-United States-Mexico Agreement Implementation Act (the "CUSMA Implementation Act").

The prohibitions in the Customs Tariff Act may have the unintended effect of complicating enforcement of the import ban, because its definitions (which come from the Modern Slavery Act) do not overlap completely with the definitions of child labour (established by the International Labour Organization) relevant to the CUSMA Implementation Act. It remains to be seen if the differing definitions of child labour between Acts will lead to challenges in enforcing the prohibition on goods made with child labour.

The Canada Border Services Agency has recently begun enforcing these prohibitions, including by detaining at the border more than 50 shipments. Canadian importers should take heed and consider the vulnerability of their supply chains and the diligence they may pursue to avoid important commercial and reputational impacts of such detentions.

Unveiling the blind spots

Despite prevailing beliefs regarding the positive impact of this Modern Slavery Act, as underscored by the conclusions of the United Nations Report of the Special Rapporteur on contemporary forms of slavery (the "UN Report"), the Modern Slavery Act has significant gaps. The Report points towards a significant issue regarding the treatment of foreign workers in Canadian workplaces which the Modern Slavery Act does not address. Canada's Temporary Foreign Worker Program has been criticised for fostering problems, such as underpayment and wage theft, as well as physical, emotional and verbal abuse, excessive working hours, inadequate breaks, lack of personal protective equipment, harassment and exploitation.

The UN Report illuminates the stark reality that Canadian companies must confront: modern slavery is not an issue confined to global supply chains' overseas activities but also a pervasive problem at our own doorstep. The Modern Slavery Act and the potential for further legislative changes in this area make it essential for Canadian businesses to scrutinise their practices and develop robust strategies proactively and continuously.

Conclusion

Recent amendments to the Competition Act constitute a pivotal change in addressing environmental representations. The expanded scope of deceptive marketing rules, coupled with new avenues for private entities to bring cases before the Competition Tribunal, indicates a dynamic transformation that equips consumers, competitors and activists with powerful tools for ensuring corporate transparency and responsibility related to greenwashing. Consequently, businesses are compelled to intensify their scrutiny of marketing practices to remain compliant with these developments.

Lastly, given the increasing focus on modern slavery, as exemplified by the requirements under Fighting Against Forced Labour and Child Labour in Supply Chains Act, it is essential for companies to develop comprehensive strategies to report on these pressing issues.

These developments highlight a firm commitment by the government of Canada to continue to entrench ESG considerations into the legislative and regulatory framework of the country.

CHILE

Law and Practice

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Bertrand-Galindo Barrueto Barroilhet & Cia

Contents

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Bertrand-Galindo Barrueto Barroilhet & Cia is a premier law firm based in Santiago, Chile, recognised for delivering value-driven legal solutions across diverse practice areas, including corporate law, mining, energy, environmental law, international trade, tax and dispute resolution. The firm is widely recognised as a leading adviser on ESG matters for both national and international clients. Its lawyers are highly experienced professionals who provide strategic and comprehensive legal support to both domestic and foreign clients, aiming to add value to their businesses through tailored, client-centric advice. With a strong focus on understanding the specific needs and objectives of each client, the firm excels in navigating complex regulatory landscapes and developing innovative strategies that align with business goals. Bertrand-Galindo Barrueto Barroilhet & Cia is committed to providing exceptional legal counsel with integrity, efficiency and a focus on enhancing the success and sustainability of its clients' ventures.

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1. Introduction

1.1 General ESG Trends

Progress in Chile's ESG landscape has not advanced as quickly as previously anticipated, with much of the regulatory agenda in 2024 being dominated by the implementation of the new Economic Crimes Law. This law came into effect for companies on 1 September 2024 and requires businesses to prioritise compliance and governance reforms, overshadowing other planned ESG initiatives.

Environmental

On the environmental front, the government has proposed a new bill to reform the Environmental Impact Assessment System (SEIA). This reform aims to strengthen the Director of the Environmental Assessment Authority, reduce delays in the SEIA and improve community engagement through early and expanded participation. The bill also proposes to centralise decision-making in more specialised roles, ensuring that the evaluation is led by technical experts rather than politically appointed bodies (such as the Environmental Evaluation Commission and the Committee of Ministers), granting more authority to the Regional Directorates of the Environmental Assessment Service (SEA).

Another key development is the enactment of Law No 21,600, which established the Biodiversity and Protected Areas Service. This new agency consolidates the management of terrestrial and marine protected areas, focusing on the conservation of Chile's rich biodiversity. In October 2023, Chile officially launched the Emissions Compensation System for the Green Tax (SCE), a new mechanism aimed at reducing greenhouse gas emissions through a compensation market based on emission reduction certificates. The SCE is expected to significantly advance environmental policy and support Chile's transition towards a greener and more sustainable economy.

Social

Two major labour laws were enacted in 2024:

- the 40-Hour Workweek Law (Law No 21,561) aims to gradually reduce the standard work-

week from 45 to 40 hours by 2028, promoting better work-life balance; and
- Law No 21,643 (known as *Ley Karin*, named after a victim of workplace harassment) strengthens protections against workplace harassment and violence, forcing companies to implement protocols to address psychosocial risks and mental health issues.

It is also worth noting the SEIA reform bill, which among other things underscores the importance of fostering community engagement and ensuring transparency with local stakeholders. Despite these advances, the anticipated human rights due diligence bill has not moved forward as expected, leaving a gap in corporate responsibility for human rights impacts, especially within supply chains.

Governance

The Economic Crimes Law (Law No 21,595) has been the most impactful governance-related development, significantly expanding corporate liability for governance and environmental offences, among others. This law requires companies to update their Crime Prevention Models to include ESG-related risks, and introduces severe penalties for non-compliance. On the other hand, the Commission for the Financial Market (CMF) is reconsidering the enforcement timeline for its General Standard No 461 (NCG 461), which mandates ESG disclosures for listed companies. The CMF is evaluating a more gradual implementation strategy, including extended deadlines and simplified reporting requirements for special and relatively smaller listed joint stock companies.

In the broader context of digital governance, Chile has also advanced its regulatory framework with the introduction of a bill to regulate artificial intelligence (AI). This bill, aligned with UNESCO's recommendations, aims to ensure ethical AI use by categorising systems based on risk and establishing principles such as transparency and human oversight. In addition, the recently enacted Framework Law on Cybersecurity and Critical Information Infrastructure has established stricter cybersecurity standards, making Chile a leader in digital governance in Latin America. These legislative efforts are accompanied by ongoing reforms to the Personal Data Protection Law, further embedding data privacy and digital ethics within the ESG governance pillar.

Moreover, during the past year, Chile has seen a notable increase in the availability of ESG reporting services that are supported by AI technology. These services leverage advanced data processing and analytical capabilities to automate and enhance ESG disclosures, making it easier for companies to meet compliance requirements and deliver transparent, data-driven reports. Nonetheless, companies run the risk of reducing the focus on substantive, material issues, potentially turning compliance into a superficial "box-checking" exercise driven by algorithms, rather than fostering genuine stakeholder engagement and ethical business practices.

Overall, while Chile's ESG framework is evolving, corporate governance reforms have dominated the agenda, with environmental and social updates progressing more slowly. However, recent advancements in AI regulation and cybersecurity are positioning Chile at the forefront of digital governance in the region.

1.2 Environment Trends

In 2024, Chile has experienced a tightening of environmental regulations and oversight, reflecting an increased focus on sustainability and climate considerations, particularly following the implementation of the new Methodological Guide for the Consideration of Climate Change in the SEIA in November 2023, which establishes clear criteria for assessing climate risks and resilience. However, the most significant development in this area is the proposed reform to the SEIA, which aims to integrate climate change factors into project evaluations and enhance the efficiency of the environmental licensing process. This reform emphasises early community participation and strengthens the technical rigour of evaluations by transferring greater authority to the Regional Directorates of the SEA. The changes are intended to streamline decision-making, reduce delays and ensure that environmental reviews are grounded in technical expertise rather than political considerations.

Despite the recent tightening of environmental regulations, there is growing frustration over the increasing bureaucracy in obtaining permits, making it difficult to advance new projects. A clear example is the case of a large power generation company that was unable to initiate the process of obtaining its Environmental Qualification Resolution (RCA) for a desalinated water recirculation system using advanced "pump storage" technology due to heightened scrutiny by a regional SEA office. This project, aimed at improving energy efficiency and sustainability, has stalled due to complex regulatory requirements, highlighting the challenges high-impact projects face in navigating Chile's evolving environmental standards.

Meanwhile, the mining sector – especially lithium extraction – and the green hydrogen industry are emerging as key drivers of Chile's economic growth, closely tied to the global push for green energy as companies strive to meet climate change and decarbonisation targets. These industries are increasingly subject to stricter regulatory oversight, particularly regarding water usage, emissions and their impact on local communities. As environmental compliance becomes a critical factor for future project development, these sectors are not only meeting local legal demands but are also preparing to adhere to heightened ESG standards from the EU, driven by pressure from international trade partners as their products enter global markets.

Overall, Chile's environmental landscape in 2024 is characterised by an openness to a broader consideration of environmental impacts, incorporating aspects such as climate change and biodiversity, along with increased global oversight and a focus on aligning with international sustainability standards. These changes are significantly affecting the feasibility of high-impact industrial projects, as companies must navigate evolving regulations and demonstrate compliance with both local and global environmental criteria to move forward.

1.3 Social Trends

In 2024, social trends in Chile have been shaped by substantial labour reforms aimed at strengthening employee protections and improving workplace conditions. A key legislative update is the enactment of the Law on the Prevention, Investigation and Sanctioning of Workplace Harassment, Sexual Harassment and Workplace Violence (Law No 21,643, commonly known as *Ley Karin*). This law came into effect in August 2024 and mandates that companies establish robust protocols to handle cases of workplace harassment and violence, and ensure a respectful and safe work environment. The law also expands the oversight capabilities of labour authorities, including the Labour Directorate and the Superintendence of Social Security, to investigate and enforce compliance more effectively.

Another major social reform is the implementation of the 40-Hour Workweek Law (Law No 21,561), which gradually reduces the maximum weekly working hours from 45 to 40 by 2028. This law aims to improve work-life balance and aligns with international trends focused on enhancing employee well-being. It introduces flexibility in work arrangements, such as the option for a four-day workweek, provided there is mutual agreement between employers and employees.

Despite these advancements, the anticipated human rights due diligence bill – which would impose obligations on companies to identify, prevent and address human rights risks in their supply chains – has not progressed as quickly as expected. This delay leaves a regulatory gap in the protection of human rights, particularly in high-risk industries.

Overall, Chile's social landscape in 2024 reflects a strong focus on labour rights and workplace safety, with ongoing efforts to address human rights issues in corporate practices.

1.4 Governance Trends

In 2024, governance trends in Chile have centred on enhancing corporate accountability and transparency through new regulations. The Economic Crimes Law (Law No 21,595) has greatly expanded corporate liability for ESG offences, with companies now being required to integrate ESG risks into their compliance models, with stricter penalties for misrepresentation or non-compliance. The broad range of offences and the severity of penalties have led to a cultural shift within companies, with management and boards prioritising non-financial risks and ESG-related responsibilities as core duties.

In addition, General Standard No 508 (NCG 508), issued by the CMF in May 2024, outlines corporate governance and comprehensive risk management instructions for stock exchanges and product exchanges. This regulation emphasises the role of boards of such entities in overseeing risk management frameworks, ensuring adequate organisational structures and establishing internal control mechanisms. NCG 508 also sets standards for policies, procedures and controls, requiring entities to align with international best practices while regularly updating their governance and risk management protocols.

Furthermore, the proposed "More Women on Boards" bill seeks to increase female participation on the boards of publicly traded and special corporations, gradually implementing a maximum quota of 60% for the gender, with greater representation. This initiative aligns with Chile's broader efforts to promote gender diversity and strengthen corporate governance practices.

1.5 Government and Supervision

Chile's regulatory and supervisory authorities play a crucial role in the ESG transition by ensuring the effective implementation and enforcement of sustainability regulations. The CMF, the SEA and the Superintendence of the Environment (SMA) are known for their rigorous oversight, requiring companies to fully comply with governance and environmental standards.

Similarly, the Labour Directorate (DT) and the Superintendence of Social Security (SUSESO) oversee compliance with social regulations, ensuring that labour laws like *Ley Karin* and the 40-Hour Workweek Law are strictly enforced. Their role in safeguarding employee rights and workplace conditions is central to upholding Chile's social standards, making these authorities essential to the country's broader ESG strategy.

Each of these bodies is characterised by its rigorous oversight and is staffed by highly specialised professionals, making them difficult to bypass and ensuring that compliance is enforced with integrity and gravity. Companies must approach these regulators with due diligence, as their strong reputation for upholding legal and ethical standards means that attempts to circumvent regulations are unlikely to succeed. Their role is pivotal in driving Chile's ESG agenda forward, promoting transparency, protecting labour rights and ensuring environmental sustainability. As such, these entities are critical to the effective functioning and credibility of Chile's ESG regulatory framework.

1.6 Market Participants

In Chile, the sectors most impacted by ESG regulations in the coming years will be mining, particularly lithium extraction, and the expanding green hydrogen industry, due to their environmental footprint and strategic role in the economy. These industries face increased scrutiny on issues such as water usage, emissions and community impacts, especially under the Climate Change Framework Law. In addition, these industries operate in global markets and are increasingly pressured by stakeholders to adhere to international ESG standards and assessments, such as the Global Reporting Initiative (GRI), International Financial Reporting Standards (IFRS), the Initiative for Responsible Mining Assurance (IRMA), the Dow Jones Sustainability Index (DJSI) and the International Council on Mining and Metals (ICMM), to maintain market access and obtain financing.

Given their significant contributions to Chile's GDP, mining and energy companies must meet the stricter ESG criteria enforced by international financiers, who require compliance with green finance standards. This creates a performative effect, where the need to meet these standards materially influences how these industries operate. At the same time, financial institutions in Chile will also be subject to growing ESG obligations as the government tightens regulations to combat greenwashing and establish more robust sustainability criteria, ensuring transparency and accountability in investments.

1.7 Geopolitical Developments

Chile's deep integration into the global economy makes it particularly vulnerable to geopolitical shifts and international policy changes, which is impacting the implementation of ESG regulations. While Chile's government actively supports ESG standards, progress has been slow, likely due to global economic challenges. Despite the slow legislative progress, ESG considerations are well integrated into key sectors, particularly mining and energy, which must adopt the international standards imposed by clients and global banks.

However, as ESG practices become more embedded, the increasing complexity in obtaining the necessary permits has been a growing concern, particularly among foreign investors. Chile was once seen as having a comparative advantage due to its efficient regulatory processes, but is now facing criticism for the bureaucratic hurdles that are slowing down project approvals. This raises concerns that the added requirements might lead to a more burdensome regulatory framework, potentially creating an adverse reaction from investors and threatening the viability of future projects, thus impacting the country's economic competitiveness.

2. Corporate Governance

2.1 Developments in Corporate Governance

In 2024, corporate governance practices in Chile have evolved through key regulatory changes that emphasise transparency, diversity and digital governance. A significant development is the Economic Crimes Law (Law No 21,595), which expands corporate liability for ESG offences, requiring companies to integrate ESG risks into their Crime Prevention Models. This law is among the most stringent globally, covering a broad array of crimes and imposing severe penalties. It has led to a cultural shift, with boards and senior management now required to fully incorporate non-financial risks – such as environmental and social issues – into their fiduciary duties. This law took effect in September 2024 and its impact is expected to grow, with the first prosecutions for inadequate due diligence in preventing economic crimes expected in 2025.

NCG 508 establishes governance and risk management guidelines for stock exchanges, focusing on oversight, internal controls and alignment with international best practices. The "More Women on Boards" bill further advances gender equality by requiring 20% female representation on boards within six years, promoting greater diversity in corporate leadership.

Chile is also making strides in digital governance with the introduction of a new AI bill, which creates a risk-based framework to ensure ethical use of AI. This effort, along with updates to the National AI Policy, reinforces Chile's position as a leader in responsible AI regulation in Latin America.

The proposed Human Rights Due Diligence bill will further extend corporate responsibility, making human rights risks a core part of governance requirements. These reforms reflect Chile's commitment to modernising corporate governance through ESG integration, enhanced diversity and addressing the growing importance of digital governance.

2.2 Differences Between Listed and Unlisted Entities

In Chile, listed companies are currently the primary entities required to report on ESG matters, reflecting the government's strategy to implement sustainability disclosures gradually. At present, the obligation to report ESG data is focused on very large companies regulated by the CMF under NCG 461 and NCG 508. These regulations require detailed disclosures on ESG practices, including board composition, risk management and anti-corruption measures. As mentioned in **1.1 General ESG Trends**, there have been discussions to delay implementation by one year for special entities and relatively smaller listed joint stock companies.

Unlisted entities, particularly small and medium-sized enterprises (SMEs), are not yet subject to these reporting requirements, but ESG reporting obligations are expected to be extended to a broader range of companies over time. Regulators are mindful of the high costs and technical barriers that mandatory ESG reporting could impose on smaller businesses. To address these concerns, the CMF has proposed simplified reporting requirements and extended deadlines to ease the compliance burden on SMEs. However, with the introduction of the Economic Crimes Law, companies with annual revenue exceeding USD1 million are now required to implement prevention and due diligence mechanisms covering a range of risks, including environmental, labour, social security and corporate governance risks, regardless of whether or not they are publicly listed.

While listed companies are held to strict ESG reporting standards, unlisted entities currently enjoy more flexibility. However, market pressure and regulatory expectations are likely to push unlisted companies toward adopting ESG practices, either voluntarily through best practices or through eventual regulatory mandates tailored to their size and capacities.

2.3 Role of Directors and Officers

The roles and responsibilities of directors and officers in Chile have significantly evolved with the implementation of the Economic Crimes Law (Law No 21,595), which now holds them criminally liable for failing to establish effective Crime Prevention Models. For the first time, directors and senior management are legally required to actively consider non-financial risks, such as environmental, labour, social security and corporate governance risks, as part of their fiduciary duties. This has led to a shift from focusing solely on financial oversight to engaging in the development and integration of ESG strategies.

Directors and senior management must implement strong internal controls, ensuring that ESG matters – such as environmental impact, social concerns and governance – are incorporated into the company's decision-making processes. Failure to do so can result in severe legal liabilities. In addition, regulations issued by the CMF, such as NCG 461 and NCG 508, further mandate that boards oversee the transparency and accuracy of ESG disclosures. Given the interaction between the ESG reporting obligations and the Economic Crimes Law, there is also the potential for criminal liability if false or misleading ESG information is approved or reported by directors.

This growing responsibility emphasises the need for directors to be well-versed in sustainability issues and to ensure that ESG risks are integrated into the company's reporting and governance practices.

2.4 Social Enterprises

Chile does not have a specific legal framework designed exclusively for social enterprises, but businesses can incorporate social objectives within traditional structures like *Sociedades Anónima* s (SA) and *Sociedades de Responsabilidad Limitada* (SRL). Co-operatives are also an interesting option, as they prioritise social welfare and equitable participation over profit maximisation. Co-operatives are structured to ensure that members have a say in decision-making and benefit directly from the organisation's activities, making them ideal for businesses focused on shared value and community impact.

Many socially oriented businesses in Chile opt for B-Corp (*Empresas B*) certification, which formally recognises companies that meet high social and environmental standards. This certification provides a way for companies to distinguish themselves as socially responsible enterprises and align with global best practices in sustainability.

Moreover, a growing trend among high net worth companies is the creation of foundations aimed at benefiting local stakeholders, particularly communities where the company or its projects operate. These foundations focus on improving local livelihoods, enhancing social development and fostering positive relationships between companies and the communities impacted by their operations.

2.5 Shareholders

In Chile, current ESG obligations are not yet strong enough to drastically influence shareholder behaviour or decision-making. However, the implementation of NCG 461 has started improving transparency by requiring publicly listed companies to disclose their ESG practices. While these disclosures are still evolving, they offer shareholders more insight into a company's sustainability and risk management efforts.

Under the Economic Crimes Law, the fiduciary duties of directors and managers have been elevated, placing greater pressure on companies to comply with ESG standards to avoid risks that may threaten long-term business sustainability. Shareholders are becoming more informed through increased access to ESG data and are showing a growing interest in encouraging better practices within the companies in which they invest. Therefore, shareholder expectations and pressure are increasingly shaping corporate governance for the adoption of ESG strategies. This positions shareholders as key influencers, pushing companies to voluntarily adopt higher standards, aligning with global trends and safeguarding business sustainability.

3. Sustainable Finance

3.1 Progress in Green Financing

In Chile and Latin America, the past year has seen increased momentum in green financing initiatives. Chile issued its first Sovereign Green Bond Framework in 2019 and has continued to build on this with social and sustainability bonds, making it a regional leader. Although recent regulatory developments have only indirectly supported the growth of sustainable finance, updates to environmental regulations under the SEIA, along with the establishment of stricter environmental standards, have created a more predictable framework for sustainable projects. The Chilean Sustainable Finance Taxonomy, currently under development, will guide companies on eligible activities for green financing. However, a comprehensive regulatory framework for sustainable finance is still needed across the region, particularly to establish clear guidelines for greenwashing prevention and reporting.

3.2 Sustainable Finance Framework

In Chile, the General Banking Law does not yet explicitly codify ESG requirements, but financial institutions are increasingly incorporating ESG principles into their operations. Commercial banks are demanding non-financial disclosures from companies and promoting investments aligned with sustainable governance standards, guided by frameworks such as the IFC Performance Standards and the Equator Principles.

The CMF and the Central Bank of Chile are actively promoting ESG integration through complementary guidelines. In 2021, the CMF introduced a circular recommending the adoption of the Task Force on Climate-related Financial Disclosures (TCFD) framework, urging banks to disclose climate-related financial risks and integrate environmental and social factors into their risk management processes. This aligns Chile with international standards for ESG reporting and transparency.

The Central Bank of Chile has incorporated climate-related risks into its financial stability assessments under the *Agenda de Finanzas Verdes* initiative. This encourages the banking sector to consider environmental risks when evaluating long-term investments and asset portfolios. While not formal amendments to the General Banking Law, these developments mark a broader shift toward embedding ESG criteria in Chile's financial system.

In addition, Chile is introducing a Sustainable Finance Taxonomy, a standardised classification for sustainable activities, which will further support the integration of green financing principles into the financial sector. This taxonomy will offer clearer definitions for sustainable investments and help align financial products with ESG goals, enhancing transparency and accountability across industries.

3.3 Access to Green Financing

Access to green financing in Chile has expanded significantly through various mechanisms introduced by the government and financial institutions. The Chilean government has actively promoted green bonds, issuing approximately USD7.7 billion in green bonds since 2019. These bonds make up a substantial portion of Chile's total sovereign debt, and have primarily been allocated to climate change mitigation, sustainable water use and biodiversity protection.

The *Corporación de Fomento de la Producción* (CORFO) has developed a refinancing programme aimed at supporting projects that focus on renewable energy, energy efficiency and circular economy initiatives. Through financial intermediaries, CORFO offers loans of up to 15 years and finances up to 70% of the total investment, with a cap of USD20 million per project.

Local banks have joined these efforts by promoting green and sustainable loans for projects that prioritise environmental benefits. The Ministry of Energy has also launched a centralised website that consolidates information on public funding sources, making it easier for companies to explore financing options.

While these initiatives have increased accessibility, smaller companies and projects still face challenges in meeting stringent eligibility criteria and understanding ESG frameworks. The upcoming Sustainable Finance Taxonomy aims to standardise the criteria for green projects, making green finance more accessible and transparent.

3.4 Stranded Assets and Non-bankables

In Chile, the mining sector is the primary industry facing potential risks of becoming a stranded asset. However, unlike other traditional industries, the mining sector has been proactive in integrating ESG practices to align with global sustainability trends. Key mining companies are investing in renewable energy, water efficiency and community engagement initiatives, demonstrating a strong commitment to adapting to evolving ESG requirements, under the commitment to comply with Chile's goal of achieving carbon neutrality by 2050 and shifting its energy matrix towards renewable sources.

Chile's 2030 National Decarbonisation Plan has already led to the closure of several coal-fired power plants, but these closures have been managed through transition plans that aim to minimise economic and social impacts. A major consumer of energy, the mining industry is actively transitioning to renewable energy sources, thereby reducing its carbon footprint and aligning with national decarbonisation goals.

Rather than excluding traditional borrowers, financial institutions are increasingly supporting mining companies that adopt sustainable practices. This shift is reflected in the availability of green loans and sustainability-linked bonds tailored specifically for mining operations that meet environmental and social standards.

While the risk of stranded assets remains, particularly for non-compliant operations, the extractive resources and non-renewable energy industries are not being left behind. Instead, the focus is on transforming traditional sectors to meet ESG criteria and maintain their competitiveness in a low-carbon economy. This approach ensures that traditional industries can adapt to new requirements without losing access to critical financing.

3.5 Challenges Ahead

Chile's sustainable finance landscape faces several challenges as it adapts to growing ESG expectations. A primary concern is greenwashing, where companies exaggerate their environmental credentials to attract investment. To address this, a proposed bill against greenwashing aims to regulate sustainability claims, penalise misleading statements and establish clear guidelines for companies to follow. Once approved, this bill will help to ensure transparency and credibility in ESG claims, thereby building trust in sustainable finance.

Conversely, greenbleaching has not been observed in Chile and has not been raised as an issue, as many ESG regulations remain voluntary and primarily follow a best practices approach. This situation has allowed companies to be more flexible in their reporting without fearing liability.

An emerging concern is the rise of "anti-ESG" sentiment from sectors that view stricter regulations as barriers to competitiveness. This is particularly relevant for resource-intensive industries like mining, which may resist compliance if they see these standards as harming profitability. This is particularly true with respect to neighbouring countries with less rigorous ESG standards.

In addition, financial institutions are experiencing higher compliance burdens as ESG standards become more complex, requiring enhanced monitoring and reporting systems. This can strain smaller institutions with limited resources. An unresolved issue is the lack of a clear taxonomy to classify green projects – a challenge Chile may not be able to fully resolve independently and that requires a degree of international consensus.

Finally, effective regulatory enforcement is essential to ensure compliance. Without strong oversight, the impact of new regulations may be limited, reducing Chile's ability to attract sustainable investment and meet its climate goals. Addressing these challenges will require co-ordinated efforts between regulators, financial institutions and the private sector.

4. ESG Due Diligence

4.1 Soft Law Becoming Hard Law

In Chile, ESG-related soft law is increasingly being integrated into binding regulations, reflecting a shift towards stricter compliance. A key development is the proposed Human Rights Due Diligence Law, which aims to enforce corporate responsibility regarding human rights and environmental protection. The initiative is aligned with international standards, such as the European Union's Corporate Sustainability Due Diligence Directive, and would require companies to identify, prevent and mitigate any negative impacts across their value chains. If passed, this law would mark a significant transition from voluntary ESG guidelines to mandatory due diligence obligations.

Moreover, the CMF's NCG 461 introduced mandatory ESG disclosures for publicly listed companies. The regulation requires these companies to include information on their ESG policies in their annual reports, establishing a clear reporting standard. While NCG 461 does not yet impose penalties for non-compliance, it has laid the groundwork for more robust reporting obligations.

The Economic Crimes Law (Law No 21,595), enacted in 2023, expanded corporate liability to include offences related to environmental damage and governance misconduct. This law increases accountability for companies, making it part of a broader regulatory framework that supports ESG enforcement.

Overall, while many ESG regulations in Chile are still based on best practices, the country is moving towards hard law frameworks that aim to provide clearer guidelines and stricter compliance measures for companies.

4.2 Towards Vertical Responsibilities

In Chile, there is an increasing focus on human rights due diligence in corporate supply chains, driven by the global trend of strengthening corporate responsibility. While there is no comprehensive due diligence law covering all ESG areas, the Chilean government is considering a regulation focused specifically on human rights due diligence. This would require companies to assess, prevent and mitigate human rights risks throughout their supply chains, aligning with international standards like the United Nations Guiding Principles on Business and Human Rights.

The proposed regulation would place responsibilities on companies to actively identify potential human rights violations within their operations and business relationships, setting a precedent for broader vertical responsibilities. Although it has not yet been formally introduced as a bill, discussions around this regulation have raised awareness among companies regarding the need to implement robust risk management systems that extend to third-party contractors and suppliers. This growing attention on supply chain due diligence is also closely tied to international commercial pressure, especially concerning Chilean exports.

The Economic Crimes Law (Law No 21,595) has expanded corporate liability in areas like governance and environmental offences, and has made companies responsible for the commission of economic crimes in those areas even if committed by commercial partners such as suppliers and service providers. Thus, the implementation of the company's Crime Prevention Model requires the extension of the law's application to reach supply chains.

4.3 Partner Selection

The implementation of the Economic Crimes Law (Law No 21,595) has significantly impacted how companies in Chile manage their supplier relationships and contract partners. The law expanded the scope of criminal liability for companies, and requires businesses to integrate a comprehensive risk management approach that includes third-party suppliers in their compliance structures. This has forced companies to be more diligent when selecting partners and to incorporate them into their Crime Prevention Model as relevant stakeholders.

Under Law No 21,595, companies must consider suppliers and contractors in their risk matrix and include them in due diligence processes to identify any potential risks related to, for example, environmental, governance or corruption offences. This approach aims to ensure that companies are not only compliant with internal policies but are also protected from being held liable for illegal activities carried out by their business partners.

As a result, companies are now more cautious when contracting suppliers, often requiring them to meet specific compliance standards and sign agreements that align with the company's crime prevention policies. This includes implementing enhanced Know Your Supplier (KYS) procedures, ongoing monitoring and, in some cases, terminating relationships if a supplier fails to meet the required standards.

This regulatory shift is not only improving compliance among primary companies but is also enhancing practices down the supply chain. Smaller suppliers are being pushed to elevate their standards, adopt formal risk management procedures and invest in training programmes to understand and meet these new requirements. By doing so, suppliers strengthen their own compliance frameworks, making them more attractive business partners and minimising the risk of being excluded from supply chains.

Ultimately, this approach is fostering a more responsible and transparent business environment throughout Chile's supply chains, ensuring that suppliers play a proactive role in mitigating legal and reputational risks. Increasingly, the reputational risk of incorporating suppliers with a negative ESG track record has led large companies to adopt stricter selection criteria when choosing their business partners, encouraging better practices and alignment with sustainability goals.

4.4 ESG in M&A Due Diligence

In Chile, the integration of non-financial risks such as ESG factors has become a critical component in M&A due diligence processes. Traditionally, due diligence focused primarily on financial, operational and legal risks, but recent trends show a growing emphasis on assessing a target company's ESG performance to identify potential risks and liabilities that could impact the long-term value of an acquisition.

This shift is driven by several factors, including regulatory developments, investor expectations and the increased importance of sustainability in business strategies. For example, assessing a target company's environmental impact, labour practices, human rights policies and governance structures is now standard practice. Failing to address these non-financial risks can lead to significant reputational damage, restricted access to project financing or even legal liabilities post-acquisition.

As a result, M&A transactions now often include specific ESG due diligence modules alongside traditional parameters. This involves evaluating the target's adherence to ESG standards, identifying areas of non-compliance and estimating potential future costs for aligning the company with best practices. Incorporating ESG matters into due diligence not only helps buyers understand the full scope of risks but also ensures that the acquisition is aligned with sustainability goals.

This comprehensive approach strengthens decision-making, reduces the risk of inheriting hidden liabilities and supports sustainable growth strategies, making ESG an indispensable element in M&A due diligence processes.

5. Transparency and Reporting

5.1 Key Requirements

In Chile, ESG disclosure requirements for publicly listed joint stock companies are governed by NCG 461, issued by the CMF, which requires listed companies to report on ESG practices in their Annual Reports, including climate-related risks, human rights and governance structures. The goal is to increase transparency and ensure that non-financial risks are integrated into overall corporate strategies.

To support broader compliance, the CMF has been considering a one-year extension for the implementation of NCG 461 and introducing simplified reporting requirements for special and relatively smaller listed joint stock companies. This would allow them to submit an abridged version of the Annual Report, focusing on essential ESG information without the extensive disclosures required from larger entities.

This phased approach aims to reduce the compliance burden on smaller companies while promoting the adoption of ESG principles across the market. As a result, large companies must still provide comprehensive ESG data, while SMEs can gradually build up their reporting capacity, ensuring an inclusive transition towards more robust sustainability practices in Chile's corporate sector.

5.2 Transition Plans and ESG Targets

In Chile, there are currently no mandatory requirements for companies to publish specific transition plans or commit to ESG targets, except for those set by NCG 461, which applies to large publicly listed companies and requires them to disclose their ESG policies, strategies and risk management in their Annual Reports. However, it does not mandate formal transition plans or binding ESG targets. Moreover, there is no specific legal standard or law addressing greenwashing, which leaves a regulatory gap concerning the accuracy and verification of companies' sustainability claims.

Nonetheless, companies are increasingly expected to adopt voluntary commitments in line with international standards, such as the TCFD and Sustainability Accounting Standards Board (SASB) frameworks. Many firms – especially those in sectors with high environmental impact like mining and energy – are implementing emission reduction goals, climate risk assessments and sustainability targets to align with global best practices.

With Chile's recent approval of the Climate Change Framework Law, large emitters will soon be required to develop Climate Change Adaptation and Mitigation Plans, which will set specific emission reduction goals and outline pathways to meet national decarbonisation targets. While the detailed regulatory guidelines are still being developed, these requirements will become a crucial element of corporate ESG strategies in the coming years. Currently, companies that publicly adopt ESG targets are mainly accountable to their clients and investors.

Overall, while transition plans and binding ESG targets are not yet universal, Chile is advancing towards a more structured framework. The absence of clear greenwashing regulations is a notable gap, but future regulations are expected to close this and strengthen accountability.

5.3 Regulation of ESG Labels

In Chile, there are currently no specific regulations governing the use of ESG labels or sustainability claims. However, companies must comply with the general Consumer Protection Law (Law

No 19,496) and Advertising Standards to avoid making false or misleading statements about the sustainability of their products or services. This implies that any sustainability-related claims must be accurate, verifiable and not misleading, ensuring that consumers are not deceived by vague or exaggerated ESG statements.

Chile is working on a proposed bill against greenwashing, which aims to regulate and standardise how companies and financial institutions present their environmental and social credentials. Once enacted, this legislation will establish clear criteria for making sustainability claims and introduce penalties for companies that engage in greenwashing. The bill seeks to ensure that companies back up their claims with reliable data and certifications, ultimately enhancing the credibility of ESG labels and fostering transparency in the market.

In the absence of specific ESG label regulations, many Chilean companies voluntarily adopt international standards and certifications, such as the Global Reporting Initiative (GRI), B Corporation Certification and ISO 14001 for environmental management. These standards serve as benchmarks for validating sustainability claims and ensuring consistency in reporting.

5.4 Supervision

In Chile, environmental compliance is overseen by the SMA, which ensures that companies adhere to environmental regulations. The SMA monitors compliance with environmental standards and has the authority to enforce penalties for non-compliance.

ESG disclosures and sustainability marketing claims are primarily monitored by the CMF, which oversees compliance for large publicly listed companies. NCG 461 mandates that listed entities include ESG information in their annual reports, such as environmental policies, human rights practices and corporate governance structures.

For sustainability claims made to consumers, the National Consumer Service (SERNAC) is the primary regulatory body. SERNAC enforces the Consumer Protection Law (Law No 19,496), which prohibits misleading or deceptive advertising. Companies making false or exaggerated ESG claims can face fines and reputational damage if their marketing practices are found to mislead consumers.

It is also worth noting that Chile is drafting a greenwashing bill, and that new supervisory responsibilities may be established to oversee the use of ESG labels and claims more rigorously. This would likely involve a combination of the CMF and SERNAC, ensuring that both corporate ESG disclosures and consumer-facing sustainability claims are properly regulated and aligned with best practices.

5.5 Enforcement

In Chile, the enforcement of ESG-related non-compliance has been strengthened with the recent enactment of the Economic Crimes Law (Law No 21,595), which came into effect in 2023. This law significantly expands corporate liability by including offences related to environmental crimes and misleading disclosures in corporate reports. Under the law, companies and their executives can be held criminally responsible for providing false or incomplete ESG information that is legally mandated (for example, NCG 461), potentially facing severe penalties, including fines and imprisonment for those involved.

However, because this law is very new, there is still uncertainty about how it will be enforced by prosecutors, and the scope of its application and the criteria that will be used to assess violations are not yet fully defined. This ambiguity poses a challenge for companies, as the lack of clear enforcement guidelines means that compliance practices must be particularly cautious to avoid unintended breaches.

For consumer-facing claims, SERNAC enforces the Consumer Protection Law (Law No 19,496), which penalises misleading advertising. The anticipated greenwashing bill is expected to further strengthen penalties, providing a clearer framework to address ESG-related mis-statements and ensuring greater accountability in the Chilean market.

5.6 Expected Progress

In Chile, ESG reporting is expected to advance significantly in quality and scope as regulatory pressures and market expectations grow. The Empresas Sumando Valor 2023 report, produced by Acción Empresas, CPC, Global Compact and SOFOFA, shows an increase in ESG reporting but highlights gaps in areas like climate goals and biodiversity. The adoption of NCG 461 by the CMF has laid the groundwork for mandatory disclosures among listed companies, but its effectiveness remains limited in driving substantial improvements in reporting quality.

New regulations, such as the Economic Crimes Law (Law No 21,595), are expected to further compel companies to enhance transparency and accuracy in their ESG disclosures. This law introduces criminal liability for providing false or misleading information, creating higher stakes for compliance.

The CMF is also considering measures to support special and relatively smaller listed joint stock companies by introducing simplified reporting requirements and extended deadlines to ease compliance, promoting broader adoption of ESG practices.

Moving forward, Chilean companies will need to adopt international frameworks like the TCFD, the GRI, the SASB and the EU's Corporate Sustainability Reporting Directive (CSRD), to align with global best practices. This evolution will require improved data management and internal controls, ensuring that ESG reporting is not only comprehensive but also reliable and meaningful to investors and stakeholders. These efforts will shape a more transparent and robust ESG landscape in Chile.

6. Climate and ESG Litigation

6.1 Instruments for ESG Litigation

Chile does not have a specialised court dedicated exclusively to addressing ESG matters. Instead, disputes are generally heard by different forums, depending on the nature of the issue and the sector involved. Environmental matters, for instance, are addressed by the Environmental Courts (*Tribunales Ambientales*), which have exclusive jurisdiction over conflicts related to environmental regulations, damage assessments and remediation actions. These courts provide a specialised mechanism for environmental litigation, offering technical expertise in addressing complex environmental issues.

For social matters such as labour rights or community-related grievances, parties can resort to the *Recurso de Protección* (Emergency Injunction Action) before the local Court of Appeals. This legal instrument is designed to protect constitutional rights when there is an imminent threat to fundamental freedoms. It is widely used in Chile to seek quick judicial intervention in response to urgent social issues, such as labour rights violations or infringements of the rights of Indigenous communities.

In contrast, disputes involving corporate governance, such as breaches of fiduciary duties, shareholder conflicts or mismanagement of corporate assets, are typically handled by civil courts. These cases are usually framed as claims for damages or compensation, and require evidence of financial harm or misconduct by corporate officers. Because there is no specialised tribunal for governance issues, these matters follow standard civil procedures, which can lead to longer resolution times.

An additional forum for hearing ESG-related cases is the criminal courts, particularly in relation to the commission of economic or environmental crimes. Under the Economic Crimes Law (Law No 21,595), entities can face criminal liability for failing to prevent crimes within their companies, including those related to governance and environmental violations, and natural persons may also be held criminally accountable. This law has expanded the scope for prosecuting offences that fall within the ESG framework, making criminal courts a novel venue for addressing serious violations related to ESG compliance.

Therefore, the legal landscape for ESG litigation in Chile is fragmented and sector-specific, with no single, specialised forum to address all ESG-related issues. Companies and stakeholders must carefully identify the appropriate legal mechanism based on the nature of the conflict, whether it is environmental, social or governance-related.

6.2 Climate Activism

Non-governmental organisations (NGOs) and activists in Chile are becoming increasingly sophisticated and play a crucial role in advancing ESG-related issues. Their knowledge of the legal framework has empowered them to strategically leverage existing regulations to influence corporate and governmental decisions, particularly regarding environmental and social matters.

In recent years, Chile has witnessed a surge in climate activism, with activists actively engaging in legal processes to challenge environmentally harmful projects and promote stricter compliance with environmental laws. They frequently bring lawsuits before the Environmental Courts, challenging permits and environmental impact assessments, and demanding greater protection for ecosystems and local communities. This legal expertise allows them to effectively participate in complex cases, utilising scientific data and robust legal arguments to strengthen their positions.

In addition, activists are adept at using legal instruments like the *Recurso de Protección* (Emergency Injunction Action) to protect social and community rights when they believe constitutional guarantees are at risk. This legal sophistication has made them formidable stakeholders in large-scale projects, especially those impacting Indigenous communities and vulnerable populations.

Their strategies are not limited to litigation. Activists and NGOs also use public campaigns, media and international platforms to raise awareness, influence public opinion and pressure companies and the government to adopt higher ESG standards. As a result, they have become key drivers of more responsible business practices in Chile, compelling companies to address environmental and social issues more proactively.

The growing influence of these well-informed and organised activists is reshaping the ESG landscape in Chile, making it essential for companies to consider their perspectives when developing projects and compliance strategies.

6.3 Greenwashing v Greenbleaching

In Chile, there have been no significant claims or legal actions brought by investors or regulatory authorities related specifically to greenwashing. This is partly because many ESG regulations are still voluntary and focus on best practices rather than strict compliance. While the CMF has implemented NCG 461 to improve transparency in ESG reporting for listed companies, the regulation does not include direct penalties for exaggerated or misleading ESG statements.

That said, concerns about greenwashing are increasing, especially as the Chilean government is currently working on a proposed bill to regulate greenwashing. This bill aims to set clear criteria for sustainability claims and introduce penalties for companies that provide false or misleading information about their environmental credentials. The legislation would apply to both financial and non-financial sectors, ensuring that companies back up their sustainability claims with verifiable data.

On the other hand, greenbleaching (where companies avoid making any ESG claims to reduce liability) has not been observed in Chile. Many companies continue to voluntarily disclose their sustainability efforts, particularly due to market expectations and investor interest in ESG practices. However, as new regulations develop, the balance between avoiding greenwashing and encouraging meaningful ESG commitments will be a critical issue for both regulators and companies moving forward.

6.4 A Turbulent Future Ahead

In Chile, ESG-related litigation is expected to become increasingly frequent over the coming years, as is expected to occur internationally as well. This trend will likely be driven by the strengthening of local regulations, greater stakeholder awareness and the increasing influence of sophisticated NGOs and activists. As companies are held to higher standards of environmental and social responsibility, disputes related to non-compliance, inadequate ESG disclosures and social impacts on local communities are likely to increase.

The enactment of laws such as the Economic Crimes Law (Law No 21,595), which expands corporate liability for environmental and governance offences, combined with the potential introduction of a greenwashing bill, will provide more legal tools for plaintiffs to pursue ESG-related claims. These regulations will create clearer grounds for litigation, especially for misrepresentations in corporate sustainability reporting or breaches of new human rights due diligence obligations.

In addition, as Chile advances in its implementation of the Climate Change Framework Law and progresses with its 2030 Decarbonisation Plan, companies will face greater scrutiny over their environmental impacts and compliance with new climate regulations. This will likely lead to an increase in disputes, particularly in sectors with high environmental footprints, such as mining and energy.

Overall, as Chile's ESG landscape matures and regulatory enforcement strengthens, the number of ESG-related cases is expected to rise gradually. Companies will need to proactively manage these risks by improving their ESG strategies, enhancing transparency and adopting more robust compliance frameworks to avoid potential litigation in the near future.

Trends and Developments

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Bertrand-Galindo Barrueto Barroilhet & Cía is a premier law firm based in Santiago, Chile, recognised for delivering value-driven legal solutions across diverse practice areas, including corporate law, mining, energy, environmental law, international trade, tax and dispute resolution. The firm is widely recognised as a leading adviser on ESG matters for both national and international clients. Its lawyers are highly experienced professionals who provide strategic and comprehensive legal support to both domestic and foreign clients, aiming to add value to their businesses through tailored, client-centric advice. With a strong focus on understanding the specific needs and objectives of each client, the firm excels in navigating complex regulatory landscapes and developing innovative strategies that align with business goals. Bertrand-Galindo Barrueto Barroilhet & Cia is committed to providing exceptional legal counsel with integrity, efficiency and a focus on enhancing the success and sustainability of its clients' ventures.

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ESG in Chile: An Introduction

Chile's ESG landscape in 2024 represents a dynamic and evolving regulatory environment, driven by the need to align with international standards and address the country's domestic sustainability challenges. Over the past year, the country has implemented key reforms in environmental protection, social rights and corporate governance, signalling its commitment to transitioning towards a more sustainable future. However, the path forward is not without its challenges, including bureaucratic hurdles, the increasing complexity of ESG regulations and the need for enhanced transparency and accountability.

Environmental trends: strengthening Chile's climate resilience

Environmental concerns have long been central to Chile's sustainability agenda, given the country's vulnerability to climate change and its significant reliance on resource-intensive industries such as mining and energy. In 2024, Chile made further strides in reinforcing its environmental regulations, particularly through the proposed reforms to the Environmental Impact Assessment System (SEIA). The SEIA reform is expected to improve the efficiency of environmental reviews by integrating climate change considerations into project assessments and strengthening the role of Regional Directorates of the Environmental Assessment Service (SEA). By shifting decision-making to technical experts, the government seeks to enhance the technical rigour of evaluations while reducing delays caused by political interventions.

A key element of the SEIA reform is an emphasis on early public participation. Encouraging stakeholders, particularly local communities, to engage in the project evaluation process early on is a significant step toward ensuring transparency and fostering trust. By providing opportunities for communities to voice concerns at the start of the review process, companies can address potential social and environmental conflicts, thereby reducing the risk of future disputes and delays. This development highlights the importance of stakeholder engagement as a cornerstone of Chile's environmental policy.

In addition to these regulatory changes, Chile has continued to focus on biodiversity protection with the establishment of the Biodiversity and Protected Areas Service (SBAP) through the enactment of Law No 21,600. This new agency

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consolidates the management of terrestrial and marine protected areas, helping Chile to better protect its ecosystems from the impacts of industrial activity and climate change. Furthermore, in October 2023, Chile launched the Emissions Compensation System for the Green Tax (SCE), which incentivises businesses to reduce their greenhouse gas emissions through a compensation market based on emission reduction certificates. This market-based approach is part of Chile's broader strategy to meet its climate goals, including its ambition to achieve carbon neutrality by 2050.

However, despite the progress made in strengthening environmental oversight, bureaucratic delays continue to pose a challenge for businesses seeking environmental permits. A prominent example of this issue is the case of a large power generation company that struggled to obtain its Environmental Qualification Resolution (RCA) for a ground-breaking desalination project. The company's efforts were hindered by increased scrutiny from a regional SEA office, delaying its ability to move forward with its advanced pump storage technology project. This situation underscores the growing frustration among businesses about the complex regulatory framework and the difficulty of navigating evolving environmental standards. The need to streamline the permitting process while maintaining rigorous environmental protections is an ongoing challenge for the Chilean government.

Chile's energy transition, with the aim of achieving carbon neutrality by 2050, is being driven by a significant shift toward renewable energy sources, particularly solar, wind and green hydrogen. This transition is not only reshaping the energy sector but also transforming how companies approach non-financial risks, specifically those related to ESG factors.

The requirement to disclose and manage these non-financial risks, as mandated by regulations such as General Standard No 461, is propelling companies to adopt more sustainable practices and incorporate ESG criteria into their core operations. This growing emphasis on transparency and accountability in ESG matters is influencing market behaviour, as companies that effectively manage ESG risks are better positioned to access financing, particularly from international banks and investors who prioritise sustainability. As a result, businesses in Chile's energy sector are increasingly focusing on water usage, emissions reduction and community impact as part of their strategic risk management, aligning with global best practices and responding to the financial market's demand for greener, more responsible investments.

In this way, the intersection of Chile's energy transition and ESG obligations is playing a crucial role in shaping the country's economic and environmental landscape, making sustainability an essential aspect of long-term business viability in Chile.

Social trends: enhancing labour protections and addressing human rights due diligence

Chile's social landscape in 2024 has been marked by major labour reforms aimed at improving working conditions and protecting employees from workplace harassment. One of the most significant developments is the introduction of Law No 21,643, commonly known as *Ley Karin*, named after a victim of workplace harassment. This law mandates that companies implement comprehensive protocols to address psychosocial risks and mental health issues in the workplace. It also strengthens the role of labour authorities, such as the Labour Directorate and the Superintendence of Social Secu-

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rity, by granting them expanded oversight and enforcement powers.

Another major social reform enacted in 2024 is the 40-Hour Workweek Law (Law No 21,561), which seeks to gradually reduce the maximum weekly working hours from 45 to 40 by 2028. This law aims to improve work-life balance, and reflects a broader global trend of enhancing employee well-being. Importantly, the law introduces greater flexibility in work arrangements, such as the option for a four-day workweek, provided there is mutual agreement between employers and employees. These labour reforms are expected to improve workplace conditions across industries, fostering a more productive and sustainable work environment.

While these advancements in labour rights are notable, the anticipated human rights due diligence bill for corporations has yet to be enacted. This proposed legislation, aligned with the UN Guiding Principles on Business and Human Rights, would require companies to identify, assess and mitigate human rights risks throughout their supply chains. Although the bill has not progressed as quickly as expected, discussions surrounding its implementation have heightened awareness among companies about the importance of human rights due diligence. Many Chilean companies, particularly those operating in the international markets, are already voluntarily adopting best practices in this area, but the absence of binding regulations creates a gap in the country's corporate responsibility framework.

In lieu of more developed local standards, Chilean companies operating abroad or as part of international corporate conglomerates face increasing pressure to meet international ESG standards from their stakeholders and clients. Therefore, industries such as mining, energy and infrastructure, which are critical to Chile's economy, willingly adhere to the highest international standards and assessments, including those set by the Global Reporting Initiative (GRI), International Financial Reporting Standards (IFRS), Initiative for Responsible Mining Assurance (IRMA), the Dow Jones Sustainability Index (DJSI), etc. These international standards drive greater transparency and accountability within Chilean companies, further aligning the country's social policies with global best practices.

Governance trends: expanding corporate accountability and liability

Chile's governance landscape has undergone significant transformations in 2024, largely driven by regulatory reforms aimed at enhancing corporate accountability and transparency. The full entry into force of the Economic Crimes Law (Law No 21,595) has been one of the most influential governance-related changes, imposing stricter compliance requirements on businesses and significantly expanding corporate criminal liability. Under this law, companies are now required to update their Crime Prevention Models to incorporate ESG risks, ensuring that governance practices reflect not only financial oversight but also social and environmental considerations.

One of the key features of this law is its broad scope, covering a wide range of crimes related to environmental damage, corruption, social security offences and other corporate misconduct. The severity of penalties under Law No 21,595 has brought about a cultural shift in Chilean corporate governance: for the first time, companies are integrating non-financial risks, such as ESG factors, into their core business strategies. This move has pushed boards of directors and senior management to reevaluate their fiduciary

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duties, focusing on long-term sustainability and stakeholder engagement beyond the traditional financial metrics.

Directors and officers could now potentially face criminal liability for failing to prevent corporate crimes, making corporate governance a more holistic concept that includes compliance with ESG duties. The Crime Prevention Model, initially introduced to prevent corruption and financial crimes, has been expanded to include ESG risks, thereby aligning with international best practices in corporate governance. Companies must now implement due diligence mechanisms to identify potential risks across their supply chain, ensuring compliance with both local laws and global ESG standards.

Corporate disclosures and governance reporting

Chile's focus on corporate governance reforms also includes increased transparency in reporting practices. General Standard No 508 (NCG 508), issued by the Commission for the Financial Market (CMF), establishes governance and risk management guidelines for stock exchanges and product exchanges, focusing on oversight, internal controls and alignment with international best practices. This regulation aims to improve corporate governance practices and align Chile with global governance standards.

In addition to this, the "More Women on Boards" bill, currently in discussion in the Senate, seeks to promote gender diversity by requiring a minimum of 20% female representation on corporate boards within six years. This bill reflects broader efforts to promote diversity and inclusion in Chile's corporate sector, recognising that diverse leadership teams are more likely to prioritise sustainable practices and consider stakeholder interests in decision-making processes. Gender diversity, especially at the board level, has been linked to better governance outcomes and improved risk management, particularly in relation to ESG considerations.

The CMF's General Standard No 461 (NCG 461) has also played a significant role in advancing corporate governance, as it requires publicly listed companies to disclose ESG policies, strategies and risk management practices in their Annual Reports, thereby integrating non-financial risks into mainstream reporting. By making these disclosures mandatory, the CMF is pushing companies to consider ESG factors as part of their overall governance strategy, enhancing transparency for investors and stakeholders. There is an ongoing discussion regarding delaying the implementation of NCG 461, particularly for relatively smaller listed companies that may face greater challenges in meeting the reporting requirements.

The rise of digital governance and cybersecurity standards

Another emerging trend in Chile's governance landscape is the increased use of artificial intelligence (AI) in corporate governance and ESG reporting. The introduction of an AI bill in 2024 has created a risk-based framework for regulating the ethical use of AI in corporate decision-making. This bill establishes principles such as transparency and human oversight, ensuring that companies use AI technologies in a responsible manner.

In addition to AI regulation, cybersecurity has become a critical component of corporate governance, particularly as companies face growing risks related to data breaches and cyber-attacks. The recently enacted Framework Law on Cybersecurity and Critical Information Infrastructure has set stricter cybersecurity standards, aligning

Chile with international best practices in digital governance. These developments are helping to position Chile as a leader in digital governance in Latin America, with companies now required to adopt more robust cybersecurity measures as part of their overall governance frameworks.

Moreover, the use of AI in ESG reporting has increased, with many companies leveraging AI technologies to enhance data processing and analytical capabilities. This allows businesses to automate their ESG disclosures, ensuring greater accuracy and efficiency in meeting reporting requirements. As AI becomes more integrated into corporate governance practices, it is expected to improve risk management and support the development of more effective compliance strategies.

It is crucial to recognise that, while AI-driven tools offer enhanced efficiency and precision in ESG reporting, they also present certain risks. For instance, the reliance on algorithms could shift the focus away from meaningful stakeholder engagement and human-driven insights. This could inadvertently lead to a "tick-box" approach to compliance, where companies prioritise using AI to meet technical requirements, such as employing the right terminology to satisfy algorithmic patterns, rather than ensuring genuine, impactful actions that align with ethical business practices. In this way, ESG compliance risks become more about meeting technological criteria than addressing the actual material concerns and impacts on stakeholders.

The Economic Crimes Law: a new era of corporate responsibility

The Economic Crimes Law (Law No 21,595) has been a game changer for governance in Chile. It introduces criminal liability for directors and officers who fail to implement effective Crime Prevention Models within their companies, particularly in relation to ESG risks. This law has expanded the range of offences that companies can be held accountable for, including environmental crimes, governance failures and other corporate misconduct.

Under this law, companies are required to demonstrate that they have taken all necessary steps to prevent criminal activities, including those related to ESG violations. This has led to a greater emphasis on risk management and internal controls, particularly in industries with high environmental impact such as mining and energy. Directors and officers must now be more proactive in monitoring compliance and mitigating risks, ensuring that their companies are aligned with both local regulations and international ESG standards.

The penalties for non-compliance are severe, including sanctions for the corporation as well as fines, criminal charges and even imprisonment for the individuals responsible, and for those found guilty of governance due diligence failures. This has made ESG compliance a top priority for companies in Chile, with many investing in training programmes, compliance officers and third-party audits to ensure that their governance frameworks are up to date. The law's emphasis on accountability has also led to a shift in corporate culture, with companies placing a greater focus on ethical behaviour, transparency and responsibility.

The prospect for corporate governance in Chile

As Chile continues to develop its ESG framework, the focus on corporate governance will remain critical. The Economic Crimes Law, NCG 508 and the proposed More Women on Boards bill are expected to drive significant changes in how companies approach governance. These reforms reflect Chile's commitment to aligning its governance practices with international best practices, ensuring that companies are held to the highest standards of accountability, transparency and responsibility.

Looking ahead, the introduction of digital governance frameworks, such as the AI bill and the Framework Law on Cybersecurity, will further shape the governance landscape in Chile. Companies will need to invest in technology-driven governance solutions, incorporating AI and cybersecurity measures to effectively manage risks and meet evolving regulatory requirements. However, it is crucial that these efforts do not overshadow the focus on the material impact of the policies and actions implemented, ensuring that ESG compliance remains meaningful and substantive rather than merely procedural or a box-checking exercise. As Chile positions itself as a leader in sustainable governance, these trends are likely to create new opportunities for corporate growth, while also posing challenges for companies that fail to adapt to the changing regulatory environment.

In summary, Chile's governance reforms in 2024 reflect a holistic approach to corporate responsibility, integrating ESG principles into crime prevention, risk management and board governance. As companies navigate these changes, they will need to prioritise transparency, diversity and digital innovation to remain competitive in a globalised market.

Looking forward: the future of ESG in Chile

As Chile moves toward a more sustainable and inclusive economic model, ESG considerations will continue to play a central role in shaping corporate strategies, regulatory frameworks and financial systems. The country's commitment to carbon neutrality by 2050, coupled with its focus on promoting sustainable finance, positions Chile as a regional leader in the global transition towards sustainability. However, the path forward will require balancing economic growth with environmental protection, social responsibility and corporate governance reforms.

In the coming years, Chile is expected to expand its ESG regulations, with a particular focus on strengthening corporate accountability, improving transparency in sustainability claims and promoting green financing. Once enacted, the greenwashing bill will play a critical role in ensuring that companies adhere to rigorous ESG standards and provide accurate and verifiable information about their sustainability practices. Similarly, the introduction of the Sustainable Finance Taxonomy will help to standardise definitions for green investments, making it easier for companies to access green financing and align their projects with global sustainability goals.

At the same time, the challenges facing the sustainable finance sector – particularly around greenwashing, regulatory complexity and the risk of non-compliance – will need to be addressed through co-ordinated efforts between regulators, financial institutions and the private sector. As ESG becomes a more central pillar of Chile's economic policy, companies will need to adopt more robust compliance frameworks, improve their data management capabilities and enhance their transparency in order to meet the evolving regulatory demands.

In the coming years, compliance with ESG standards will become increasingly important for access to credit and financing. Therefore, financial institutions, particularly banks, will need to develop and standardise their ESG criteria to ensure that they are consistent and transparent across the industry. At the same time, private companies will have to adopt comprehensive strategies to meet these evolving standards. They must not only ensure compliance with ESG principles but also be able to provide verifiable, reliable evidence of their efforts and achievements.

Overall, Chile's progress in ESG considerations reflects the country's commitment to sustainable development, but further efforts are needed to ensure that the regulatory framework is inclusive, efficient and transparent. As Chile continues to align its policies with global sustainability standards, the ESG landscape will evolve, presenting both challenges and opportunities for companies seeking to operate in a sustainable and socially responsible manner.

FINLAND

Law and Practice

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Contents

Castrén & Snellman is a forerunner in addressing the most demanding legal issues. It advises Finnish and international clients in M&A and other transactions, dispute resolution, and the full scope of business law. Castrén & Snellman is based in Helsinki, Finland - although more than 50% of the firm's work is cross-border and it has global contacts with renowned law firms throughout the world. Castrén & Snellman serves as its clients' strategic speaking partner, with a comprehensive approach. The firm's goal is to help clients shape their market and build their own sustainable success stories. Castrén & Snellman's ESG and corporate sustainability service is the leading ESG practice among Finnish law firms. Its lawyers integrate ESG know-how across all services in the firm, with a particular focus on M&A, contract negotiations, and investigations. Castrén & Snellman regularly conducts ESG due diligence reviews and provides analysis of the reviewed company's ESG practices and risk management.

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1. Introduction

1.1 General ESG Trends

The regulatory framework for corporate sustainability is taking shape at a rapid pace, and evolving regulations concern companies of all sizes – either directly or indirectly. Being a member of the EU, most of Finland's ESG legislation originates from Brussels, and there was little national legislative activity regarding ESG and sustainability laws and regulations in Finland in 2023. The attention of both government and businesses has been mostly on preparing for and adapting to the EU's regulatory tsunami, which includes the Corporate Sustainability Reporting Directive (CSRD), the Corporate Sustainability Due Diligence Directive (CSDDD), the Taxonomy Regulation, the Deforestation Regulation, and the Green Claims Directive.

Finland had parliamentary elections in April 2023 and a new government took office in June 2023. No major legislative ESG projects were completed before the end of the year. In the current government programme, ESG issues are mentioned mostly in connection to Finland's objective of becoming a leader in clean energy and green transition technology (Programme of Prime Minister Petteri Orpo's Government 20 June 2023, Chapter 7) - for further details, see **1.2 Environment Trends**.

In 2024, the Finnish government has opened several new legislative packages that relate to ESG issues. The EU Deforestation Regulation, the CSDDD, EU regulations on greenwashing and consumer protection, the EU Carbon Border Adjustment Mechanism and other sector-specific legislation are being reviewed in order to prepare the needed changes to national legislation. A key trend is the national implementation of the CSDDD - the process of which has been initiated in Finland, with a working group and a monitoring group set to evaluate and prepare the necessary legislation. Additionally, an open stakeholder meeting was held on 30 September 2024 to gather input on the national implementation.

1.2 Environment Trends

Government Programme: Focus on Energy Transition and Uncertainty About Achieving Emission Targets

As mentioned in **1.1 General ESG Trends**, the Programme of Prime Minister Petteri Orpo's Government (published in June 2023) contains a chapter on clean energy. The programme focuses on the opportunities that the green transition and clean technologies can offer Finland in creating jobs and economic growth. The programme also mentions a risk for the carbon sink falling short of the targets in 2021–25 and notes that, according to calculations, Finland will "inevitably accrue a significant amount of emission debt in the 2020s". According to the programme, the government intends to "take sustainable measures to accelerate the uptake of technical solutions in this area" and "pledges to draw up a programme by the end of 2024 [to] reverse the emissions debt accumulated since the start of the decade".

In its Growth Package, the Finnish government has set out ways to promote sustainable economic growth. The most significant of the measures proposed in the package is an investment grant under the form of a tax credit for the low-carbonisation of industrial production processes through electrification or the use of renewable hydrogen and energy efficiency measures, as well as for accelerating investment in sectors that are strategic for the transition towards a climate-neutral economy. According to the proposal, the tax credit could amount to 20% of the total amount of the investment up to a maximum of EUR150 million per project. The proposed aid scheme, which is currently in consultation, is subject to prior approval by the EC.

Climate Adaptation and Litigation

In early 2024, the National Audit Office of Finland (NAOF) commenced an audit to find out whether the government climate policy is based on scientific information and whether the measures adopted are justified. In August 2024, the Finnish Climate Change Panel - a scientific and independent panel of experts - warned that the current government's measures would not be sufficient to achieve its climate targets.

In August 2024, six environment and human rights NGOs brought an action against the Finnish government for its lack of adequate climate action. The claimant NGOs argue that the government is breaching the Finnish Climate Act (*ilmastolaki*, 423/2022) and failing to meet its constitutional obligation to protect human rights. The case is currently pending in the Supreme Administrative Court.

A similar action was brought against the previous government in 2022, when Greenpeace and the Finnish Association for Nature Conservation took the Finnish State to court over insufficient measures to combat climate change. At the time, the Supreme Administrative Court declined to hear the case because, in Finnish administrative law, inaction does not constitute grounds for administrative appeal and because the Climate Act had only entered into force a few months earlier and the court deemed that the government had thus not had time to adopt the necessary measures yet. On that occasion, however, the court mentioned that – in theory – insufficient climate action by the government could be deemed to constitute grounds for a lawsuit.

The NGOs' action in 2024 was also made possible by:

- an amendment made to the Climate Act in 2023, which extended the right of action to NGOs; and
- the landmark case KlimaSeniorinnen v Switzerland, in which the ECHR ruled that Switzerland violated human rights by failing to take adequate action with regard to mitigation of climate change.

Legislation: New Climate and Circular Economy Obligations Introduced

The new Building Act (*rakentamislaki*, 751/2023) was adopted in March 2023 and will enter into force on 1 January 2025. It will introduce new climate and circular economy obligations - for instance, all new buildings and buildings that are to be extensively renovated will be required to have a climate declaration that specifies the building's carbon footprint and handprint.

The Building Act will also strengthen circular economy in the construction industry. According to the new essential technical requirements, buildings must be designed so that they are adaptable and can be used for a long time. With regard to new buildings and buildings to be demolished, an account must be provided on materials that have been used or will be released, on soil and rock material to be removed from the building site, and on the amount of hazardous waste.

In July 2024, a project for the reform of the Waste Act (*jätelaki*, 646/2022) commenced. The aim is to replace the Waste Act with a new Circular Economy Act that will take into consideration, among other things, upcoming EU legislation. The reform is based on one of the objectives of the Government Programme, according to which "Finland will improve its self-sufficiency, increase value added and reduce pollution by improving the recycling and reuse of materials".

A reform of the nature conservation legislation entered into force in June 2023. The Nature Conservation Act (*luonnonsuojelulaki*, 9/2023) is one of the main instruments for safeguarding Finland's biodiversity. In the new act, the protection of biodiversity is tied to ESG responsibilities, with sections on ecological compensation. Ecological compensation allows for the harm done in one area to be offset by enhancing biodiversity elsewhere. The previous act had been in force since 1997 and, since then, plenty of new information – for example, on biodiversity and climate change - has become available and other related legislation has evolved.

On 1 February 2023, the Finnish Ministry of the Environment and the Ministry of Agriculture and Forestry published a guide on good practices for the voluntary carbon market. Its aim is to improve the reliability of the domestic carbon market and prevent greenwashing in the market.

Criminal Investigation: Suspected Nature Conservation Offence

In August 2024, Finnish media reported on an incident where a forest machine destroyed thousands of extremely endangered freshwater pearl mussels by driving repeatedly across Hukkajoki River, one of the most important habitats for this protected species. In addition to directly crushing thousands of mussels, the machinery caused mud and silt to flow downstream from the crossing site, suffocating an even larger number of young mussels. The freshwater pearl mussel is a key species, vital for water quality and aquatic life. Due to habitat impacts, the species is extremely endangered and has been protected in Finland since 1955.

The police are investigating the events as an aggravated nature conservation offence. The case will probably become a key example of due diligence from the perspective of liability in the value chain – although it has been assumed that the machine operator was an independent subcontractor, the fact that the logging operation was commissioned by forestry giant Stora Enso has been widely publicised and, only a few days after the incident, the Finnish Minister of Climate and the Environment hastened to demand that the company compensate the restoration costs in full.

1.3 Social Trends

Human Trafficking and Forced Labour

The industrial picking of wild berries in Finland has relied heavily on foreign berry-pickers, recruited mainly from Thailand. For the past ten years, problems related to the status of these pickers have been discussed and various working groups have been working on solutions to them – an example of the results was the adoption, in 2021, of a law on the legal status of foreigners gathering natural products.

In 2023, the police conducted human trafficking investigations against three out of four of Finland's largest wild berry companies and, in 2024, prosecutors brought charges against two Finnish companies for aggravated trafficking in human beings in cases concerning Thai berry-pickers subjected to forced labour and other conditions that violate human dignity. The alleged offences were committed in various parts of Finland in 2022. The court proceedings regarding the wild berry case are still ongoing.

In recent years, similar crimes have been suspected or found in Finland in the restaurant and cleaning industries. In October 2023, the District Court of Helsinki found a couple of restaurant entrepreneurs guilty of four cases of human trafficking and extortionate work discrimination in their restaurants. In December 2023, the police announced that they had completed their investigation on several suspected cases of human trafficking in cleaning companies; the case has been submitted to the prosecutor for the consideration of charges.

A working group established by the Finnish Ministry of Economic Affairs and Employment in February 2024 is looking into different regulatory options to improve the position of foreign berry-pickers and other foreign employees in Finland.

Food Couriers

In a ruling in May 2024, the Finnish Insurance Court ruled that two food delivery couriers working for Delivery Hero Finland Logistics Oy (Foodora) were not employees under the Employment Contracts Act (*työsopimuslaki*, 55/2001). This decision overturned previous rulings by the Accident Insurance Appeal Board. The court determined that, despite the couriers working under the employer's direction and supervision via the Foodora app, they were not obligated to perform the work personally and could use substitutes or subcontractors. Consequently, the criteria for an employment relationship were not fully met. However, in another case, the Finnish Insurance Court ruled that a food courier working for the same company was under an employment contract and thus was not an independent contractor. This decision - in which the Employee Pensions Act (*työntekijän eläkelaki*, 395/2006) was applied - was based on the presence of all employment relationship characteristics, including personal commitment to the work and the employer's direction and supervision.

The wider question of whether food couriers are employees is currently pending at the Supreme Administrative Court. In February 2024, the Hämeenlinna Administrative Court ruled that Wolt food couriers were not employees, thereby overturning a previous decision by the Southern Finland Regional State Administrative Agency's occupational safety division. The court found that the couriers did not meet the criteria for an employment relationship under the Employment Contracts Act – specifically, because the employer did not have a right to direct and supervise the work. Consequently, the Working Hours Act (*työaikalaki*, 872/2019) also did not apply to their work. The occupational safety authority has appealed to the Supreme Administrative Court for a precedent, as the legal status of food couriers remains unclear and requires further clarification.

1.4 Governance Trends

As elsewhere, in Finland corporate sustainability issues are increasingly being integrated into the policies and processes of companies in all sectors. This is mainly due to recent ESG regulation - in particular, the CSRD and the CSDDD.

The CSRD requires the companies in scope to report on sustainability matters. Entered into force in 2023, its application will begin gradually. The first reports of the largest entities are due in 2025 for FY 2024, meaning that in these companies the preparations are well under way. Although the CSRD will only apply to relatively large companies (fewer than 1,000 companies in Finland), it is expected to have a spillover effect, as large companies will need to obtain information from smaller companies in their value chain and incorporate corresponding obligations into their supplier contracts. It is expected that the new legislation compels companies to pay more attention to ESG matters and be more transparent - ie, communicate on sustainability issues publicly.

Diversity, Equality and Inclusion (DEI)

A new government bill (HE 60/2024) proposes amending the Companies Act (*osakeyhtiölaki*, 624/2006) and the Chamber of Commerce Act (*kauppakamarilaki*, 878/2002). The proposed law would implement the EU Quota Directive (2022/2381) on balancing the gender distribution of board members in listed companies and related measures. The proposed law is expected to come into force by the end of 2024. For further details, refer to **2.1 Developments in Corporate Governance**.

1.5 Government and Supervision

In Finland, regulators and supervision authorities play a crucial role in the ESG transition by enforcing compliance with the various EU regulations.

The Finnish Competition and Consumer Authority (FCCA)

The FCCA plays a significant role in the ESG transition by ensuring competition and protecting consumer rights. By promoting competition and safeguarding consumer interests, the FCCA supports the broader goals of the ESG transition, fostering a competitive market environment where sustainable and responsible business practices can thrive.

The FCCA has already stated that the increased transparency of the supply chain as a result of ESG reporting must not result in commercially sensitive information being disclosed to competitors. The Finnish Consumer Ombudsman, which is a part of the FCCA, has increasingly focused on green claims in marketing and product packaging. The Finnish Consumer Ombudsman has emphasised that marketing communication may not contain false or misleading information; this also applies to environmental claims, which must be clear, precise, understandable, provable, and not misleading. The FCCA has already dealt with a number of ESG marketing cases (see **6.3 Greenwashing v Greenbleaching**)

The Finnish Financial Supervisory Authority (FIN-FSA)

The FIN-FSA provides guidance to help financial market participants navigate sustainable finance, ensures compliance, and collaborates with EU bodies to align national regulations with broader EU standards. The FIN-FSA oversees reporting and ensures compliance, with mandatory external audits.

In overseeing the stability of financial markets, the FIN-FSA ensures that supervised entities consider sustainability risks in their operations. Notably, information provided to customers and investors about sustainability factors must be appropriate so that customers can assess the sustainability of products and services, and investors can make sustainable investments if they wish.

Environmental Authorities

In Finland, environmental compliance is primarily overseen by the Regional State Administrative Agencies (*aluehallintovirastot*, or AVIs) and the Centres for Economic Development, Transport and the Environment (*elinkeino-, liikenne- ja ympäristökeskukset*, or "ELY Centres"). The AVIs are responsible for granting environmental permits under the Environmental Protection Act (*ympäristönsuojelulaki*, 527/2014) and the Water Act (*vesilaki*, 587/2011), ensuring that operations do not cause significant environmental risks. The ELY Centres, along with municipal environmental protection authorities, supervise compliance with environmental regulations.

Supervisory Authorities for Social Aspects of ESG

Several laws address the social component of ESG in Finland. One of the most crucial is the Occupational Safety and Health Act (*työturvallisuuslaki*, 738/2002) (OSHA), which aims to enhance the working environment and conditions to protect and sustain employees' ability to work, while preventing occupational accidents, diseases, and other work-related health risks. Additionally, the Non-Discrimination Act (*yhdenvertaisuuslaki*, 1325/2014) (NDA), the Act on Equality between Women and Men (*tasa-arvolaki*, 609/1986 (AEWM), and the Consumer Safety Act (*kuluttajaturvallisuuslaki*, 920/2011) (CSA) are important acts related to the social aspect of ESG.

The Ministry of Social Affairs and Health (MSAH) and the occupational safety and health divisions of the AVIs oversee the implementation and enforcement of OSHA. They ensure safe and healthy working conditions and monitor compliance through inspections and guidance.

The Non-Discrimination Ombudsman and the National Non-Discrimination and Equality Tribunal are the primary authorities responsible for monitoring compliance with the NDA. They handle complaints, provide guidance, and can impose sanctions for non-compliance.

The Ombudsman for Equality and the National Non-Discrimination and Equality Tribunal supervise compliance with the AEWM. They ensure that gender equality is promoted and that discrimination based on gender is prevented.

The Finnish Safety and Chemicals Agency (Tukes) and the FCCA are responsible for enforcing the CSA. Tukes monitors the safety of consumer goods and services, whereas the FCCA oversees broader consumer protection issues.

Finnish Food Authority

The Finnish Food Authority (FFA) is the competent national authority for the EU Deforestation Regulation. The tasks of the FFA with regard to the EU Deforestation Regulation mostly derive from the text of the legal act itself, but the exact role of the authority will be gradually defined after the application of the EU Deforestation Regulation begins on 30 December 2024.

Possible New Authority for CSDDD

Finland is currently in the early stages of implementing the CSDDD and many practical questions are still to be resolved. At the moment, however, it seems likely that Finland will need a new authority for the implementation and enforcement of the CSDDD.

1.6 Market Participants

ESG regulation touches all sectors and industries in Finland, either directly or indirectly. Traditionally, the largest Finnish companies come from the forest industry, energy industry and technology, so they will be affected most. As sustainable finance progresses, the banking and finance sector will also be affected.

1.7 Geopolitical Developments

The current geopolitical landscape - in particular, the war in Ukraine and the resulting tensions with Russia – has led to a shift in the Finnish government's focus. Finland became a full member of NATO on 4 April 2023. The militarisation and heightened defence concerns have resulted in increased defence budgeting, which has somewhat diverted attention away from ESG themes.

The foregoing also concerns the Arctic region, which is crucial for the green transition. The geopolitical situation in the Arctic makes it difficult to implement and maintain ESG-focused policies. Despite the urgent need for environmental sustainability and social governance in this region, the political situation complicates the efforts to address these issues effectively.

2. Corporate Governance

2.1 Developments in Corporate Governance

As mentioned in **1.4 Governance Trends**, a new government bill (HE 60/2024) proposes amending the Companies Act and the Chamber of Commerce Act. The proposed laws would implement the EU Quota Directive on balancing the gender distribution of board members in listed companies. The proposed law is expected to come into force by the end of 2024.

The EU Pay Transparency Directive (2023/970) entered into force in June 2023 and EU member states are required to bring into force the laws, regulations and administrative provisions necessary to comply with it by 7 June 2026. In Finland, the MSAH has appointed a working group to prepare the national implementation of the EU Pay Transparency Directive.

Besides this EU Directive, the Finnish government and central labour market organisations have also negotiated an Equal Pay Programme for 2024–27. The aim of the programme is to reduce the gender pay gap to less than 15% in the above-mentioned period. The measures focus on, among other things, pay awareness, gender equality planning at workplaces, the reconciliation of work and family life, and the dismantling of the gender-based division of labour. The Equal Pay Programme takes account of changes in collective bargaining and negotiation activities in the labour market and it also includes discussions between private sector trade unions about their possible participation in future Equal Pay Programmes.

2.2 Differences Between Listed and Unlisted Entities

Corporate governance requirements for listed companies are stricter than for unlisted companies. The Corporate Governance Code, which is a collection of recommendations on good corporate governance for listed companies, is applicable to all companies that are listed on Nasdaq Helsinki Ltd (Helsinki Stock Exchange). It is currently being amended to reflect the requirements of the EU Quota Directive on improving the gender balance among directors of listed companies.

2.3 Role of Directors and Officers

In the Finnish context, the company management's duty of care (which also covers the consideration of ESG issues) is primarily governed by the Companies Act. Under Chapter 1, Section 8 of the Companies Act, the management of a company must act with due care and promote the interests of the company. Pursuant to Chapter 22, Section 1 of the Companies Act, directors (which are specified to include members of the board of directors or the supervisory board, as well as the managing director) are liable to compensate the company for any damage that they have intentionally or negligently caused to the company in violation of the duty of care. Neglecting to pay sufficient attention to long-term sustainability and ESG factors could harm the company's reputation, financial performance, and shareholder value and could amount to violation of the duty of care.

Violation of the duty of care recently led to criminal sanctions in a case concerning environmental crime. In case KKO 2016:58, the Finnish Supreme Court was called to decide a case concerning the liability of the managers of a limited liability company for an environmental damage. The case has value as a precedent, given that similar court cases in Finland have been very rare. The Supreme Court held that the negligence of two board members was gross, considering that they had not familiarised themselves with the content of the environmental permit and had neglected their duty to arrange and supervise matters related to the environmental permit.

In practice, the tightening of ESG requirements means that the management of a company will need to take ESG issues into account in the company's strategy in order to ensure its long-term success. This involves identifying ESG risks and opportunities and ensuring they are addressed in the business model.

2.4 Social Enterprises

In Finland, there are approximately 1,700 social enterprises (*yhteiskunnallinen yritys*) – ie, enterprises whose primary business objective is to provide societal benefits and that use the majority of their profits to pursue goals associated with this objective. The legal form of business for these enterprises is not restricted; they can be limited liability companies, co-operatives, or associations or foundations engaging in business activities.

2.5 Shareholders

If the company management fails to take ESG issues into account as their duty of care requires, they can ultimately be held responsible for the damage this causes to the company. See **2.3 Role of Directors and Officers** for more detail.

3. Sustainable Finance

3.1 Progress in Green Financing

The sustainable finance framework in Finland is mainly EU-based, focusing on the EU Taxonomy Regulation and the EU Green Bonds Regulation (2023/2631) in line with European standards and practice. In addition, Finland has played an active role in sustainable finance initiatives internationally, and the Sustainable Development Goals (SDG) Finance Roadmap (Finnish Roadmap for Financing a Decade of SDG Action) provides guidelines for the Finnish operators to implement the necessary changes. The roadmap is part of the project on Developing Finland's Sustainable Finance Ecosystems. The roadmap aims to mobilise both public and private sector investments towards sustainable development, ensuring that financial flows support the achievement of the SDGs by 2030. For further details of Finland's sustainable finance roadmap, see **3.2 Sustainable Finance Framework**.

In Finland, green transition projects are prioritised through a combination of streamlined permit procedures and targeted funding. The AVIs and the ELY Centres play key roles in this process. From 2023 to 2026, AVIs are implementing a priority procedure for processing permits related to green transition projects, such as renewable energy production, low-carbon hydrogen production, electrification of industry, carbon capture and storage, and battery manufacturing. The ELY Centres support these projects by providing guidance, streamlining environmental procedures, and offering funding for initiatives that promote sustainable economic growth, circular economy, and biodiversity. This co-ordinated approach ensures that projects critical to the green transition can proceed without unnecessary delays.

In the summer of 2023, the FIN-FSA conducted a thematic review on the current status of the management of climate and environmental risks in a few Finnish banks and credit institutions under the FIN-FSA's direct supervision. The review concerned four areas of climate and environmental risk management:

- materiality assessment;
- impacts on the credit institution's business model and strategy;
- impacts on governance and risk appetite; and
- impacts on risk management with regard to different risk areas, focusing on credit, business model and operational risks.

The review showed that significant improvement is needed in many areas – in particular, the assessment of materiality, risk management and disclosures – and the FIN-FSA requires credit institutions under its supervision to develop their management and reporting of climate and environmental risks. It will continue to monitor their progress and reassess them in the near future.

3.2 Sustainable Finance Framework

When raising and providing finance in Finland, companies need to adhere to several regulations and guidelines set by the FIN-FSA. Certain financial services, such as investment services, credit institutions, and mutual funds, require authorisation from the FIN-FSA. The sustainable finance framework in Finland is mainly EU-based, as discussed in **3.1 Progress in Green Financing**.

When it comes to sustainable finance, the sustainable finance roadmap for Finland is a strategic plan designed to align financial activities with the UN's Sustainable Development Goals (SDGs). As mentioned in **3.1 Progress in Green Financing**, the roadmap aims to mobilise both public and private sector investments towards sustainable development, ensuring that financial flows support the achievement of the SDGs by 2030. The roadmap outlines specific goals and actions to integrate sustainability into financial decision-making. This includes promoting sustainable investments, enhancing transparency, and developing skills in sustainable finance.

To implement the roadmap, several pilot projects have been initiated. These projects focus on areas such as offshore wind power, sustainable protein production, climate-smart water solutions, and the export of vocational education. The Ministry of Economic Affairs and Employment is responsible for the national co-ordination of the roadmap, with input from various key Ministries and stakeholders.

3.3 Access to Green Financing

Sustainable finance has developed rapidly in recent years. The EC's Action Plan for Sustainable Finance, published in 2018, aims to reorient capital flows towards sustainable investment. This has had an effect across the entire financing sector, from bank finance to direct lending. It has also resulted in a vast body of new sustainable finance-related regulation in the EU.

In the light of these developments, there is a pressing need in sustainable finance for a standardised definition of "green" and a taxonomy of green activities in order to enable investors and financial institutions to make informed assessments effectively. For the time being, however, there is no generally applicable legal definition available. This is why the future EU Green Bond Standard will be based specifically on the EU Taxonomy Regulation. At the same time, the principles of the Loan Market Association (LMA) and the International Capital Market Association (ICMA) have gained in popularity and provided a widely followed, strong basis for self-regulation in the industry.

Sustainability is an increasingly important theme for financial institutions in Finland, and banks and institutional investors habitually assess their customers' sustainability performance and ESG risks. The EU Taxonomy Regulation provides a frame of reference for investors and financiers, but even activities that are not taxonomy-eligible can access sustainable finance. Companies looking for financing should, however, be aware that the question of whether a potential investment target fulfils certain sustainability criteria has become as important as the company's financial data for the financiers deciding on investments or funding.

In September 2024, the Finnish government submitted a bill (HE 77/2004) to Parliament proposing legislation to supplement the EU Green Bonds Regulation. Although the EU Green Bonds Regulation is directly applicable in all of the EU member states, it also requires some changes to the Finnish national legislation.

3.4 Stranded Assets and Non-bankables

Large Finnish companies have quite comprehensively internalised the need to go green and align their operations with the Paris Agreement's 1.5°C target, and many Finnish companies are international pioneers in their sector in this respect. By way of example, the Finnish oil company Neste has made significant investments in renewable fuels and corporate sustainability in its value chain. In Finland, the debate on just transition mainly concerns certain sectors and SMEs, as follows.

- Russia's war of aggression in Ukraine and the subsequent changes in the market have created new challenges for the forest industry. By way of example, wood raw material is no longer available from Russia, which has put pressure on the forest industry to increase felling volumes in Finland and neighbouring areas. On the other hand, the significant

carbon sink potential of forests is increasing pressure to limit logging. Around 60% of Finland's productive forest land is owned by private individuals and forest ownership is a key source of income for many. This also contributes to the debate on a just transition.
- Finland's previous government committed to halving the use of peat for energy by 2030 and the target was reached nine years early, largely due to the high price of emission allowances. This rapid change has posed challenges for businesses, entrepreneurs and workers in the peat sector.
- ESG requirements also affect SMEs, which are directly or indirectly subject to ESG requirements. At the same time, their resources may be limited and their ability to influence the sustainability of their own value chain may be small. There is general concern about the competitiveness of the SME sector, particularly in the context of the difficulties caused by the economic downturn.

3.5 Challenges Ahead

Finland is addressing greenwashing in sustainable finance through a comprehensive thematic assessment conducted by the FIN-FSA during 2023–24. This assessment focuses on how investment funds and special investment funds consider sustainability risks and disclose sustainability information. It aims to evaluate compliance with sustainable finance regulations, gather information on greenwashing risks, and identify necessary supervisory and regulatory actions to manage these risks. The assessment covers all Finnish fund management companies and alternative fund managers, examining their consideration of greenwashing and sustainability risks.

The first part of the assessment revealed that, even though companies acknowledge greenwashing risks, their measures are relatively limited. The FIN-FSA recommends that all companies review the findings of the study, assess their operations, and implement corrective actions as needed. The second part of the assessment will be reported in late 2024.

There are no anti-ESG legislation or initiatives concerning the financial sector.

4. ESG Due Diligence

4.1 Soft Law Becoming Hard Law

While ESG issues were previously mostly regulated by soft-law instruments, the upcoming CSDDD will be implemented nationally into hard law. All EU legislation related to ESG and sustainability will either be directly applicable in Finland or implemented through national legislation.

4.2 Towards Vertical Responsibilities

The impact of the CSDDD and other EU legislation goes far beyond the companies that are directly within their scope. Indirectly, the CSDDD will have a major impact on companies within the upstream and downstream value chain of the companies bound by the CSDDD. This means that there is likely to be a network of agreements between companies requiring emission reductions, due diligence on environmental issues and human rights, reporting obligations, and other ESG requirements.

4.3 Partner Selection

While the field is still evolving, it is expected that ESG compliant partners with proof of sustainability will be prioritised, to avoid risks. Most companies also have a Code of Conduct (CoC) and a Supplier Code of Conduct (SCoC), through which they voluntarily emphasise that they expect their supply chain partners to act sustainably and comply with high ESG standards. Through SCoCs and contractual clauses, many of the legal obligations that apply to large companies are actually cascaded to smaller supply chain partners as well.

4.4 ESG in M&A Due Diligence

ESG due diligence reviews have become an important and critical part of M&A in recent years. It is expected that ESG due diligence will be increasingly carried out before signing and closing transactions. Vendors are eager to show proof of their sustainability and buyers will want to verify the sustainability of the target. However, even though an increase in ESG due diligence can already be seen, the market practice in Finland is still evolving.

5. Transparency and Reporting

5.1 Key Requirements

Finnish companies that are in the scope of the CSRD are obliged to make ESG disclosures. For other companies, no requirements to disclose ESG information exist. Thus, mainly large and listed Finnish companies are affected. Under the CSRD, these companies are required to report on how their activities impact the environment and society, report on how ESG factors affect their business, set clear ESG targets, and publish the progress according to European Sustainability Reporting Standards (ESRS). The reported information must also be verified and published in a digital format for easier access and comparison.

5.2 Transition Plans and ESG Targets

The CSRD makes it obligatory for Finnish companies in the scope of the CSRD to publish and communicate their transition plans and sustainability targets. The CSDDD will require in-scope companies to adopt, implement and monitor transition plans.

5.3 Regulation of ESG Labels

Sustainability and green claims are regulated in Finland as marketing claims. Advertising is regulated by, for instance, the Consumer Protection Act (*kuluttajansuojalaki*, 38/1978), the International Code of Advertising Practice, the Unfair Business Practices Act (*laki sopimattomasta menettelystä elinkeinotoiminnassa*, 1061/1978) and legislation concerning competition. In general, marketing claims must not be misleading and they need to be truthful and substantiated.

Several significant amendments at EU level will affect Finnish marketing legislation. One of these amendments is the EU Green Claims Directive, and another amendment concerns the Consumer Package - ie, the changes to the EU Consumer Rights Directive (2011/83) and the EU Unfair Commercial Practices Directive (2005/29) introduced by the EU Directive on Empowering Consumers for the Green Transition (2024/825). The latter EU Directive entered into force in March 2024 and EU member states are to integrate its rules into their respective national legislation by March 2026.

Once in force, these amendments mean that the use of environmental claims – such as “green”, “environmentally friendly”, “gentle for the environment” and other corresponding vague claims – will be completely prohibited, unless the marketer can demonstrate a recognised excellent level of environmental protection and thus justify the use of this kind of very general claim.

Future objectives such as “we will be carbon-neutral by 2040” need to be based on clear, objective, publicly available, and verifiable commitments in order for the marketing not to be considered misleading. The commitments should be presented in a detailed and realistic implementation plan that includes, for example, measurable objectives to achieve the improvement presented in the environmental claim (as well as a timetable for them).

5.4 Supervision
The oversight of marketing claims is distributed across various administrative bodies.

The Consumer Ombudsman serves as the primary authority for consumer advertising. The Finnish Transport and Communications Agency (Traficom) is responsible for regulating radio and television advertising. The FFA oversees the advertising of food, beverages, and tobacco, whereas Fimea supervises drug advertising. Valvira is tasked with enforcing alcohol and tobacco legislation. Additionally, Tukes handles marketing supervision under consumer safety and cosmetics legislation. Beyond the Consumer Ombudsman, the AVI monitors price indications in advertising. The Office of the Data Protection Ombudsman oversees data protection issues related to marketing.

Marketing and advertising are also influenced by the rulings and decisions of the Consumer Disputes Board, the Market Court, the Council of Ethics in Advertising (*mainonnan eettinen neuvosto*, or MEN), the Board of Business Practice of the Chamber of Commerce, and general courts of law.

The FIN-FSA monitors ESG disclosures in Finland. The monitoring encompasses:

- risk-based selection - companies are chosen based on predefined risk factors for comprehensive or partial reviews;
- thematic reviews - recently, the FIN-FSA has carried out reviews focused on specific themes, such as goodwill impairment testing and corporate acquisitions; and
- responsive monitoring - investigating the appropriateness of financial statements or sustainability reports based on stock exchange releases or complaints.

5.5 Enforcement
In case of missing or false ESG disclosures, the FIN-FSA can require the company to correct and complete the reported information. It may also impose a conditional fine to ensure compliance. Finally, the FIN-FSA can impose administrative sanctions as outlined in Chapter 4 of the Act on the Financial Supervisory Authority (*laki Finanssivalvonnasta*, 878/2008). These sanctions include a penalty payment, a public warning, and an administrative fine.

5.6 Expected Progress
The first ESG disclosures for 2024 are due in 2025. Although the first year of reporting and data collection has been somewhat hard for most companies, the task will be easier in the coming years. Thus, after initial challenges, it is expected that meeting reporting obligations will become a normal part of business in the coming years.

6. Climate and ESG Litigation

6.1 Instruments for ESG Litigation
Individuals and companies have limited options to launch ESG-related cases against a company unless they have a direct contractual relationship with it. Depending on the nature of the ESG violation, it may be possible to inform authorities of suspected infringements of ESG legislation and – in many situations - authorities can

investigate cases on their own initiative. In such cases, individuals do not need to start proceedings themselves.

In limited liability companies, shareholders have limited options to launch a case against the management for causing damage to the company by failing to take ESG issues into account. One or several shareholders have the right to pursue an action in their own name for the collection of damages to the company if it is probable that the company will not make a claim for damages and:

- the plaintiffs hold at least one tenth of all shares at that moment; or
- it is proven that the non-enforcement of the claim for damages would be contrary to the principle of equal treatment of the Limited Liability Companies Act.

In the future, the CSDDD will open up new options for persons suffering damage due to ESG violation to launch cases against companies.

As the ESG legislation is still evolving, the current tools are sector- and issue-specific and not necessarily regarded as ESG cases but - rather - as labour law cases, environmental law cases or even criminal proceedings. Individuals may also have the right to claim damages on the basis of general tort law.

6.2 Climate Activism

Certain NGOs - such as associations and foundations whose purpose is to protect nature, health or the environment - were expressly given the right to appeal against government decisions regarding climate change policy plans in January 2023, as an amendment to the Finnish Climate Act entered into force. In August 2024, six NGOs brought an appeal to the Supreme Administrative Court against the government's lack of adequate climate action (for more details, see **1.2 Environment Trends**).

Among activist movements, Extinction Rebellion Finland (*Elokapina*) has organised street blocks, demonstrations and protests approximately once a month. This has received a fair amount of media attention in 2024.

6.3 Greenwashing v Greenbleaching

The Finnish Consumer Ombudsman has given guidelines that are based on Section 2 of the Consumer Protection Act and on the legal practice of the Finnish Market Court and the Consumer Ombudsman. Together with the EC's guidance on the interpretation and application of Directive 2005/29/EC of the European Parliament and of the Council concerning unfair business-to-consumer commercial practices in the internal market, these guidelines lay down clear rules for lawful environmental marketing. Marketing claims are required to be clear, precise and comprehensible, and the overall message must not be misleading. Also, all claims must be supported by evidence. Marketing communications must give an accurate picture of the product or service without exaggerating its environmental benefits.

The Consumer Ombudsman has repeatedly intervened and required changes to environmental marketing claims. The most recent cases include an environmental claim on the greenhouse gas emissions of aviation fuel used in the marketing of Finnair, misleading sustainability claims on the websites of Marimekko and Stockmann, and too-vague sustainability claims on ice cream package labels by Froneri Finland.

In the Finnair case, the Consumer Ombudsman examined the following claim used in Finnair's advertising: "We procure renewable aviation fuel, which reduces greenhouse gas emissions by as much as 80% – our aim is to be completely carbon neutral in 2045." The advertisement was published in several marketing channels, including social media platforms and Finland's largest newspaper. According to the Consumer Ombudsman, consumers could not know what the procurement (which was the key message of the advertisement) meant for Finnair's total emissions. The advertisement could have been interpreted as meaning that Finnair had completely switched to renewable fuel and reduced its overall emissions by 80%, whereas in reality the percentage of renewable aviation fuel was as low as 0.2% of all fuel consumed by Finnair.

6.4 A Turbulent Future Ahead

It is likely that ESG litigation will increase in the next five to ten years. Tightening regulation, increased supervision and public awareness, and ambitious ESG goals will result in more ESG-related proceedings. Climate litigation is already on the rise in Europe and in Finland, and the same trend - although perhaps not as prominently – is expected to touch social and governance issues in the next few years.

Trends and Developments

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Castrén & Snellman is a forerunner in addressing the most demanding legal issues. It advises Finnish and international clients in M&A and other transactions, dispute resolution, and the full scope of business law. Castrén & Snellman is based in Helsinki, Finland - although more than 50% of the firm's work is cross-border and it has global contacts with renowned law firms throughout the world. Castrén & Snellman serves as its clients' strategic speaking partner, with a comprehensive approach. The firm's goal is to help clients shape their market and build their own sustainable success stories. Castrén & Snellman's ESG and corporate sustainability service is the leading ESG practice among Finnish law firms. Its lawyers integrate ESG know-how across all services in the firm, with a particular focus on M&A, contract negotiations, and investigations. Castrén & Snellman regularly conducts ESG due diligence reviews and provides analysis of the reviewed company's ESG practices and risk management.

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ESG Regulatory Tsunami Hits Finland

In Finland, as in the whole of Europe, ESG matters are fast becoming increasingly regulated. For a long time, corporate sustainability was based on voluntarism and mainly driven by reputational concerns; in the past few years, however, many of the previously voluntary commitments have become mandatory obligations laid down in legislation. This strong trend has been referred to as the EU regulatory tsunami.

In the past few years in Finland, there has been little national legislative activity regarding sustainability and ESG, as the government and companies alike have mostly focused on preparing for and adapting to the EU-wide legislation. Notably, the Corporate Sustainability Reporting Directive (CSRD) is currently a hot topic, given that many large companies are preparing for their first sustainability report to be published in 2025 or 2026.

Other trending topics for discussion have included:

- the rules on green claims (eg, claims concerning a company's environmental objectives) in marketing communications;
- the EU Deforestation Regulation, which will become applicable in December 2024; and
- the rapid shift towards sustainable finance, with a broad collection of new EU-wide legislation.

Tightening of rules on environmental marketing claims

Marketing rules are becoming stricter, particularly with regard to environmental claims. Slogans such as "We will be carbon-neutral by 2030" must be substantiated and verifiable. Similar commitments must also be backed up by a feasible and precise implementation plan that includes, for example, clear objectives and a timetable for achieving them. This is a significant change - for a long time, it was very common for companies to make claims about their climate neutrality goals lightly without any real plan towards them. However, in the past few years, the Finnish Consumer Ombudsman has repeatedly intervened and required changes to misleading environmental marketing claims.

The most recent cases include:

- a claim concerning the greenhouse gas emissions of aviation fuel made by Finnair in a marketing campaign;
- unsubstantiated sustainability claims on the websites of Marimekko (a Finnish design house) and Stockmann (a Finnish retailer selling quality and luxury products); and

- sustainability claims on Froneri Finland's ice cream packaging that were found to be too vague.

Electrification of transport brings about new obligations

The Act on Equipping Buildings with Electric Vehicle Charging Points and Charging Point Capabilities and Automation and Control Systems, also known as the Charging Points Act (*sähköautolaki*, 733/2020), entered into force in November 2020. It includes an obligation to install electric car charging points to all existing non-residential buildings by the end of 2024. All non-residential buildings that are in use and have more than 20 parking spaces in the property are required to have at least one charging point for electric vehicles; the obligation does not concern existing dwelling houses or buildings that are soon to be torn down.

Compliance with the obligation is supervised by the Finnish Transport and Communications Agency (Traficom). If the building owner does not comply with this obligation, Traficom requires the owner to remedy the matter in a time limit set by Traficom. Eventually, Traficom may reinforce the order under the threat of a fine or the threat that the installation of a charging point will be commissioned at the expense of the owner.

Civil liability included in CSDDD requires changes in Finnish procedural rules

Article 29 of the Corporate Sustainability Due Diligence Directive (CSDDD) lays down provisions on the civil liability of companies. Pursuant to Article 29, a company can be held liable for damage caused to a natural or legal person, provided that the company intentionally or negligently failed to comply with the obligations relating to preventing adverse impacts and bringing them to an end and this has resulted in damage to the natural or legal person's legal interests that are protected under national law. Pursuant to paragraph 3(d) of Article 29, EU member states must ensure that conditions are provided for under which any alleged injured party may authorise a trade union or NGO to bring action to enforce the rights of said injured party. A company cannot be held liable if the damage has been caused only by its business partners in its chain of activities.

This kind of authorisation has been unfamiliar to Finnish procedural law, whereby a lawsuit may normally be started only by the legal subject whose own legal interests are concerned. Any other party would be deemed to lack legal standing and the court would dismiss its case as inadmissible. It has also been held in literature that the parties with legal standing are not entitled to mandate someone without such standing to bring action on their behalf. The only exception to this rule in Finnish law is the Class Actions Act (*ryhmäkannelaki*, 444/2007), which entered into force in October 2007; however, its scope is very limited (it only applies to certain types of disputes between consumers and businesses) and no class actions have actually been initiated under it so far.

It is also worth mentioning that in 2023, the Finnish Climate Act (*ilmastolaki*, 423/2022) was amended so that the right to appeal against government decisions regarding climate change policy plans was given not only to those whose rights, obligations or interests are affected by the impacts of climate change but also to certain NGOs and civil society organisations representing these individuals, such as nature protection associations. Before the amendment, the Finnish Climate Act did not contain any right to appeal for any parties; however, recent developments such as the increasing number of climate change cases being tried before the ECHR have led the Finnish legislators to include the described provision in the Climate Act. In any case, the right to appeal remains very limited in scope, as it only applies to government decisions regarding climate change policy plans and appeals to the Administrative Court.

The provisions of Article 29(3)(d) on the rights of parties to pursue damage claims against undertakings and of Article 29(3)(e) on evidence disclosure were introduced late in the negotiations concerning the CSDDD. Finland, which had mostly supported the CSDDD, viewed these new elements as highly problematic from the perspective of its national law. One specific issue raised was that organisations could file class actions in Finnish courts on behalf of victims of human rights violations in third countries. This was seen as potentially having significant impacts both on companies and the court system. The Ministry of Justice, for example, expressed concerns about the strain this could place on court resources. Both the Ministry of Justice and a part of the business sector were particularly opposed to extending class actions beyond consumer cases. Despite these criticisms, Finland ultimately supported the adoption of the CSDDD after an amendment clarified that - for example - trade unions could only bring actions for damages against companies based on an authorisation by an injured party and not in their own name.

As the CSDDD is transposed into national law, Finland will therefore need to revise its rules on legal standing to allow parties to authorise entities such as trade unions or environmental organisations to take legal action on their behalf in cases covered by the CSDDD. The recent amendment to the Finnish Climate Act could serve as a precedent for law-makers in this process.

Rise of climate litigation

Finland, as per many other countries, has seen increasing climate-related activism and an emerging trend towards climate litigation. Finnish administrative and procedural rules have made it difficult for civil society organisations to bring cases to court. However, the growing number of EU cases - for example, the recent ECHR judgment in KlimaSeniorinnen v Switzerland - has spurred attention and encouraged activists and organisations to try to find ways to bring their cases to court.

In August 2024, six environment and human rights NGOs filed a lawsuit against the Finnish government, citing insufficient climate action. The NGOs claim that the government is violating the Finnish Climate Act and the Finnish government's constitutional duty to protect human rights. The case is currently pending before the Supreme Administrative Court.

A similar lawsuit was filed in 2022 by Greenpeace and the Finnish Association for Nature Conservation, who challenged the previous government's inadequate climate measures. The Supreme Administrative Court declined to hear the case at the time, citing Finnish administrative law (which does not recognise inaction as grounds for appeal) and noting that the Climate Act had only recently entered into force, giving the government limited time to implement the required measures. In its ruling, however, the Supreme Administrative Court acknowledged that inadequate climate action could - in theory - be grounds for a lawsuit.

The 2024 lawsuit was also made possible by a 2023 amendment to the Climate Act, which extended the right of action to NGOs, as well as by the aforementioned landmark ruling by the ECHR in KlimaSeniorinnen v Switzerland, which found Switzerland in violation of human rights due to insufficient climate action.

ESG issues likely to remain strongly harmonised domain in EU

As Finland is an EU member state, a large part of its new legislation is of European origin. The EU, on the other hand, aims to be a forerunner in the transition towards a more sustainable, climate-neutral society. In the past few years, this has resulted in an actual regulatory tsunami in ESG matters.

Lately, Finland has mostly focused on adapting to these EU developments and implementing them nationally, and there are currently very few national legal initiatives in this domain. Environmental and climate issues do not stop at country borders and, in the EU single market, the aim is to create a level playing field for all EU companies. For these reasons, the trend towards the harmonisation of ESG legislation at EU level is expected to grow stronger rather than weaker and it is anticipated that EU legislation will prevail over national laws and regulations in this area.

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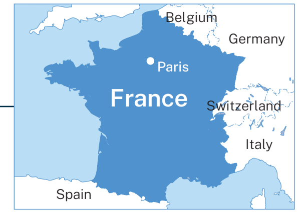

Trends and Developments

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Signature Litigation AARPI is a specialist firm handling major, high-value litigation, arbitration and regulatory investigations. From offices in London, Paris, Frankfurt and Gibraltar, it handles multi-party disputes stretching across multiple jurisdictions and acts for numerous worldwide manufacturers in all industries as well as financial institutions. The firm's Paris office comprises lawyers who trained at major international law firms and who are highly regarded for their expertise. The team is recognised for its work in complex, cross-border litigation; commercial, banking, corporate and post-M&A disputes, insurance/reinsurance, product liability and environmental litigation; as well as mass litigation and class actions. Its work on mass and group litigation linked to the field of hazardous substances is well recognised, with some of its pro-company case law featuring in the Civil, Civil Procedure and Social Security Codes due to their significance.

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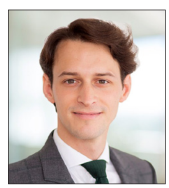

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The European Union (EU) has set itself the tasks of reducing greenhouse-gas emissions, promoting a circular economy, and improving consumer information – and we have been hearing a good deal about these objectives of late.

These goals are not unfamiliar to French lawmakers, who have been enacting environmental legislation for some time, and have promoted themselves as pioneers in this field. The most notable laws in this area are the Anti-Waste Law (Law No 2020-105 of 10 February 2020), aimed at transforming the French linear economy into a circular economy, and the Climate and Resilience Law (Law No 2021-1104 of 22 August 2021), which supports the fight against greenwashing in advertising.

The European legislator has also taken up this legislative trend. In 2020, the European Commission adopted the “Green Pact”, a set of measures designed to put the EU on the path to ecological transition with the ultimate goal of achieving carbon neutrality by 2050.

This objective will primarily be achieved through the “Fit for 55” package – a number of proposals aimed at revising and updating EU legislation so that greenhouse-gas emissions in Europe can be cut by 55% by 2030. In 2024, several of these proposals have already been successively adopted, and will be implemented gradually.

Although these new regulations will not overturn the current French legislative environmental framework, which has often been a forerunner in this area, they do deserve a closer look. The focus will be on consumers’ right to repair, ecodesign production and the battle against greenwashing.

Product Repair Over Replacement

In France, if a consumer wishes to have a defective product repaired, they can now take advantage of the legal warranty of conformity. This is a legally binding warranty that entitles consumers to have a defective tangible personal product repaired or replaced, if they choose, within two years of its purchase.

To facilitate the implementation of this warranty, the French legislator has created a presumption of non-conformity whereby defects that appear within 24 months of the delivery of a product are, in the absence of proof to the contrary, presumed to have existed at the time of delivery. For second-hand products, this period was initially set at six months, but the Anti-Waste Law has extended it to 12 months.

The purpose of the Anti-Waste Law has been to reform the legal warranty of conformity to make it more attractive to consumers. This should also be achieved by improving consumer information on their right to repair. Therefore, since 1st January 2022, professionals have been required to provide information on legal warranties and their duration on product invoices to increase visibility. Failure to comply with this requirement is punishable by a fine up to EUR3,000 for a natural person and EUR15,000 for a legal person.

The Anti-Waste Law goes even further in respecting consumers' right to repair as it provides that, if a product is repaired under the legal warranty of conformity, the consumer benefits from an additional six months' warranty, giving a total warranty of 30 months.

The aim is clearly to encourage product repair in order to transform the linear economy – producing, consuming and discarding – into a circular one, by manufacturing products in a sustainable way and limiting the consumption and waste of resources. Manufactures and sellers are expected to comply with this regulation.

The message has also resonated at European level, however, as the European Parliament and Council have recently adopted Directive (EU) 2024/1799 of 13 June 2024 on the right to repair (the so called "R2R" Directive), which must be transposed by Member States no later than 31 July 2026.

Under the R2R Directive, manufacturers are required to provide fast and cost-effective repair services and to inform consumers of their repair rights.

It is interesting that, after expiry of the legal warranty, manufacturers will still be required to repair certain products – such as washing machines, dishwashers, refrigerators, vacuums, mobile phones and tablets – listed in an appendix to the R2R Directive. This list is set to grow, as the European Commission will be able to update it line with future regulatory developments.

The listed products will be repaired free of charge or at a reasonable price and, during the repair, manufacturers may lend consumers a replacement product. Manufacturers established outside the EU are not exempt from this obligation, which cascades down to other economic operators established in the EU, such as the manufacturers' authorised representatives, importers or distributors. Furthermore, manufacturers will have to make spare parts and tools available at a reasonable price that does not deter repair.

Manufactures will not be able to limit these obligations, as contractual clauses and hardware or software techniques hindering the right to repair the listed products are prohibited. More specifically, manufacturers may not prevent independent repairers from using second-hand or 3D printed spare parts, nor may they refuse to repair a product on the grounds that it has previously been repaired by someone else.

Even though its success has been relative, France has legislation fairly similar to that recently adopted in Europe. For example, the Anti-Waste Law introduced a "repair bonus" – ie, an amount deducted directly from the consumer's invoice to encourage them to repair a defective product and, in so doing, combat programmed obsolescence. However, the success of this bonus is debatable. The environmental association Zero Waste France has counted 165,000 acts of repair in 2022, whereas 1.2 billion products of electronic equipment were sold in 2021.

It remains to be seen whether, when the R2R Directive is transposed into French law and in the rest of the EU, consumer behaviour will change.

Concrete Requirements on Ecodesign Production

Ecodesign is an approach to products that considers their environmental impact throughout their life cycle – from the extraction of raw materials to manufacture, use, recycling, and, finally, disposal.

In France, the Anti-Waste Law introduced principles of ecodesign under Article L. 541-10-12 of the French Environmental Code. According to this provision, producers are required to prepare and implement a prevention and ecodesign plan to reduce the use of non-renewable resources and increase the number of recycled materials.

This prevention and ecodesign plan, which is revised every five years, may be individual or common to several manufacturers. It must include an assessment of the previous plan and define the prevention and ecodesign objectives and actions to be implemented by manufacturers over the next five years. The individual and common plans are referred to the eco-organisation set up by the manufacturers, which publishes a summary that is accessible to the public.

The Ecodesign for Sustainable Products Regulation (ESPR), which entered into force on 18 July 2024 and replaces Directive 2009/125/EC, takes ecodesign one step further by setting out very clear and concrete rules for manufacturers.

For instance, regarding durability and reparability, manufacturers must design products in such a way as to maximise their period of use and, simultaneously, minimise their need for replacement. In this respect, the design must allow reasonably simple disassembly and repair, and components and sub-assemblies must be accessible to allow repair and replacement.

Moreover, the ESPR requires manufacturers to limit or totally exclude the use of materials or substances that could hinder their re-use or recycling, or that are harmful to the environment. Manufacturers will also have to incorporate a minimum threshold of recycled materials in the products to stimulate the circular economy and encourage the use of secondary resources.

The European Commission will issue delegated acts to define certain indicators relating to the environmental performance of the products before they are placed on the market. For example, the European Commission will have to define the minimum percentage of recycled materials in the composition of products or, conversely, the maximum quantity of emissions authorised for the manufacture, use and disposal of products. Manufacturers will therefore have to pay close attention to future acts to comply with these new production requirements.

A core measure of the ESPR regulation that is also worth mentioning is the Digital Product Passport, which will provide information on the environmental sustainability of products. The aim is to make this information easily accessible by scanning a data medium, and to provide consumers with information on sustainability and reparability indicators, the use of recycled materials and the availability of spare parts.

The Digital Product Passport will in fact enable manufacturers to promote their ecodesigned products throughout the EU. Therefore, consumers who are concerned about their carbon footprint will have access to this information and will prioritise such products. However, care must be taken here, as the provision of information about a product's environmental qualities is also subject to specific regulations.

A Dual Remedy to Combat Greenwashing

In the context of increasing environmental awareness and requirements, some professionals have been using misleading arguments based on good ecological practices in their marketing or communication operations. This is commonly known as "greenwashing".

Under French law, professionals that provide misleading information to consumers are penalised under Article L. 121-2 of the French Consumer Code.

To ensure that consumers are well informed about carbon neutrality claims, the Climate and Resilience Law of 22 August 2021 has amended Article L. 121-2 to include false claims, indications or presentations likely to mislead the consumer about the environmental impact of the product or the extent of the advertiser's environmental commitments in the definition of "misleading advertising".

Misleading environmental claims may be subject to a fine of up to EUR300,000 (EUR1,500,000 for a legal entity). These amounts may be increased to 10% of the annual average turnover calculated over the last three years, or 50% of the amount of the expenses incurred to communicate on the misleading claim, when the profit generated from the misleading practice exceeds the amount of the initial fine. The amount of this fine can be increased to 80% when it is a misleading environmental claim.

The Anti-Waste Law has additionally prohibited the use of certain type of claims, such as "biodegradable", "compostable" or "environmentally friendly", or any other equivalent wording on all packaging, products and advertising. Such claims are considered too vague, and can therefore mislead consumers.

The European institutions have also taken action in this field to harmonise the framework for environmental claims.

On the one hand, the European Parliament and Council have adopted Directive 2024/825 amending Directives 2005/29/EC and 2011/83/EU (the so-called "Greenwashing Directive") to offer consumers the means to act in favour of the green transition through better protection against unfair practices and improved information.

For instance, the Greenwashing Directive provides a definition of "environmental claim" and "generic environmental claim", which are welcome in France where environmental claims are mainly defined by professional recommendations.

Moreover, the new Directive punishes practices which mislead the consumer regarding the environmental characteristics of the product. In this respect, there are no major changes in France, as the Climate and Resilience Law already targeted these practices when they concerned the environmental impact of a product or the scope of professional commitments.

This Directive must be transposed in Member States by 27 September 2026 at the latest.

There is also a proposal for a directive on the justification and communication of explicit environmental claims presented by the European Commission on 22 March 2023, known as the "Green Claims Directive".

The Green Claims Directive has not yet come into force, but we already know that it will lay down minimum requirements for the justification and communication of environmental claims. More specifically, environmental claims will have to be based on widely recognised scientific evidence, and demonstrate that environmental effects are significant from the point of view of a product's life cycle.

The Directive also provides a framework for comparative environmental claims and proposes to regulate environmental labels so that only labels awarded under environmental labelling schemes established under EU law are permitted.

The proposal for a directive is currently awaiting its first reading by the Council, following its adoption by the European Parliament on 12 March 2024.

In conclusion, the French legal environmental backdrop will not drastically change after the implementation of the recent EU legislation. The foundations of a circular and sustainable economy are already there. However, under the influence of the EU, the legal framework will be even more demanding for manufacturers, who will need to think carefully about the environmental impact of their products throughout their entire lifecycle, and the way they are marketed, sold, and used, or they will expose themselves to a serious risk of litigation based on consumer and environmental French laws.

GHANA

Trends and Developments

Contributed by:
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AB & David Africa

AB & David Africa is a pan-African business law firm with a network of firms in 30 African countries, serving private and public organisations across the world, including businesses, public sector agencies, financial institutions, and international organisations. The firm's aim is simple: to help its clients succeed in Africa with their business and projects by guiding, developing strategy and working with them to implement their strategic mission and objectives. As a full-service law firm, AB & David Africa's cross-practice team specialising in green transition, sustainability, and carbon markets leads the way in advising on strategy and legal aspects of business and policy regarding the just transition in the region. The team provides clients with comprehensive legal services in the energy, infrastructure, and natural resources sectors, including advice on project development, licensing and permitting, M&A, financing, regulatory compliance, dispute resolution, and taxation.

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GHANA TRENDS AND DEVELOPMENTS

Contributed by: Vera Owusu Osei, Akua Chrappah Ayippey and Pauline Anaman, **AB & David Africa**

Introduction

In recent years, Ghana's financial sector has witnessed significant reforms and initiatives aimed at promoting sustainability and aligning with global climate goals. These efforts intensified in 2024 with the introduction of three major frameworks that address green finance taxonomy, climate-related financial risks, and the issuance of green bonds. These frameworks – the Ghana Green Finance Taxonomy, Securities Industry (Green Bonds) Guidelines, and the Climate-Related Financial Risk Directive serve to strengthen the nation's financial architecture, ensuring that both public and private institutions are well-equipped to mitigate climate risks and drive green investment. Additionally, developments in carbon markets and the restructuring of key institutions within Ghana's energy sector signal a broader shift towards a sustainable and climate-resilient economy.

The sections below highlight the emerging trends, implications for Ghana's financial system and the country's strategic efforts to achieve its climate objectives.

Emerging Trends Within Ghana's Financial Sector

The following frameworks outlined below emerged in 2024 to strengthen Ghana's financial system against climate-related financial risks.

The Ghana Green Finance Taxonomy (Phase 1)

In October 2024, the Ministry of Finance released the Ghana Green Finance Taxonomy (Phase 1) (GFT), to identify and classify environmentally sustainable economic activities. The GFT addresses concerns from the business community about the lack of clarity and guidance in translating government policies into concrete commercial actions.

The GFT serves as a screening tool for stakeholders such as financial institutions, project promoters, investors, and policymakers, helping to direct capital towards green projects and initiatives. It also aims to align the country's national policies with international best practices, ensuring that Ghana not only fulfils its global environmental commitments but also capitalises on green investments for economic growth. The classification criteria include:

- climate mitigation;
- climate adaptation;
- environmental protection;
- resource efficiency; and
- pollution prevention.

Over the next four years, the implementation of the GFT will prioritise key sectors such as energy and transportation, agriculture, forestry, water and waste management, the blue economy, and building and construction. These sectors have been identified as critical for green investment, based on emissions data from Ghana's greenhouse gas (GHG) inventory by source.

The GFT principles, identified sectors, classification methods, and eligible projects align with established green growth frameworks and financing guidelines beyond the financial sector. These include the Carbon Market Framework, the Energy Transition and Investment Plan (which prioritises transportation within the energy sector for emission reduction), the Green Bond Guidelines, and the Climate-related Financial Risk Directive.

Chapter 5 of the GFT document outlines the governance framework designed to ensure the ongoing implementation and refinement of the Green Finance Taxonomy. A multi-stakeholder oversight committee has been established with a mandate to provide strategic oversight, conduct technical reviews, align policies, and support monitoring, reporting, and risk management. Additionally, a GFT Secretariat has been established to provide administrative and operational support to the committee and its subcommittees.

As the implementation of GFT progresses, a second phase is anticipated to be launched in May 2025. The second phase will likely introduce quantitative thresholds, tax exemptions, and sector-based incentives. Subsequently, a transitional taxonomy will be developed in Phase 3 to incorporate carbon-intensive sectors such as the extractive industries.

The Climate-Related Financial Risk Directive, May 2024

In May 2024, the Bank of Ghana (BoG) issued the Climate-Related Financial Risk Directive (the "Directive") to guide regulated financial institutions (RFIs) to adopt measures that avert climate-related financial risks and a system for quarterly reporting by 31 December 2024. The Directive aligns with international standards, such as the Basel Committee on Banking Supervision and the International Financial Reporting Standards (IFRS). It is also anchored in the principle of proportionality, which ensures that RFIs' climate risk management processes match their risk profile and business model complexity, without imposing undue regulatory burdens. The affected RFIs include banks, specialised deposit-taking institutions, financial holding companies, mortgage finance companies, leasing companies and development finance institutions.

The BoG recognises that RFIs in Ghana are exposed to climate-related financial risks which can affect traditional financial areas such as credit, market, liquidity, and operations. The Directive focuses on governance, internal controls, capital adequacy, risk management, and reporting. The goal is to enhance risk management and ensure a more resilient financial system in Ghana that supports sustainable growth. To achieve this goal, RFIs must disclose how climate risks affect their strategy, governance, and capital, promoting transparency and market discipline. RFIs must also integrate advancements in climate risk data and methodologies into their governance and risk management frameworks.

Some key features of the Directive are discussed below:

Corporate governance

The board of directors and senior management of RFIs must develop strategies and policies to manage climate-related financial risks. They are responsible for assessing the impacts of both physical and transition risks on operations and integrating these risks into business goals. This includes setting clear roles, monitoring progress toward climate targets, and ensuring adequate resources for risk management. Continuous training for staff at all levels and regular review of strategies are essential to keep the organisation aligned with climate commitments and effectively manage climate-related financial risks.

Internal control framework

RFIs are required to integrate climate-related financial risks into their internal control systems to ensure effective identification, measurement, and mitigation. The internal control framework must clearly define roles and responsibilities while ensuring that staff understand the potential impacts of these risks. An independent review by the internal audit function is necessary to evaluate the overall control framework and data quality. By embedding climate risks into their controls, RFIs can improve their ability to manage these risks comprehensively and maintain financial stability.

Internal capital and liquidity adequacy

RFIs need to identify and quantify climate-related financial risks over a minimum three-year timeframe to assess vulnerabilities. These risks should be included in internal capital and liquidity assessments, along with stress testing as appropriate. RFIs can use scenarios developed by the Network for Greening the Financial System (NGFS) to tailor climate stress testing. The Internal Capital Adequacy Assessment Process (ICAAP) should also provide insights into how these risks impact capital positions. Such ICAAP insights include the assessment methodologies and underlying assumptions, as well as any human judgement applied in the evaluation process. It should also address the use of proxies where data gaps exist, acknowledging any resulting uncertainties. Additionally, details regarding the climate risk stress testing calculations and the methodologies used must be provided.

Risk management process

RFIs must establish processes to identify, measure, and manage material climate-related financial risks over appropriate time horizons. These risks should be integrated into the risk appetite statement and overall risk management frameworks. Collecting reliable data on climate risks, implementing appropriate assessment tools, and developing specific indicators related to climate risk are essential. Additionally, RFIs should consider climate impacts on business continuity and adapt their stress testing accordingly. Engaging counterparties and outlining responsibilities at all levels in their risk management policy will strengthen their approach to climate risk management.

Management monitoring and reporting

RFIs should create internal reporting systems to monitor climate-related financial risks, ensuring timely information for decision-making. Accurate data collection on climate risks and engagement with clients about their transition strategies are vital. Developing risk indicators to categorise entities by climate risk exposure and implementing metrics for internal assessments and reporting will enhance understanding. The reporting systems should provide reliable information on risk concentrations, which supports strategic planning and helps the institution effectively manage climate-related financial risks in their operations.

Comprehensive management of climate-related financial risk

RFIs must evaluate how climate-related risk factors influence their credit, market, and liquidity profiles, ensuring that risk management systems adequately address these aspects. Clear credit policies should be established to tackle climate-related credit risks, with continuous monitoring throughout the credit lifecycle. A comprehensive approach is essential for RFIs to understand and manage climate-related financial risks across their operations, thereby enhancing overall resilience and stability.

Reporting requirements and compliance

RFIs must use standardised climate-related disclosure templates developed by the BoG in consultation with the Institute of Chartered Accountants, Ghana (ICAG) to enhance transparency. Additionally, RFIs must regularly review and update their climate disclosures, considering international standards and best practices to ensure they remain clear, comprehensive, and relevant. In addition, RFIs must submit annual climate-related transition plans to BoG. The plan must address any significant data gaps or updates in their disclosure tools and management reporting processes.

These requirements enhance the stability, transparency, and sustainability of Ghana's bank-based financial system by promoting robust risk management, fostering sustainable investment, and ensuring alignment with global standards and national climate goals.

The Securities Industry (Green Bonds) Guidelines, 2024

In March 2024, the Securities and Exchange Commission of Ghana (SEC) issued the Securities Industry (Green Bonds) Guidelines (the "Green Bonds Guidelines" or the "Guidelines"), 2024, which align with the Green Bond Principles set by the International Capital Market Association (ICMA). Green bonds are a recent development in Ghana. The Green Bonds Guidelines were established in line with the SEC's 2021 commitment to support the Ghana Stock Exchange's plan to introduce green bonds and diversify investment options, enhancing market liquidity for investors. The Green Bonds Guidelines seek to uphold the integrity of the green bond market through transparency, adequate reporting, and the prevention of "greenwashing". They also support the development of a domestic green securities market, ensuring credibility and compliance for issuers such as public companies, external entities, and local authorities.

The Green Bonds Guidelines apply to issuers of green bonds, including public companies, external companies, supra-national institutions, local government authorities and statutory corporations. With the objectives of supporting the growth of a domestic green securities market, ensuring the credibility of green securities through transparency, disclosure, and integrity, and preventing the issuance of and investment in misleading "greenwashed" bonds, the Green Bonds Guidelines are a timely intervention to ensure Ghana achieves her climate targets.

Some of the key highlights of the basic rules governing the issuance of green bonds in the Guidelines are described below.

Eligible and ineligible projects for green bond financing in Ghana

The Green Bond Guidelines specify eligible projects for the issuance of green bonds which support the climate adaptation and mitigation strategy of Ghana's updated Nationally Determined Contribution, as well as the Energy Transition and Investment Plan. Eligible projects include, but are not limited to:

- renewable energy;
- energy efficiency;
- pollution prevention and control;
- environmentally sustainable management of living natural resources;
- environmentally sustainable land use;
- terrestrial and aquatic biodiversity conservation;
- clean transportation;
- sustainable water and wastewater management;
- climate change adaptation;
- circular economy-adapted products, production technologies and processes; and
- green buildings.

The Guidelines prohibit production or trade in any product or activity deemed illegal under Ghanaian law, international conventions, or bans, including pharmaceuticals, pesticides, ozone-depleting substances, PCBs, and wildlife regulated under CITES. Restrictions also apply to weapons, alcoholic beverages (excluding beer and wine), tobacco, gambling, radioactive materials (with exceptions for medical equipment), unbonded asbestos fibres, drift net fishing with nets over 2.5 km, exploitative labour practices, logging in tropical forests, non-sustainable forestry, coal, oil, and gas power generation, fossil fuel industrial processes, and landfills.

Disclosure requirements in the issuance of green bonds

The project evaluation and selection process must be clear and transparent, focusing on project objectives, environmental impact, eligibility criteria, and environmental risk management. Green bond proceeds must be allocated to specific projects or sub-projects and tracked internally, with periodic adjustments made to ensure proper allocation. Issuers must disclose unallocated proceeds and undergo external audits to verify fund tracking. Performance of eligible projects must be measured using relevant indicators, and any changes in measurement methods must be disclosed to bondholders. Additionally, independent external reviews conducted by qualified experts are necessary to validate the green nature of projects and confirm compliance with green bond principles, covering project impact, risk management, and overall alignment with environmental goals.

The approval process for green bond issuance

The approval process includes submission of a draft prospectus or pricing supplement to the SEC in compliance with relevant legal and regulatory frameworks, including the Companies Act, 2019 (Act 992) and the Green Bond Guidelines. Additionally, the issuer must meet the requirements for the issuance of bonds, including obtaining approval from the appropriate sector/industry authorities, obtaining credit ratings for the bond where necessary, and structuring the bond issuance with advisory support.

The issuer must also comply with mandatory declarations in relation to responsibility for the document's accuracy, a statement from the promoters and directors on their intent regarding interest transfers, a confirmation from the manager that all material facts are disclosed, and cautionary statements approved by relevant authorities for investor guidance.

Reporting obligations

Green bond issuers have continuous reporting obligations to stakeholders and must comply with standard bond disclosure obligations and additional commitments outlined in the Green Bond Guidelines. The reporting obligations include the use of raised funds, specifying funded projects, allocated amounts, issuance schedules, and environmental impacts.

Impacts must be measurable and aligned with predetermined indicators, compared to expected results and eligibility criteria. Issuers must also immediately disclose significant events to the SEC, bondholders, and stock exchanges. Such events include delays in fund usage, discrepancies between expected and actual environmental impacts, changes in external reviewers, or any changes affecting the environmental performance or commitments made at issuance.

Developments in Ghana's Carbon Markets

Ghana-Singapore Implementation Agreement

On 27 May 2024, Ghana and Singapore signed an Implementation Agreement for carbon credits co-operation under Article 6 of the Paris Agreement. Following this, both countries have commenced operationalisation by setting out the processes for authorising carbon credit projects under the Implementation Agreement. As of 30 September 2024, Ghana's Carbon Market Office (CMO) within the Environmental Protection Agency's (EPA) Climate Change Unit and the

National Climate Change Secretariat (NCCS) of Singapore have called for carbon market project applications under the Implementation Agreement.

Project developers seeking authorisation under the Implementation Agreement are expected to undertake eligible emissions reduction or removal projects in Ghana that generate high-integrity carbon credits. These projects must also deliver sustainable development benefits to local communities, such as job creation, improved public health, clean water access, enhanced forest and soil management, energy security, and reduced pollution. The carbon credits must align with Article 6 of the Paris Agreement and Ghana's international carbon markets framework.

Ghana-Sweden co-operative approach under Article 6.2 of the Paris Agreement

Ghana and Sweden signed a bilateral agreement on 27 May 2024 to engage in co-operative approaches involving internationally transferred mitigation outcomes (ITMOS). While the adoption of an implementation roadmap is still pending, a technical committee has been established to set out the processes for operationalising the agreement in line with Article 6. Currently, no projects are under development, but it is anticipated that this agreement will create opportunities for project development, supporting the achievement of both countries' Nationally Determined Contributions targets.

Institutional arrangements, systems and processes for carbon market development and management

Ghana's Carbon Market Framework, which provides the policy and technical context for Ghana's engagement in carbon markets, outlines the responsibilities of the Carbon Market Office (CMO), the implementation of the Ghana Carbon Registry, and the processes and standards for operationalising the carbon market, from activity conception to carbon credit issuance and retirement. In 2023, the operational CMO, along with relevant state agencies, worked on a bill to amend the Environmental Protection Agency Act, 1994 (Act 490) (the "Bill"). The Bill introduced a Chapter 5 amendment to the Act 490 focused on climate change, which incorporates new institutional arrangements, systems, and processes detailed in the Carbon Market Framework.

The Bill passed its third parliamentary reading, positioning it for passage into law by the end of 2024. Key provisions in the Bill include the establishment and functions of the CMO, the Carbon Market Committee, and the Carbon Market Technical Advisory Committee, which work together to enhance the development and management of Ghana's carbon market. Additionally, the Bill creates the Greenhouse Gas Emission Mitigation Ambition Fund to facilitate bilateral co-operative approaches for authorised Internationally Transferred Mitigation Outcomes (ITMOS) and to finance supplementary climate mitigation activities. This fund will be financed through fees paid to the EPA by mitigation activity developers or acquiring participating parties. A committee has been established to oversee and ensure that funds are disbursed to attain the objects of the fund.

Other milestones chalked by the carbon market office

The following are notable milestones of the CMO since its establishment in 2020:

- The CMO has developed four pipeline projects in e-mobility, green cooling, and sustainable artisanal oil palm processing, which are awaiting authorisation by the end of the year.

- The CMO also intends to issue carbon credits on the Ghana Carbon Registry by year's end for clean cookstove projects developed by ACT Commodities and Envirofit.
- The CMO has been working on guidelines that offer a comprehensive resource for key stakeholders, outlining the requirements and standards for developing eligible projects across various sectors. The guidelines for clean cooking biomass stoves are well advanced and are set to be launched before the end of the year.

Institutional Restructuring of the Power Sector

In 2024, a significant number of draft bills have been proposed as part of the restructuring of Ghana's power sector. The bills include:

- the Hydro Authority Bill, 2024;
- the Thermal Authority Bill, 2024;
- the Power Distribution Authority Bill, 2024;
- the Energy Regulatory Bill, 2024; and
- the Nuclear Power Corporation Bill, 2024.

The purpose of the new bills is to realign institutions within the sector in order to improve efficiency in the sector. The realignment includes the consolidation of hydro assets, including renewable assets, the separation of thermal power generation and the merger of institutions within the energy sector.

The passage of the Ghana Hydro Authority Bill and the Ghana Thermal Authority Bill will merge the Volta River Authority (VRA) and the Bui Power Authority (BPA), each of which currently manages separate state-owned hydro, thermal, and renewable power generation assets. These bills, if passed into law, will streamline operations and optimise the management of the country's diverse energy resources. Following the merger of VRA and BPA, two separate authorities will be created – the Ghana Thermal Authority, which will be responsible for developing and operating state-owned thermal power generation, and the Ghana Hydro Authority, which will be responsible for developing and operating state-owned hydro-power and renewable energy assets.

Also, the Power Distribution Authority Bill will result in the merger of the Electricity Company of Ghana (ECG), and Northern Electricity Distribution Company (NEDCo), which together are responsible for the distribution and sale of more than 98% of power in Ghana, and the creation of the Ghana Power Distribution Authority.

The passage of the Energy Regulatory Bill will merge the Public Utilities Regulatory Commission (PURC), which is responsible for regulating and overseeing the provision of utility services by public utilities to consumers and the Energy Commission (EC), which is responsible for regulating the utilisation of energy resources in Ghana and co-ordinating policies in relation to them. The objective of this merger is to streamline regulatory functions, eliminate overlapping oversight, align economic and technical regulation and optimise investor participation.

The Ghana Nuclear Power Corporation Bill is also expected to lead to the establishment of the Ghana Nuclear Power Corporation, which will be responsible for developing and operating nuclear power plants for the purpose of providing base load electricity for social and economic development and industrial transformation. This is in line with the National Energy Transition Framework (2022-2070), which provides for the incorporation of nuclear energy in Ghana's power mix.

Concerns have been raised by staff of the affected institutions and some civil society organisations, such as the Institute for Energy Security (IES) and the Africa Sustainable Energy Centre (ASEC), about the intended restructuring. It has been argued that although the restructuring is well intended, it may have dire effects on the operational and financial position of these institutions, which will greatly impact the country's energy security, affordability and long-term sustainability. Also, stakeholders have called for more extensive and transparent dialogue to avoid potential pitfalls and ensure that the national interest is prioritised.

Conclusion

Ghana's financial sector is undergoing significant reforms driven by a global emphasis on climate resilience, green growth, and sustainable development. The Ghana Green Projects Taxonomy, the Bank of Ghana's Climate-Related Financial Risk Directive, and the Securities Industry (Green Bonds) Guidelines demonstrate the country's commitment to international standards on green financing. These frameworks enhance investor confidence in the green project investments in Ghana, financial sector governance and risk management. Additionally, advancements in carbon markets and energy sector restructuring reflect Ghana's proactive stance in aligning with global trends while addressing local climate and energy needs, positioning the country as a leader in Africa's green transition.

INDONESIA

Trends and Developments

Contributed by:
Kirana Sastrawijaya and Angela Vania Rustandi
UMBRA

UMBRA has demonstrated unprecedented growth in the Indonesian legal industry since its establishment in November 2017, becoming the fastest-growing law firm in Indonesia's history. The firm's dedication has led to the recognition of its partners and associates as rising stars, future leaders, and highly regarded lawyers in Indonesia and South-East Asia. The firm stands at the forefront of green initiatives, carbon and energy transition in Indonesia, making it a trusted partner in this vital area of sustainable development. The firm has contributed to significant projects, including the 60 MW Saguling Floating Solar Power Plant in West Java, the 70 MW Wind Farm in Tanah Laut, and the 35 MWac Floating Solar Photovoltaic Power Plant in Batam. In 2024, UMBRA launched the Sustainability, Carbon and Climate Change Initiative division, aimed at empowering corporate clients to navigate Indonesian regulations while integrating ESG principles into their businesses.

Authors

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Introduction

The practice of ESG is continuously gaining traction in Indonesia as businesses and organisations recognise its importance in sustainable development. This year, several notable ESG projects have emerged, reflecting Indonesia's commitment to integrating ESG principles into various sectors. For instance, the launch of Orange Bonds in July 2024 by the Ministry of National Development Planning/National Development Planning Agency (Bappenas) together with the Ministry of Finance and Impact Investment Exchange. The Orange Bonds are issued as a support to the Orange Movement mission to offer an innovative financing solution that promotes social and economic inclusion by providing greater financial access to women and marginalised groups (Bappenas, 2024).

Another significant milestone in Indonesia is the issuance of SEC-registered dual currency bonds, which include a USD1.8 billion global bond and an EUR750 million Sustainable Development Goals (SDG) global bond (Ministry of Finance, 2024). This marks the largest global USD and EUR bond by Indonesia, demonstrating Indonesia's commitment to integrate ESG principles into its financing strategy. Indonesia will use the bond issuance to fund projects under Indonesia's SDGs Government Securities Framework, which aligns with the International Capital Market Association (ICMA) principles.

The Issuance of Guidance for Sustainable Finance in Indonesia

In February 2024, the Indonesian Financial Service Authority (OJK) released the Guidance for Sustainable Finance in Indonesia (*Taksonomi untuk Keuangan Berkelanjutan Indonesia* or TKBI). The TKBI provides a guideline for investors, developers and stakeholders aimed at increasing capital allocation and sustainable financing in order to support Indonesia's net-zero emission target by classifying economic activities into three categories: green, energy transition or not meeting any classification.

The TKBI is designed to replace the Green Taxonomy Indonesia (*Taksonomi Hijau Indonesia* or THI), the existing guideline for sustainable finance. This year, OJK has prioritised the development of the TKBI in the energy sector to support a gradual and balanced energy transition. The TKBI is set to gradually expand to include other sectors covered in Indonesia's Nationally Determined Contributions (NDC), such as waste, industrial processes and product use, agriculture, forest and other land use (FOLU). Therefore, the THI remains applicable for sectors other than the energy sector.

The TKBI enhances the rating mechanism for economic activity classification by introducing environmental objectives (EOs) and essential criteria (EC) as key parameters. EO include:

- climate change mitigation;
- climate change adaptation;
- protection of ecosystem and biodiversity; and
- resource resilience and transition to a circular economy.

All activities in the TKBI must also meet the EC, which include:

- do no significant harm;
- remedial measures to transition; and
- social aspects.

Based on these parameters, the TKBI will categorise activities as "green" if they fulfil at least one EO and all EC or as "transition" if they meet one EO and some EC.

A notable advancement in the TKBI is its inclusion of energy sector activities previously unaddressed by the THI, such as early termination of coal-fired power plants, electricity storage, energy efficiency/conservation services, and carbon capture and storage. Since these activities currently lack specific classifications under the Indonesian Standard Business Field Classification (*Klasifikasi Baku Lapangan Usaha Indonesia* or KBLI – classification codes used to identify the risk level and business licences required for each business activity), the TKBI groups these activities under the most relevant existing KBLI categories. For example:

- early termination of coal-fired power plants and electricity storage are included within the KBLI for electricity generation;
- conservation services/energy efficiency is categorised under the KBLI for electricity supporting activities; and
- carbon capture and storage is included within the KBLI for oil and gas mining.

This strategic integration provides a clearer regulatory pathway, indicating that businesses in these emerging areas may utilise existing KBLIs and business licences to operate.

Transformation to Green Economy to Achieve the Indonesia Gold 2045 Vision

On 13 September 2024, Indonesia issued the long-awaited Law No 59 Year 2024 on National Long Term Development Plan 2025-2045 (*Rencana Pembangunan Jangka Panjang Nasional* or RPJPN 2025-2045). RPJPN 2025-2045 lays out the "Indonesia Gold 2045 Vision", which consist of five goals with a notable commitment to reducing carbon intensity towards net zero. Specifically, the RPJPN 20245-2045 aims to reduce greenhouse gas emissions to 93.5% by 2045 (compared to the 2010 baseline) and increase environmental quality to 83% by 2045. For the energy sector, the RPJPN 2025-2025 aims to achieve a new and renewable energy mix of 70%.

Acknowledging the impact of global warming on Indonesia's development, the RPJPN 2025-2045 calls for a paradigm shift to curb greenhouse gas emissions and promotes a green economy, which encompasses energy transition, circular economy practices and sustainable forest management. The energy transition programme comprises renewable and nuclear development, energy storage development and fossil fuel retirement.

The RPJPN 2025-2045 divides national development into four phases over the next two decades, namely:

- transformation strengthening;
- transformation acceleration;
- global expansion; and
- the embodiment of Indonesia Gold 2045.

Through the RPJPN 2025-2045, Indonesia is making a bold statement: energy transition is central to its vision of becoming a developed nation by 2045.

Energy transition is embedded in each of the four phases as follows.

- First phase (2025-2029): carbon capture and storage/carbon capture, storage, and utilisation (CCS/CCUS), implementation and limitation of coal-fired power plant development, utilisation of energy storage system, development of renewable power plants, new energy policy development, widespread carbon credit implementation, alteration of fossil subsidy to renewables, electrification of household and vehicle, smart grid development, and extension of mandatory biofuel policy.
- Second phase (2030-2034): retirement of coal-fired power plants, biomass co-firing, implementation of CCS/CCUS in hard to abate sectors, preparation of low carbon hydrogen and ammonia infrastructures, ocean energy exploration, commissioning of the first nuclear power plant, expansion of renewable power plant capacities, smart grid expansion and grid interconnection, massive utilisation of electric vehicle and electric household, and extension of mandatory biofuel policy.
- Third phase (2035-2039): continued retirement of coal-fired power plants, expansion of renewable power plant capacities, expansion of nuclear power plants, pilot project development of ocean power plant, electricity utilisation and efficiency in the industry sector, and grid enhancement through interconnection and smart grid.
- Fourth phase (2040-2045): expansion of coal-fired power plant retirement, increase of renewable power plant capacity, expansion of low carbon hydrogen and ammonia for transportation and heavy machineries, commercial development of ocean power plants, and grid extension through interconnection and smart grid.

The vicennial RPJPN 2025-2045 will serve as a directive for the future presidents to develop their quinquennial National Mid Term Development Plan (*Rencana Pembangunan Jangka Menengah Nasional*, or RPJMN). Therefore, the RPJPN will ensure Indonesian commitment to sustainable development beyond the current presidency for the next 20 years.

The inclusion of energy transition milestones across all four phases of the RPJPN 2025-2045 underscores Indonesia's serious and enduring commitment to a sustainable future. By embedding energy transition as a core component of its long-term development strategy, Indonesia signals to both domestic and international stakeholders that the shift to clean energy is not just a short-term policy choice but a foundational priority for the nation's growth and resilience.

ESG Integration in the Industry Sector

The industry sector has long embraced the principles of sustainability, evident through the integration of the green industry concept in the umbrella law of industry, namely Law No 3 of 2014. The Law defines green industry as industries that prioritise the efficiency and effectivity of natural resources sustainably in order to align industrial development with environmental functions as well as to provide benefit to the public. One of the primary manifestations of green industry is the "green industry standard" (*standar industri hijau*).

The green industry standard aims to establish a green standard for each economic activity, comprising:

- raw materials, auxiliary materials and energy;
- production processes;
- products;
- business management; and
- waste management.

The standard can either be voluntary or mandatory. Some of the standards issued by the Ministry of Industry are green industry standard for ceramic tile, textile, snack, fertiliser, and batik industries. Industrial companies meeting the green industry standard will receive a green industry certificate, symbolising their commitment to eco-friendly practices.

In a further step towards sustainable industrial development, the Indonesian government recently issued Government Regulation No 20 Year 2024 on Industrial Zoning that introduces the concept of an Eco-Industrial Park (*kawasan industri berwawasan lingkungan*). Eco-Industrial Park is a centralised industrial area equipped with supporting infrastructures and facilities to ensure sustainability through integrated social, economic and environmental aspects in location selection, planning, development and management.

The Regulation describes aspects of an Eco-Industrial Park, namely:

- area management;
- environmental management, consisting of energy utilisation, raw water utilisation, waste management and climate change;
- social, ie, prioritising social management systems and social infrastructures; and
- economic, consisting of job creation, economic value creation and access for small and medium industries.

Further regulation on the Eco-Industrial Park will be provided in a Minister of Industry Regulation, which is expected to provide detailed provisions on implementing and managing the Parks effectively. The introduction of an Eco-Industrial Park marks a significant step towards embedding ESG principles directly into industrial development, helping companies adopt more sustainable practices. Through the four aspects of an Eco-Industrial Park, the framework encourages industrial companies to reduce their carbon footprints, utilise renewable energy sources, and promote social inclusion and economic benefits for local communities.

The Latest Developments in Carbon Trading in Indonesia

The focus on carbon trading initiatives in Indonesia continues to grow rapidly. Since the issuance of Presidential Regulation No 98 of 2021 on the Implementation of Carbon Pricing to Achieve Nationally Determined Contribution Target and Control Over GHG Emissions in the National Development (PR 98/2021) as the umbrella regulation for carbon trading, Indonesia has laid a comprehensive regulatory foundation for carbon trading, such as Minister of Environment and Forestry Regulation No 21 of 2022 as the implementing regulation of PR 98/2021, sectoral regulations on carbon trading, particularly for the electricity and forestry sectors, and regulations on carbon exchange. A significant milestone was also achieved in October 2023 through the launch of the highly anticipated Indonesia carbon exchange (IDXCarbon). IDXCarbon aims to facilitate transparent carbon credit transactions and increase market participation among individuals and corporations.

The electricity sector has emerged as a frontrunner in this carbon trading initiative. According to data published by the Ministry of Energy and Mineral Resources, the emission ceiling for each unit of coal-fired power plants was established in 2023, which gave rise to carbon trading transactions among 42 companies. In 2023 alone, the Ministry of Energy and Mineral Resources claimed that carbon trading transactions amounted to 7.07 million tons of CO2, equating to IDR84.17 billion. However, the establishment of an emission ceiling for coal-fired power plant units and those carbon trading transactions are not yet recorded in the National Registry System for Climate Change Control as the integrated platform for carbon trading.

Moreover, as IDXCarbon celebrated its one-year anniversary in September 2024, the number of transactions conducted on the carbon exchange remains limited. Reports indicate that the transaction value on IDXCarbon can be considered as relatively low at IDR37 billion (IDN Times, 2024). This figure remains substantially below Indonesia's potential for carbon credit, which is estimated at IDR3,000 trillion (CNBC, 2024). This underscores the need for governmental interventions, such as incentives or mandatory trading requirements to boost participation and realise the full potential of IDXCarbon.

The plan to impose carbon tax in 2025 will also add another layer of momentum to Indonesia's carbon market. According to Law No 7 of 2021 on the Harmonisation of Tax Regulations, carbon tax will first be imposed on coal-fired power plants. The Law established a floor price for the carbon tax at IDR30,000 per ton of CO2, a rate relatively lower than the carbon tax values recommended by the World Bank and the International Monetary Fund (IMF) for developing countries, which ranges from USD30 to USD100 per ton of CO2 (LPEM FEB UI, 2023). Though the tax rate may draw some criticism for its modest value, it is expected to catalyse greater participation in carbon trading, potentially setting a foundation for more robust pricing in the future.

The Issuance of Minister of Environment and Forestry Regulation on NDC Implementation

In September 2024, the Minister of Environment and Forestry issued Minister of Environment and Forestry Regulation No 12 of 2024 on the Implementation of Indonesia's Nationally Determined Contribution (NDC). One notable aspect of this Regulation is the stipulation that the outcome of climate change mitigation and adaptation actions carried out under domestic and international co-operation for capacity building (as one of the strategies of NDC implementation) belongs to the person in charge of such actions. While the Regulation stops short of specifying exactly who qualifies as the "person in charge," it represents an important step towards defining ownership rights over greenhouse gas emission reductions. This clarity fills a gap left by PR 98/2021, which did not specify entitlement to carbon credits generated through greenhouse gas emission reduction projects.

Additionally, the regulation clearly states that no transfer of carbon units abroad can occur for international co-operation projects for capacity building. Though not specifically aimed at carbon trading, this provision underscores the Ministry of Environment and Forestry's stance that carbon credits generated within Indonesia should be retained to meet the nation's own NDC targets. This aligns with the broader objective of prioritising domestic needs in emissions reduction and sustainable development, ensuring that Indonesia retains control over its carbon assets in pursuit of its climate commitments.

Moreover, the Regulation introduces a system of recognition to acknowledge stakeholders' efforts in emissions reduction through two types of acknowledgments: (i) certificates of appreciation and (ii) letters of appreciation. The certificate of appreciation is awarded by the Ministry of Environment and Forestry to persons in charge of climate change mitigation and adaptation actions who reduce emissions beyond their obligations. Meanwhile, a letter of appreciation, granted by the relevant minister recognises partners contributing to climate change initiatives that involve international co-operation, especially where no carbon units are transferred abroad.

As Indonesia welcomes its eighth President on 20 October 2024, there is an increased need for public vigilance to ensure that ESG priorities, along with energy transition efforts, continue to be emphasised under the newly formed Red and White Indonesian Cabinet. While recent regulations lay the groundwork for a more sustainable Indonesia, their impact will largely depend on the steadfast commitment and actions of the new administration.

President Prabowo Subianto's "Asta Cita Vision" includes a robust focus on green economic growth, underscoring his goal for Indonesia to become a "superpower" in renewable energy and bioenergy. Among his ambitious plans are the acceleration of net-zero emissions targets and advancements in carbon sink and offset initiatives. His agenda highlights a comprehensive overhaul of new and renewable energy policies to facilitate Indonesia's transition to cleaner energy sources.

In a notable move to underscore sustainability as a priority, President Prabowo has decided to separate the Ministry of Environment and Forestry into two distinct entities: the Ministry of Environment/Environmental Control Agency and the Ministry of Forestry. This restructuring, which reverts to the structure in place before President Jokowi's administration, aims to create more focused, responsive and strategically aligned ministries to tackle the complex and evolving challenges of environmental management and climate change impacts. The reformed Ministry of Environment is expected to serve as a central advocate for the green economy, ensuring that investment policies are aligned with sustainable development goals.

As Indonesia's ESG and energy transition policies evolve under the new government, the nation's commitment to sustainability will be tested. The direction taken by this administration will be crucial in determining whether Indonesia can both achieve its Indonesia Gold 2045 Vision and lead as a sustainable economic powerhouse in the region. Public scrutiny and engagement will play a vital role in holding the government accountable to its green vision, ensuring that the ideals of sustainability are transformed into tangible outcomes.

ITALY

Law and Practice

Contributed by:
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Legance

Contents

Legance is an independent law firm with offices in Milan, Rome and London, with over 400 lawyers. Founded in 2007, Legance distinguishes itself in the legal market as a point of reference for both clients and institutions. Independent, dynamic, international and institutional are the qualities that most characterise the strengths of the firm and have contributed to it becoming a leader in the legal market. The professionals in the ESG and impact team have significant experience in assisting clients – eg, companies, investment funds, managers and other players – in the area of sustainability and ESG-related issues. In particular, the team has built up a strong presence in this area, developing multidisciplinary skills that enable it to support clients who wish to approach sustainability in a rigorous and innovative way.

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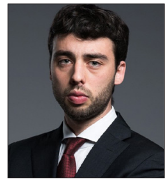

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1. Introduction

1.1 General ESG Trends

2024 marked significant developments in ESG and sustainability laws and regulations, primarily driven by European initiatives also affecting the Italian regulatory framework. Among the most notable updates are new sustainability disclosure and due diligence standards for both companies and financial operators (including banks, insurance undertakings, asset managers, etc) related to the following:

- Enactment of Legislative Decree 125 of 6 September 2024 ("Decree 125/2024") implementing EU Directive 2022/2464 on Corporate Sustainability Reporting (CSRD): In line with the CSRD, Decree 125/2024 introduces sustainability disclosure obligations (and, indirectly, sustainability due diligence standards) for large and listed companies into the Italian regulatory framework. These companies are now required to provide ESG information under a more comprehensive and standardised approach, codified through EU Delegated Regulation 2023/2772 introducing the European Sustainability Reporting Standards (ESRS).
- Approval of EU Directive 2024/1760 on Corporate Sustainability Due Diligence (CS3D): CS3D focuses on human rights and environmental due diligence across the entire chain of activities, including business relationships. Its goal is to hold companies accountable for identifying, preventing, and mitigating adverse human rights and environmental impacts within their operations and supply chains. De facto, CS3D complements CSRD by supplementing the ESG regulatory framework with specific due diligence standards. Although the CSRD and CS3D primarily apply to large companies, they indirectly affect SMEs, as these are often contractually obligated to comply with ESG reporting and due diligence requirements imposed by large-scale business partners (the so-called cascading effect).
- Application of EU Commission Delegated Regulation 2023/2486 starting from 1 January 2024: This regulation supplements EU Regulation 2020/852 ("Taxonomy Regulation") by establishing the technical screening criteria for determining when an economic activity can be considered as substantially contributing to the sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control, or the protection and restoration of biodiversity and ecosystems.

1.2 Environment Trends

Environmental law in Italy has seen significant advancements in 2024, mainly driven by legislative innovations at EU level.

On 10 June 2024, the Italian Council of Ministers approved the first draft of the Legislative Decree implementing EU Directive 2023/959, concerning the fourth phase of the EU Emission Trading System (ETS). Among the most relevant updates, the scope of the ETS will be broadened to cover, among others, emissions from the maritime sector starting in 2024 and emissions from the building and road transport sector from 2025. Furthermore, operators from the building and road transport sectors will be required to monitor and report their Scope 3 emissions and offset them by surrendering an equivalent number of emission allowances annually.

Additionally, through Law 115/2024, Italy has implemented EU Regulation 2024/1252 ("Critical Raw Materials Act"), concerning the secure and sustainable supply of critical raw materials, which came into force at the EU level on 11 April 2024. The Law will streamline the authorisation procedures for mining research projects involving critical raw materials and will require mining operators to contribute financially to the state and regional authorities based on the value of the materials extracted.

Also worth noting is EU Regulation 2023/1115 on Deforestation-free Products ("Regulation Deforestation-Free"), which will be applicable from 30 December 2024. Under this regulation, any operator or trader who places on the EU market or exports from it commodities like cattle, wood, cocoa, soy, palm oil, coffee, rubber, and some of their derived products, such as leather, chocolate, tyres, or furniture, must be able to prove, by conducting, for example, a specific due diligence procedure, that the products do not originate from recently deforested land or have contributed to forest degradation.

Lastly, Law 101/2024, concerning agrovoltaic plants, has entered into force. This law prohibits the installation of ground-mounted photovoltaic plants on areas classified as "agricultural areas" under local urban planning regulations. However, exemptions are provided for projects already approved under the previous regulatory regime, as well as ground-mounted photovoltaic projects aimed at developing energy communities or to be implemented in specific areas, such as abandoned mines and quarries. Notably, the law does not explicitly address agrovoltaic projects (ie, photovoltaic systems that allow the continuation of agricultural and pastoral farming activities on the installation site, while ensuring significant energy production from renewable sources), which, according to Italian case law, are considered a separate category from traditional ground-mounted photovoltaic plants.

From a case law standpoint, in 2024, the Court of Rome ruled on Italy's first climate litigation against the government. The case was filed in 2021 by an environmental NGO alleging that the Italian government's failure to properly address climate change violated Italy's obligations under international law, such as those stemming from the Paris Agreement, also in view of the human rights of current and future generations. The claimants requested a court order for the government to cut Italy's emissions by 92% by 2030, using 1990 levels as a baseline. However, the court dismissed the case, ruling that decisions on national climate policy fall within the purview of political and legislative bodies, and thus cannot be evaluated by any ordinary court.

It is also relevant to mention that the first climate litigation was brought against a private large company in Italy. An environmental NGO alleged that the Italian company failed to adopt an appropriate climate transition plan and that this, as a consequence, violated international and domestic law, as well as other soft law instruments. Furthermore, the company was accused of significantly contributing to climate change and infringing human and environmental rights. However, due to uncertainties concerning the competence of ordinary courts over climate policy matters, the case is currently pending before the Italian Court of Cassation, which will decide on the competence of ordinary courts over such matters.

Furthermore, in July 2024, the Italian Constitutional Court addressed the legitimacy of an Italian regulation that required the judicial authority to authorise the operational continuity of petrochemical companies. The court declared the challenged provision unconstitutional solely in the part where it failed to set a clear time limit for the temporary measures to ensure continuity of production for installations declared of national strategic importance. The court emphasised that safeguarding the environment requires the state to adopt every necessary act to avoid any damage to the environment, considering not only the rights of current generations but also those of future generations as well.

Based on the above, it is clear that the Italian legal framework, along with the related case law, is becoming increasingly stringent concerning ESG matters, and especially environmental issues. This trend is likely to intensify in light of the upcoming European ESG regulations, as well as the growing public and stakeholder focus on environmental matters.

1.3 Social Trends

Regulatory and jurisprudential developments in the social sphere in 2024 were not as numerous as those in the environmental sphere but were nonetheless significant. With respect to the above-mentioned ESG law regulations:

- Decree 125/2024 obliges large and listed companies to report on specific social issues, including labour conditions, human rights, and employee engagement.
- CS3D places strong emphasis on human rights due diligence. It mandates companies to assess and address adverse impacts on human rights within their operations and supply chains, compelling businesses to prevent practices such as forced labour and poor working conditions.

Beyond regulatory developments, social issues have been a significant focus for Italian courts, particularly concerning corporate responsibility in two main areas:

- Human rights abuses in supply chains: Cases often involve multinational companies with operations or suppliers with poor labour practices. The courts have focused on enforcing transparency and due diligence obligations, particularly in the fashion and agriculture sectors, which are known for labour exploitation risks.
- Gig economy and worker classification: Courts have ruled on the status of gig workers, particularly in determining whether they should be classified as independent contractors or employees. Several rulings aimed to protect delivery riders and platform workers by ensuring they receive proper protections under labour laws, including minimum wage, social security, and health benefits.

To conclude, a growing number of companies are obtaining UNI/PdR 125:2022 certification for gender equality. This certification, introduced in 2022 as part of Italy's National Recovery and Resilience Plan, prioritises businesses that adopt policies promoting diversity and equal opportunities in the labour market.

1.4 Governance Trends

A significant development, falling under the scope of so-called good governance practices and, particularly, tax compliance, is the recent adoption of Legislative Decree 128/2024, which implements EU Directive 2021/2101. The Decree, enacted on 12 September 2024, introduces requirements for the public disclosure (via company websites) of corporate income tax information and related business data. These requirements provide valuable support for compliance, transparency, and the assessment of tax risks and tax planning strategies, particularly for ESG-focused professionals and rating agencies.

Additionally, on 28 December 2023, Bank of Italy published key findings and best practices regarding the action plans of banking and non-banking financial intermediaries concerning the integration of climate and environmental risks into corporate processes ("Bank of Italy ESG Best Practices"). Among the reported governance best practices are:

- the formalisation of roles and responsibilities related to climate and environmental risks;
- the initiation of targeted training programmes for top management or the strengthening of boards' ESG competencies with new members experienced in ESG;
- the development of sustainability policies; and
- the planning of ESG-related reporting lines to the board through specific briefings.

It is also worth highlighting the growing trend of companies updating their organisational and management model in accordance with Legislative Decree 231/2001 (MOG) by incorporating ESG procedures to mitigate the risk of committing criminal offences. The MOG allows companies to be exempt from administrative liability arising from crimes, and given that many offences are linked to ESG issues (eg, environmental crimes, violations of human rights, etc), ESG procedures, such as due diligence processes, play a crucial role in monitoring and preventing such criminal conduct.

1.5 Government and Supervision

Regulators and supervisory authorities play a crucial role in driving the ESG transition.

Regulators codify and enforce ESG practices, marking a shift from a voluntary approach based on guidelines and non-binding standards (soft law) to stricter regulations imposing ESG reporting and due diligence obligations (hard law). In Italy, the integration of sustainability into the regulatory framework is not only the result of EU legislation but also of national initiatives. These initiatives aim to recognise and promote companies that pursue both business and social-environmental objectives through specific legal statuses, such as benefit corporations, social enterprises, and innovative start-ups with a social vocation (see **2.4 Social Enterprise** and **5.1 Key Requirements**).

Similarly, national supervisory authorities ensure the proper enforcement of ESG regulations within their respective areas of competence, by adhering to the guidelines of the European Supervisory Authorities (ESAs). For example:

- the Italian securities market regulator ("Consob") issued Warning No. 1/24 of 25 July 2024 ("Consob ESG Warning") on compliance with sustainable finance obligations in the provision of investment services; and
- the Italian Competition Authority's (AGCM) Annual Report of 31 March 2024 reaffirmed the authority's commitment to monitor and discourage marketing strategies based on the improper use of green claims.

1.6 Market Participants

ESG laws and regulations impact various sectors and industries, as already evident. Current regulations apply to all market participants, with specific ESG reporting and due diligence obligations designed for financial operators and companies. Although such initiatives primarily target large or listed companies, their scope extends to SMEs as well, which are often contractually required to meet similar reporting and due diligence standards if they are part of the supply chain of large and listed companies.

Some "critical" sectors are already under increased regulatory scrutiny. For example, Bank of Italy and Consob closely monitor the activities of financial operators and listed companies, issuing specific expectations and warnings (see **3.1 Progress in Green Financing**). Furthermore, judicial authorities have begun investigating human rights violations, particularly in the logistics and fashion sectors. In this regard, the Milan Prefecture has introduced a Protocol for Legality in Contracting, aimed at increasing transparency in the logistics industry and combating illegal labour practices, worker exploitation, and tax evasion (see **4.2 Towards Vertical Responsibilities**).

In summary, ESG regulations are poised to impact all industries, but some are already experiencing more intensive oversight.

1.7 Geopolitical Developments

In recent years, not only global institutions such as the United Nations, but also NGOs, activists, and the general population too, have recognised the need to do more to promote sustainability.

In particular, the younger generations are showing a growing awareness and consideration for environmental and social issues. Figures like Greta Thunberg have given momentum to global climate movements and inspired a generation of young activists to engage in issues related to sustainability, inclusion, diversity, and LGBTQ+ rights. These social movements represent increasing grassroots pressure on governments and companies to make more responsible choices, but progress is not always aligned at an institutional and political level.

From a political perspective, ESG and sustainability policies are strongly influenced by European-level strategies such as the European Green Deal. However, the implementation of these policies faces numerous challenges, especially regarding the distribution of funds and generating tangible value from both an environmental and social standpoint.

Italy, in particular, seems to follow more European directives rather than developing a coherent and long-term internal strategy. Political fragmentation in Italy reflects a diverse vision on sustainability: the left wing tends to focus on climate, education, and social assistance, while the right wing places greater emphasis on security, subsidies for renewable energy, energy efficiency, and economic development. However, the short-term nature of recent Italian governments hinders the development of a clear and strategic vision on sustainability and ESG.

In Italy, as in Europe, attention remains primarily on the environmental aspect of ESG (the "E" in ESG), although there is still a lack of systemic acceptance and sufficient incentives to foster an effective transition. Moreover, ESG has the political tendency to be considered a mere reporting task for disclosure, instead of a strategy to spur innovation and enhance governance and risk management. The public infrastructure that could support this transformation is lacking, and the transition process entails high costs, which, in a context of taxation exceeding 50%, presents a significant challenge for Italian companies. These companies show resistance to making radical changes toward sustainable innovation.

Even more concerning is the inadequate focus on governance (the "G" in ESG), while the social aspect (the "S" in ESG) is often merely mentioned and lacks a clear vision. In this context, Italy struggles to develop a mature and strategic ESG balance.

2. Corporate Governance

2.1 Developments in Corporate Governance

In Italy, the implementation of the CSRD through Decree 125/2024, and the upcoming CS3D will bring notable changes to corporate governance. Boards of directors will increasingly be responsible for overseeing ESG risks, impacts and opportunities (IRO), aligning corporate strategy with sustainability goals.

According to Delegated Regulation 2023/2772 setting the mentioned ESRS for large and listed companies, there is a requirement to disclose detailed information on how the board is informed on ESG, its competencies on ESG issues, and how it ensures that sustainability risks and opportunities are identified and managed, particularly in relation to environmental and social impacts. It is clear that the increasing role played by sustainability in the successful development of companies requires the creation of dedicated ESG committees and/or functions, with specific expertise and competencies. Moreover, the sustainability statement under Decree 125/2024 must be approved by the board of directors, forming part of the management report attached to the financial statement.

Consequently, there are burdensome responsibilities and sanctions for companies and board members in case of non-compliance with Decree 125/2024. Consequently, it is crucial for companies to establish solid governance procedures to oversee the sustainability reporting process, manage its underlying content, and address IRO management. As an example, ESG due diligence processes will be a key aspect for implementing Decree 125/2024 correctly. While due diligence is the core element of CS3D, which will introduce specific due diligence obligations as to how the process must be conducted, companies must already consider Decree 125/2024 alongside CS3D. ESG due diligence forms the basis of the materiality assessment (requested by the ESRS) which, in turn, informs the sustainability statement.

Furthermore, the massive amount of data to be reported under Decree 125/2024 requires the implementation of ESG data governance, with specific procedures for the collection of data, involving subsidiaries and business partners.

2.2 Differences Between Listed and Unlisted Entities

In Italy, corporate governance requirements differ significantly between listed and unlisted companies due to regulatory frameworks and market expectations. Listed companies are subject to stricter governance rules imposed by both national legislation and European regulations. The primary legislation governing corporate governance in Italy is the Italian Civil Code, supplemented by the Consolidated Law on Finance (TUF) and regulations from Consob.

Listed companies must adhere to rigorous transparency, accountability, and reporting standards, including disclosing detailed information on their governance structures, board composition, and internal controls. These companies may also comply with the Corporate Governance Code developed by the Italian Stock Exchange (Borsa Italiana), which sets voluntary best practices for governance, including recommendations on board independence, diversity, and sustainable governance.

Listed companies may also adopt, on a voluntary basis, the Corporate Governance Code (the "Code"). While the Code is not legally binding, it operates under a "comply or explain" principle.

This means that listed companies must either adopt the recommendations or explain why they have chosen not to. Many Italian listed companies voluntarily adhere to the Code because it offers a competitive advantage in attracting institutional investors, enhances stakeholder trust, and aligns with increasing expectations for sustainable governance and ESG performance.

On the other hand, Italian unlisted companies, particularly smaller or privately held ones, are generally subject to less stringent governance requirements. These companies must comply with the Italian Civil Code but are not bound by the additional layers of governance oversight required for listed companies. However, large unlisted companies or those with significant public interest, such as financial institutions, may still be subject to heightened governance and transparency standards under specific sectoral regulations, for instance ESG laws such as CSRD.

2.3 Role of Directors and Officers

In Italy, the growing importance of ESG requirements, particularly under Decree 125/2024, significantly influences the role and responsibilities of directors and officers. Under Italian law, directors have fiduciary duties to act in the best interests of the company, including the duty of care and diligence. With the introduction of Decree 125/2024, directors must now integrate sustainability considerations into their decision-making processes, aligning with the principle of informed decision-making. This means they are required to fully understand and evaluate their company's ESG risks, as well as the long-term impact of corporate activities on stakeholders, including employees, the environment, and society. Neglecting these factors may lead to decisions that are not in the best interests of the company and could breach their fiduciary duties. Such fiduciary duties are now extended to ensuring accurate and transparent sustainability reporting, as mandated by Decree 125/2024. Directors must ensure that sustainability disclosures, such as those related to carbon emissions, human rights, and supply chain impacts, are fully compliant with the new reporting standards. Failure to provide accurate or complete ESG reports can expose the company to regulatory sanctions and reputational damage, and directors may be held personally liable for failing to oversee these risks. Sanctions for incorrect or misleading sustainability reporting, as outlined in Decree 125/2024, could include administrative fines or legal actions. This elevates the stakes for directors, making it essential to adopt robust governance frameworks and internal controls to ensure compliance with ESG requirements.

Additionally, ESG due diligence under CS3D, which will be implemented alongside CSRD, further increases the responsibilities of directors. Directors will need to proactively assess, monitor, and mitigate ESG risks throughout the company's value chain. Failure to conduct proper due diligence, particularly regarding environmental and human rights impacts, can lead to legal liabilities and sanctions. This expanded responsibility requires directors to take a long-term, sustainable approach to governance, ensuring that they not only protect shareholder value but also consider broader stakeholder interests. This shift means that directors and officers must be more engaged in corporate sustainability strategies, making ESG considerations a core part of their fiduciary duties.

2.4 Social Enterprises

In Italy, there are several specific legal forms and statuses for companies and/or not-for-profit entities, to be distinguished depending on their key characteristics and purpose. This range of legal forms and statuses, starting with the most social/public mission-driven, comprises traditional non-profit organisations, social enterprises, socially responsible business and corporations practicing social responsibility, also known as purpose-driven companies.

Non-profit organisations cannot generate income in order to share dividends, while, within strict limits (eg, not more than 50% of the profits) this is admitted for social enterprises (*Imprese Sociali*) according to Legislative decree 112/2017. Italian social enterprises are not-for profit companies carrying out their business activity pursuing general interest purposes. They adopt responsible and transparent management practices, promoting the broadest possible involvement of workers, users, and other stakeholders in their activities.

As to socially responsible business and corporations practicing social responsibility, companies may adopt a specific legal status – the benefit corporation (*Società Benefit*) status. According to Law 208/2015, benefit corporations are required, inter alia, to include in their articles of incorporation "benefit objectives", which companies must pursue as a corporate purpose. These objectives must be related to positive impacts on people, communities, stakeholder engagement, the environment, and social and cultural activities.

Another socially responsible business legal status is the "innovative start-up with social vocation (SIAVS), which is required to pursue social purposes.

These legal statuses include the obligation to publish specific annual reports to give evidence of the social purposes they have promoted (see **5.1 Key Requirements**).

In addition to legal statuses, there is the B Corp Certification, a private certification scheme issued by the American non-profit organisation B Lab. This certification requires companies to undergo a specific evaluation process called the B Impact Assessment, which measures and verifies their positive social or environmental impact and the shared value they create. Certified B Corp companies are also required to publish the results of their evaluation process online.

2.5 Shareholders

In Italy, ESG obligations under Decree 125/2024 and the upcoming CS3D are transforming the relationship between companies and their shareholders. These obligations require companies to provide transparent and comprehensive reporting on ESG matters, shifting corporate focus from purely financial performance to long-term sustainability. This affects shareholders by broadening their understanding of the company's risk profile and performance beyond traditional financial metrics, giving them insights into how well the company manages sustainability IRO.

For shareholders, this increased transparency promotes informed decision-making. Particularly, institutional investors are increasingly interested in how a company addresses ESG risks and opportunities, as these factors are seen as critical to long-term value creation. Furthermore, companies measuring and improving their ESG performance are more likely to attract ESG-conscious investors and maintain better relations with long-term stakeholders. On the other hand, non-compliance with ESG obligations or inadequate reporting may lead to reputational damage, potential regulatory sanctions, and diminished shareholder value, potentially leading to shareholder activism or demands for governance changes.

Moreover, ESG obligations also strengthen shareholder engagement. Shareholders are now more empowered to question management and the board on how they are addressing ESG risks and opportunities, setting long-term strategies, and complying with reporting requirements. Shareholders may push for more sustainable practices or hold the company accountable for failing to meet its ESG obligations, fostering a more responsible and engaged corporate culture.

3. Sustainable Finance

3.1 Progress in Green Financing

From a legal perspective, no particular new developments are noted: the European regulatory framework on sustainable finance has been consolidating since the adoption of the SFDR in 2019, and of the other corollary EU regulations, and continues to be the benchmark.

From a supervisory perspective, authorities played, and are expected to play in future, a crucial role in promoting sustainable finance. Bank of Italy ESG Best Practices and Consob ESG Warning are two clear examples of how these authorities are actively supporting, and indeed requiring, the market's transition towards sustainable finance.

Looking forward, the following developments are anticipated:

- an update to the existing regulatory framework based on the current review by the EU Commission and the ESAs of the SFDR and the related Commission Delegated Regulation (EU) 2022/1288, which supplements the SFDR with regard to regulatory technical standards specifying the details of the content and presentation of sustainable finance disclosures (RTS);
- new regulatory tools, complementing the current framework, such as the ESG rating regulation, whose publication in the EU official journal is pending; and
- an increase in supervisory activities by national authorities in co-ordination with ESAs, as planned in Bank of Italy ESG Best Practices and Consob ESG Warning and following the surge of ESG practices and expectations (eg, ESMA 2024 Guidelines on funds' names using ESG or sustainability-related terms, as well as ESMA 2024 Final Report on Greenwashing).

3.2 Sustainable Finance Framework

In addition to the already mentioned regulations and expectations, guidelines, etc, of the supervisory authorities, the implications arising from the following should be carefully considered:

- ESG provisions on investor protection under Directive (EU) 2014/65 (MiFID II);
- legal and technical criteria for environmentally sustainable activities provided by the Taxonomy Regulation;
- integration of clients' "sustainability preferences" in the assessment of suitability of investment operations, under EU Delegated Regulation 2017/565;
- consideration of sustainability-related objectives in financial product governance processes, under EU Delegated Directive 2017/593;
- increased access, comparison and verification of sustainability information of companies and their value chains, under the ESG corporate transparency (and governance) rules of Decree 125/2024; and

- new due diligence rules and standards on the environment and human rights, for companies and their value chain, under CS3D.

3.3 Access to Green Financing

While the supply of "sustainable" capital (and related transparency obligations) has grown, the requirements and terms under which such supply is conditioned have increased, precisely to avoid greenwashing, making access to this capital more burdensome.

To access such capital, companies shall, for example, comply with good governance practices (which are increasingly defined) and analyse and report on sustainability-related risks, impacts and opportunities (environmental, climate but also social). This requirement has implications for how companies present themselves, particularly in terms of their internal organisation, strategic direction, governance, and their relationships with suppliers, as well as with the broader value chain.

At the same time, the entry into force of transparency and due diligence obligations on companies, particularly large ones, with effects on SMEs through the supply chain, is fostering a progressive alignment between supply and demand for capital, in terms of ESG compliance.

3.4 Stranded Assets and Non-bankables

There is major concern that these market players remain excluded from ESG capital, while one of the pivotal goals of the EU regulatory framework on ESG is precisely to foster an inclusive and just transition.

The most recent example of such concerns is the speech from the president of Confindustria (the main association representing manufacturing and service companies in Italy) who, during the assembly held in Rome on 18 September 2024, pointed out the need to review the European Green Deal and that decarbonisation pursued even at the price of deindustrialisation is a debacle.

Legislators and supervisory authorities, however, seem to have already taken note of these market signals, as evidenced, for example, by proposals toward an amendment to the sustainable finance regime, in particular the SFDR, to encourage investment in the just transition of stranded assets, etc.

3.5 Challenges Ahead

The key challenges in sustainable finance in the coming years are:

- simplifying the regulatory framework without undermining the investments made so far by companies and financial operators, through further clarification by the relevant authorities, including national ones (eg, Q&A, interpretations, guidelines, best practices, etc);
- strengthening supervision and enforcement of the rules (including sanctions), to ensure a common playing field and preserve fair competition (by discouraging greenwashing phenomena that alter the proper capital allocation, misleading other investors and business partners); and
- clarifying, including through the establishment of a taxonomy (such as the existing green taxonomy), the scope of disclosure and due diligence obligations with respect to social issues (eg, human rights compliance).

4. ESG Due Diligence

4.1 Soft Law Becoming Hard Law

Originally, ESG due diligence was governed by soft law instruments, such as the OECD Guidelines for Multinational Enterprises on Responsible Business Conduct ("OECD Guidelines") and the UN Guiding Principles on Business and Human Rights (UNGPs). However, ESG due diligence is now fully embedded within hard law regulations. This occurs through two mechanisms:

- The incorporation of the OECD Guidelines and the UNGPs into Directives and Regulations, making them part of mandatory due diligence requirements, as seen in frameworks such as the CSRD, CS3D, SFDR, Taxonomy Regulation or Regulation (EU) 2017/821 (Conflict Minerals): This also involves the activation of specific agencies established by governments, such as the National Contact Point for Responsible Business Conduct (NCP), to promote the OECD Guidelines, and related due diligence guidance, and to handle cases as a non-judicial grievance mechanism. Italy activated its own NCP.
- The establishment of dedicated due diligence provisions, such as Regulation (EU) 995/2010 (Timber Regulation) and its repealing Regulation Deforestation-Free: The shift from soft law to hard law is driven by the critical role the due diligence practice plays in the transition to more sustainable development models, aligned with the goals of both the EU and the United Nations. Indeed, due diligence can no longer rely on voluntary approaches, being a key activity to prevent ESG risks and negative impacts, and to protect companies and their directors from potential liabilities.

4.2 Towards Vertical Responsibilities

In Italy, due diligence requirements have significantly expanded since 2017, when the Non-Financial Disclosure (DNF) first mandated large public-interest entities to map the sustainability profiles of their supply chains to identify potential ESG risks and impacts.

The practice of ESG due diligence further spread in 2021 with the introduction of the SFDR, which requires specific assessments to determine whether an investment promotes social or environmental characteristics or contributes to sustainable investment objectives.

The adoption of the CSRD in 2022, which mandates reporting on a company's due diligence practices to prevent, mitigate, or address actual or potential environmental and human rights impacts, extended ESG due diligence across supply chains. This expansion was further supported by the legislative process for adopting the CS3D, which aimed to introduce mandatory due diligence obligations, shifting the focus from mere disclosure to proactive risk management.

In 2024, due diligence practices gained additional momentum with the already mentioned enactment of Decree 125/2024, implementing the CSRD, and the EU Commission approval of the CS3D. In parallel, cases involving human rights violations in subcontracting chains led to the prosecutor's intervention. Italian judicial authorities launched significant investigations into labour abuses in both the logistics and fashion industries, sectors critical to the country's economy.

In particular, cases of "*caporalato*" (illegal recruitment and labour exploitation) received notable attention. The Milan Court established a task force to combat exploitation in the fashion and logistics sector, urging companies to adopt robust due diligence measures to prevent human rights violations within their supply chains. These efforts led to the drafting of the Protocol for Legality in Contracting, promoted by the Prefecture of Milan, that aims to enhance transparency and address labour exploitation and illegal labour intermediation.

Looking ahead, ESG due diligence practices are expected to become even more prevalent, as they help mitigate reputational and compliance risks, as well as potential sanctions and liabilities for companies and their directors.

4.3 Partner Selection

ESG due diligence practices have a significant impact on supply chain partners. In fact, both the CSRD and CS3D for suppliers, and the SFDR for investment portfolios, mandate the verification and disclosure of a supply chain's ESG performance and impacts.

As a result, market operators subject to these regulations are increasingly adopting binding tools such as ESG clauses in supply chain contracts (in line with the so-called European Contractual Model Clauses, available online) to enforce:

- adherence to ESG principles outlined in ethical codes or supplier codes of conduct;
- verification of compliance with these principles through mandatory assessments or ESG audits;
- measurement of the suppliers' ESG performance and impacts; and
- verification of compliance with ESG principles throughout the supply chain.

These measures aim to mitigate legal and reputational risks, often providing companies with the option to terminate contracts in case of non-compliance with contractual obligations.

Consequently, ESG due diligence on supply chain partners and investee companies is increasingly becoming an exclusion criterion, in line with the growing trends of "sustainable procurement" and "responsible investment" adopted by companies and financial operators.

4.4 ESG in M&A Due Diligence

ESG is gaining increasing importance in the M&A landscape due to its relevance across three key areas: (i) regulatory compliance; (ii) risk management; and (iii) market opportunities.

Regarding point (i), the past five years have seen a significant increase in sustainability regulations at EU level, both in corporate and finance sectors, imposing ESG reporting and due diligence obligations on a growing number of market participants. Along with these obligations, the regulations introduce specific penalties for companies and personal liability for directors and supervisory bodies, shifting sustainability from being a "marketing-related" issue to a core responsibility of legal and compliance functions and, above all, boards of directors.

As for point (ii), ESG risks are crucial because they could have actual or potential financial impacts affecting the company's financial position (performance, cash flows, access to finance, or cost of capital) in the short, medium, or long term. For this reason, risk management systems should be improved with potential ESG events that could negatively affect the company.

Regarding point (iii), particularly in light of the ESG reporting requirements imposed on financial operators by the SFDR and on large companies by Decree 125/2024, having strong sustainability governance – including ESG data governance – along with positive ESG performance or a sustainable business model, is becoming a valuable asset. It serves as a potential competitive advantage in (i) public and private procurement processes; (ii) access to financing; and (iii) relationships with investors and/or clients who are required to report on the ESG performance of their investment portfolios or value chains.

These factors, when combined, highlight the strategic importance of ESG matters, which now extend far beyond marketing, as was the case in the past, and beyond mere regulatory compliance.

5. Transparency and Reporting

5.1 Key Requirements

Under Italian law, sustainability reporting obligations may depend on (i) the size or (ii) the legal status of the company.

With respect to point (i), under Decree 125/2024, large companies must report on the undertaking's impacts on sustainability matters where these companies exceed at least two of the three following criteria:

- balance sheet total of 25 million;
- net turnover of EUR50 million; and
- an average number of employees during the financial year of 250.

This obligation also applies to small and medium-sized listed companies, but not micro undertakings.

These reporting obligations include describing, among other things:

- the business model and strategy with regard to sustainability risks;
- the sustainability objectives set by the company and the progress made towards achieving them;
- the sustainability due diligence process put in place;
- the main actual or potential adverse impacts related to the company's value chain; and
- the indicators related to sustainability information.

With respect to point (ii), according to the Italian legislation, companies with specific legal statuses promoting benefit or social objectives are required to report on their ESG performances or impacts. In particular:

- According to Law 208/2015, benefit corporations are required to draft an annual report, attached to the financial statement, concerning the pursuit of common benefit objectives. The report shall include (i) information regarding the attainment of the benefit objectives and assess how effective the actions taken by the company have been, and (ii) the measurement of the impacts related to governance, employees, stakeholders, and the environment areas, according to specific external evaluation standards.
- According to Legislative Decree 112/2017, social enterprises are required to draft a report on the impact they have achieved. To provide guidance on the content of this report, the Ministry of Labour and Social Policy issued its own guidelines on 4 July 2019. On 23 July 2019, a second set of guidelines was released to further define the criteria and methods for voluntarily assessing social or environmental impact.
- According to Circular 3677/C of the Ministry of Economic Development, SIAVS are

required to draft an annual social impact assessment, according to the criteria outlined in the Circular. The report also serves as a self-certification to the Chamber of Commerce, demonstrating a company's continued compliance with the requirements of its particular legal status and confirming its eligibility for benefits and incentives.

5.2 Transition Plans and ESG Targets

According to the reporting obligations outlined in the regulations mentioned in **5.1 Key Requirements** :

- Benefit corporations and social enterprises, which embed benefit and social objectives in their by-laws, are required to disclose the actions and results undertaken to achieve these objectives.
- Companies reporting under Decree 125/2024 are obliged to disclose whether they have, or do not have, transition plans or commitments to targets.
- SIAVS are only required to describe the social impacts generated by operating in specific social sectors.

5.3 Regulation of ESG Labels

The Italian Consumer Code contains general provisions regarding sustainability claims. The Code, which regulates misleading advertising and consumer protection, also applies to practices of greenwashing and social washing. This approach aligns with (i) the European Commission's guidelines, which explicitly categorise greenwashing and social washing as forms of unfair commercial practices, and (ii) precedents set by the AGCM.

This stance has been reaffirmed by Directive 2024/825, "Empowering Consumers for the Green Transition through Better Protection Against Unfair Practices and Better Information" (ECD), which updates Directive 2005/29/EC (UCPD). The ECD formalises principles already laid out in the European Commission's guidelines, explicitly introducing the concepts of greenwashing and social washing into the legal framework. Specifically, the ECD:

- identifies as unfair commercial practices:
  - (a) misleading information regarding the environmental or social characteristics of a product, or aspects related to circularity (eg, durability, repairability, recyclability);
  - (b) environmental claims about future performance which are not substantiated with information related to the programmes to achieve such performance; and
  - (c) promoting irrelevant benefits to consumers that do not stem from the product's or company's actual characteristics; and
- updates Annex I of the UCPD, listing commercial practices which are in all circumstances considered unfair:
  - (a) generic or exaggerated environmental claims;
  - (b) claims related to positive environmental impacts that are based on carbon offsetting; and
  - (c) claims related to legally mandated requirements.

It is important to note that the ECD defines environmental claims as any commercial communication conveyed in any form, including text, images, graphics, or symbols, such as labels. Therefore, in addition to the above, claims based on sustainability labels that are not supported by an authorised certification system or established by public authorities are included in the blacklist of commercial practices that are considered unfair in all circumstances.

5.4 Supervision

The competent regulatory authorities in Italy responsible for verifying ESG disclosure compliance are:

- Consob for listed companies subject to the CSRD;
- Consob and Bank of Italy, for financial operators subject to the SFDR; and
- AGCM for all market operators subject to the Consumer Code.

5.5 Enforcement

With regard to non-compliance with the CSRD for false or misleading ESG disclosures, administrative monetary penalties are foreseen exclusively for publicly listed companies, in accordance with the provisions of TUF. Additionally, because the sustainability statement required by Decree 125/2024 is included in the management report, all companies may be subject to the general regime governing false statements in financial reports, which could involve criminal law provisions.

Similarly, non-compliance with the SFDR for false or misleading ESG disclosures also results in administrative monetary penalties, again in accordance with the TUF.

In cases of non-compliance related to unfair competition for false or misleading ESG disclosures, actions constituting unfair competition can be prohibited, and compensation for damages may be required, according to the Italian Civil Code provisions.

Regarding non-compliance with misleading advertising regulations for false or misleading ESG disclosures, according to the provisions of the Consumer Code, the AGCM may (i) prohibit the advertisement and (ii) impose an administrative monetary fine ranging from EUR5,000 to EUR5 million, depending on the seriousness and duration of the violation.

5.6 Expected Progress

In the coming years, companies are expected to make significant strides in meeting their ESG reporting obligations, driven by increasing regulatory and supervisory pressure, investor demand, and rising public awareness.

With frameworks like the CSRD, SFDR and ECP becoming mandatory, companies will likely enhance their sustainable corporate governance models. This will enable better management of ESG-related impacts, risks and opportunities, incorporating robust policies, procedures, and internal organisational measures to strategically govern ESG. These efforts will help mitigate key risks – especially reputational and legal risks – while creating long-term value for both shareholders and stakeholders at large.

However, several challenges remain. First, companies will face the complexity of collecting accurate and comprehensive ESG data across various business operations and global supply chains. Second, the need to align with multiple regulatory frameworks and ensure consistency in ESG disclosures across jurisdictions will continue to be a significant challenge. Third, the risk of greenwashing – whether intentional or unintentional – will persist, as companies may feel pressured to overstate their sustainability initiatives. Finally, integrating ESG considerations into core business strategies, while also ensuring adequate internal resources and expertise, will require a substantial cultural and operational shift within many organisations.

In summary, while companies are likely to make substantial progress, navigating the evolving regulatory landscape, ensuring transparency and accuracy, and aligning with global standards will remain ongoing challenges. This is due to the inherent complexity of a new system that must be understood and adapted by individual market participants based on their unique characteristics and needs.

6. Climate and ESG Litigation

6.1 Instruments for ESG Litigation

In Italy, the commencement of ESG-related legal actions depends on the type of claim and the parties involved. In recent years, there has been a notable rise in such cases, underscoring the practicality and effectiveness of existing legal mechanisms in addressing ESG issues. In particular, the main avenues for pursuing these actions include:

- civil court proceedings, which may involve (i) ordinary proceedings initiated either by private individuals under tort law, seeking compensation for damages or orders mandating specific actions due to companies' violation of ESG-related regulations, or by competitors under the unfair commercial practices rules, aiming to obtain injunctive relief or other remedies; or (ii) class actions for injunctive or declaratory relief brought by consumer associations or individuals to obtain a court order against unlawful acts or omissions, such as cease-and-desist orders or orders mandating specific actions;
- administrative court proceedings before the AGCM to determine the existence of unfair business practices under the Consumer Code or misleading advertising under the Advertising Law, which may result in sanctions; and
- proceedings before the Advertising Self-Regulation Jury (*Giurì di Autodisciplina*, the "Jury"), based on the Self-Regulation Code: If a company has adhered to the Code, the Jury can order the company to stop disseminating any commercial communication found to be in violation. If the communication clearly violates the Code, the Chairman of the Control Committee can also issue a desist order. The decisions are publicly available and can be subject to further public announcements, naming the involved parties.

6.2 Climate Activism

In understanding the Italian jurisdiction, it is useful to consider, again, the broader European context. The primary objectives of European Union ESG laws include providing ESG information to civil society actors, including NGOs and activists, enabling them to hold companies accountable for their impacts on people and the environment.

In addition, the CSRD requires companies to implement:

- stakeholder engagement activities, meaning an ongoing process of interaction and dialogue between the company and its stakeholders that allows the company to listen, understand, and respond to their interests and concerns; and
- grievance mechanisms, meaning processes through which stakeholders can raise concerns and seek remedies; these processes can be managed by the organisation either independently or in collaboration with other parties, and must be directly accessible to the organisation's stakeholders, thus preventing both harm and grievances from escalating.

To conclude, the forthcoming CS3D will mandate companies to establish a fair, publicly available, accessible, predictable, and transparent procedure for handling complaints from individuals or entities concerning actual or potential adverse impacts related to the company's operations, those of its subsidiaries, or its business partners throughout the chain of activities.

Complaints may be submitted by:

- natural or legal persons who are affected, or have reasonable grounds to believe they might be affected, by an adverse impact, as well as their legitimate representatives, such as civil society organisations and human rights defenders;
- trade unions and other worker representatives on behalf of individuals employed within the relevant value chain; and
- civil society organisations that are active and experienced in areas related to the environmental issues at the heart of the complaint.

With this in mind, in Italy, in addition to several mediation proceedings under the OECD Guidelines initiated before the NPC, some NGOs, including ReCommon and Greenpeace, have also initiated the first climate litigation cases against the state and against a company operating in the energy sector. In light of these developments, coupled with the rise of environmental activism, NGOs and activists play a significant role in shaping the ESG landscape in our jurisdiction.

6.3 Greenwashing v Greenbleaching

On 16 July 2024, the AGCM launched an investigation into several fashion companies over potential unlawful practices in the promotion and sale of clothing and accessories, in violation of the Consumer Code.

According to the AGCM, in some cases, these companies sourced supplies from workshops employing workers:

- who received inadequate wages; and
- who worked hours beyond legal limits and in unsafe and unhealthy conditions, in contrast to the companies' claims of excellence in production.

The alleged unfair commercial practices relate to corporate communication emphasising the craftsmanship and quality of the creations. On the contrary, the companies were apparently sourcing from workshops that employed exploited workers, thus misleading consumers. The AGCM clarified that the investigation was also prompted by actions taken by the Milan Prosecutor's Office and the Milan Court (see **4.2 Towards Vertical Responsibilities**).

Another investigation has been recently launched by the AGCM, targeting another fashion company that promoted an image of sustainable production and marketing for its clothing through generic, vague, confusing, and/or misleading environmental claims.

Furthermore, in April 2024, the Italian Council of State, the highest authority on administrative matters, ruled on the legitimacy of sanctions imposed by the AGCM against an Italian oil company for greenwashing and misleading advertising. The Council of State, taking into account the upcoming ECD, upheld the legitimacy of the green claims, provided the product had a demonstrably lower environmental impact compared to others in the same category and that the claim was supported by clear, sufficient, and contextual information enabling customers to accurately understand the product's sustainability.

6.4 A Turbulent Future Ahead

The future of ESG-related litigation in Italy is set to grow considerably in the coming years. This growth is driven by several factors, including increasing regulatory focus on the enforcement of ESG standards and the rising awareness among both consumers and activists about companies' environmental and social impacts.

We may expect to see a marked increase in enforcement actions, particularly related to greenwashing and violations of supply chain transparency. Both administrative authorities like the AGCM and private litigants are likely to pursue cases concerning misleading ESG claims, and Italian courts will face growing scrutiny on corporate compliance with new EU regulations such as the CSRD and the CS3D.

Moreover, with more companies required to disclose their ESG metrics and sustainability efforts, there will likely be more cases challenging the authenticity of those claims. As ESG policies continue to mature, coupled with increased activism and legal scrutiny, the number of ESG-related proceedings in Italy will undoubtedly rise. We will also likely witness a corresponding increase in contractual disputes over violations of ESG clauses, which are becoming more prevalent in a broad variety of commercial agreements.

Trends and Developments

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Legance

Legance is an independent law firm with offices in Milan, Rome and London, with over 400 lawyers. Founded in 2007, Legance distinguishes itself in the legal market as a point of reference for both clients and institutions. Independent, dynamic, international and institutional are the qualities that most characterise the strengths of the firm and have contributed to it becoming a leader in the legal market. The professionals in the ESG and impact team have significant experience in assisting clients – eg, companies, investment funds, managers and other players – in the area of sustainability and ESG-related issues. In particular, the team has built up a strong presence in this area, developing multidisciplinary skills that enable it to support clients who wish to approach sustainability in a rigorous and innovative way.

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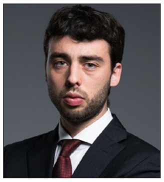

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How the CSRD is Changing the Approach to Sustainability in Italy: From Legislator to Prosecutors, From Litigation to Investors' Choices

The European Union (EU) has been at the forefront of driving sustainability within corporate governance and investment practices. The landscape of ESG regulation in Europe has evolved significantly in recent years, with several key frameworks converging to create a robust legal and regulatory environment. Among these, Regulation 2019/2088 on Sustainable Finance Disclosure (SFDR), Directive 2022/2464 on Corporate Sustainability Reporting (CSRD) 2022/2464, and Directive 2024/1760 on Corporate Sustainability Due Diligence 2024/1760 (CS3D) have played crucial roles.

It is also worth mentioning Regulation 2023/1115 on Deforestation-free Products, which will be applicable from 30 December 2024. Under this regulation, any operator or trader who places on the EU market or exports from it commodities like cattle, wood, cocoa, soy, palm oil, coffee, rubber, and some of their derived products, such as leather, chocolate, tires, or furniture, must be able to prove, by conducting – eg, a specific due diligence procedure, that the products do not originate from recently deforested land or have contributed to forest degradation.

These "sustainability laws" all share the common feature of extraterritoriality. The reach of their effects extends beyond EU jurisdictions, imposing obligations on importers of specific commodities and, in the case of the CSRD and CS3D, on large non-EU businesses. Notably, starting with the CSRD, non-EU business partners located across value chains of the recipients will also be thoroughly impacted, being required to communicate ESG information and align with ESG standards.

The EU ESG legal framework is putting sustainability at the centre of corporate strategies, affecting the action and drawing the attention of investors, consumers, national legislators and authorities. Italy exemplifies this shift, with recent developments such as the decree transposing the CSRD into national law and legal actions by Milanese prosecutors targeting major fashion brands, marking a pivotal moment in the country's approach to sustainability from both legal and financial standpoints. This article delves into Italy's transposition of the CSRD, the legal cases in Milan, and how the ESG legal framework is influencing corporate and financial practices.

Italy's Transposition of the CSRD and Related Sanctions

The CSRD, which builds on the Non-Financial Reporting Directive (NFRD), expands the scope and detail of corporate sustainability reporting. It requires large companies and listed small and medium-sized enterprises (SMEs) to disclose information on how they manage social and environmental challenges. The CSRD introduces more detailed reporting requirements and extends the scope of companies covered, thereby increasing the volume of sustainability-related information available. Sustainability reporting will be an integral part of a company's financial management report and it will have to be published and made available on the websites.

Accordingly, ESG factors will have to be properly assessed, and companies can no longer uphold their sustainability efforts through mere marketing communications as they may have done in the past. Indeed, the main outcome of the CSRD is not the disclosure obligations that it introduces, but rather the identification of what is needed for sustainable corporate governance and sustainable procurement. In particular, sustainable corporate governance encompasses several legal activities related to ESG, including ESG data governance, marketing and communication as well as all the governance processes, controls and procedures to monitor, manage and oversee sustainability impacts, risks and opportunities both within a company and across its value chain and business relationships, in line with the company's ESG strategy and business model. The detailed framework for sustainable corporate governance can be found in the Delegated Regulation 2023/2772, establishing the European Sustainability Reporting Standards (ESRS), which set forth EU standards and the specific content to be disclosed in the sustainability statement according to the CSRD.

Italy, like the other EU member states, shall transpose the CSRD into national law, while the ESRS, being a regulation, directly apply to all member states. On 6 September 2024, the Italian government issued a decree (legislative decree No 125/2024) that formalises the CSRD's requirements, ensuring that Italian companies comply with the new, more stringent sustainability reporting (and, indirectly, due diligence) obligations. This decree aligns Italy's regulatory environment with EU standards, requiring large and listed companies, starting from financial year 2024 on a phase-in basis depending on the dimension, to disclose information necessary to understand the undertaking's impacts on sustainability matters (also known as "inside-out" perspective or impact materiality), and information necessary to understand how sustainability matters affect the undertaking's development, performance and position (also known as "outside-in" perspective or financial materiality).

In particular, Italian companies will have to disclose information on, inter alia, their business model and strategy, including:

- the plans for aligning with the limiting of global warming to 1.5 °C in line with the Paris Agreement;
- how their business model and strategy take account of the interests of stakeholders;
- the role of the administrative, management and supervisory bodies with regard to sustainability matters;
- the policies in relation to sustainability matters;
- the due diligence process implemented with regard to sustainability matters;
- the principal actual or potential adverse impacts connected with their value chain, including own operations, products and services, business relationships and supply chain; and
- any actions taken, and the result of such actions, to prevent, mitigate or remediate actual or potential adverse impacts.

As the sustainability statement must be published within the management report attached to the financial statement, one of the critical aspects of Italy's transposition of the CSRD is the introduction of sanctions for companies and liability for their board members in case of noncompliance with the dispositions of the decree itself and with the ESRS. Companies and board members, who must approve the sustainability statement, that fail to meet the reporting requirements, as well as omit material information or provide misleading information, can thus face significant sanctions of an administrative, civil or criminal nature. Indeed, it is important for companies to structure solid governance procedures overseeing the sustainability reporting process and the underlying contents. As an example, while due diligence is the core element of CS3D, which will introduce specific due diligence obligations as to how the process must be conducted, companies must already consider Decree

125/2024 alongside CS3D. ESG due diligence forms the basis of the materiality assessment (requested by the ESRS) which, in turn, informs the sustainability statement.

In Italy, the growing importance of ESG requirements, particularly under Legislative Decree 125/2024, will thus significantly influence the role and responsibilities of directors and officers. Under Italian law, directors have fiduciary duties to act in the best interests of the company, including the duty of care and diligence. With the introduction of Decree 125/2024, directors must now integrate sustainability considerations into their decision-making processes, aligning with the principle of informed decision-making. This means they are required to fully understand and evaluate the company's ESG risks, as well as the long-term impact of corporate activities on stakeholders, including employees, the environment, and society. Neglecting these factors may lead to decisions that are not in the best interests of the company and could breach their fiduciary duties.

The newly introduced sanctions are designed not only to enforce compliance but also to deter greenwashing and green hushing, establishing a common ground for the disclosure of companies and for the implementation of sustainable governance. Notably, the sustainability reporting shall be drafted in electronic format, with the tagging of the information pursuant to XBRL Taxonomy. In this way the EU will collect all the qualitative and quantitative data stemming from the disclosure of companies, creating a dedicated database, which will be easily accessible and readable, exposing companies to public ESG assessments by all stakeholders, along with the control of supervisory authorities and prosecutors.

In line with the enhanced transparency and accountability of companies, the Italian decree identifies a supervisory authority tasked with overseeing compliance of listed companies with the CSRD, the first companies implementing it. This authority is the already existing Italian market supervisory authority, CONSOB, which is now empowered to also conduct audits and investigations into companies' sustainability practices and reports, further reinforcing the seriousness with which Italy is approaching sustainability issues.

For non-listed companies, the standard regime is expected to apply, meaning they remain under the purview of prosecutors and shareholders for compliance and enforcement. As previously outlined, this framework imposes significant consequences for both companies and board members in cases of non-compliance.

Italian Cases: Fashion Houses and the Role of the Milan Prosecutor

The recent legal cases involving leading luxury fashion houses have underscored the increasing scrutiny of corporate sustainability practices in Italy. Spearheaded by the Milan prosecutor's office, these cases allege violations of social and human rights standards within the fashion industry, which is known for its intricate and often opaque supply chains.

The connection between these cases, the Italian CSRD transposing decree and the forthcoming CS3D is particularly significant. The CSRD and CS3D's emphasis on transparency, accurate reporting and due diligence throughout the supply chain means that companies can no longer claim ignorance of practices that occur outside their immediate operations. In the cases of the Italian fashion companies, the Milan prosecutor has focused on alleged lapses in due diligence regarding labour conditions and human rights protection within their supply chains. These allegations suggest that both companies may have failed to adequately monitor or mitigate negative impacts, which could be construed as violations under the CS3D framework once it comes into force.

More importantly, since CSRD requires the disclosure of whether due diligence measures have been adopted or not, their absence, which must be disclosed, would be indicative of a lack of effort (or best effort) to prevent such potential negative impacts, and could lead to liability. Lack of adequate effort in supply chain controls and management, such as outsourcing production to firms without sufficient production capacity that, as a result, were likely to subcontract without implementing full-chain audit systems, could lead to legal repercussions.

The Milan prosecutor's actions highlight a shift in enforcement from merely penalising false or misleading sustainability claims to actively investigating and prosecuting companies for failing to adhere to due diligence obligations. This shift indicates a broader trend where legal accountability for sustainability is moving from a passive requirement of reporting to an active obligation to ensure that corporate operations, including those of suppliers, meet specific social and environmental standards.

The Interplay Between Corporate and Finance: CSRD, SFDR, and Market Dynamics

The integration of sustainability into both corporate and financial sectors is becoming increasingly interconnected, particularly in light of the CSRD and SFDR. The Armani and Dior cases exemplify this interplay. As these companies face legal scrutiny, the financial implications are also significant, particularly in the context of the SFDR.

Under the SFDR, financial institutions as investors are required to assess the sustainability risks associated with their investments and, depending on the financial product "qualification" under the SFDR, negative impacts of the product on environmental and social factors. If a company is implicated in legal cases concerning ESG violations, this can therefore influence investors' choices given the potential implications on the financial and sustainability value of the investment. Investors are becoming more sensitive to the reputational risks associated with ESG issues and the legal actions in Milan have likely triggered reassessments by institutional investors and fund managers regarding their exposure to these companies. This can lead to divestment or demands for better compliance with sustainability standards, thereby exerting pressure on the companies to improve their ESG practices. Similar considerations can be made for other financial market participants, such as banks or insurance undertakings, subject to similar disclosure requirements with respect to financial services rendered, and also with respect to financial advisers.

The CSRD, with its stringent reporting requirements, plays a crucial role in this dynamic. The enhanced transparency mandated by the CSRD means that companies must provide detailed and verifiable information about their sustainability practices. This information is vital for financial market participants and financial advisors who rely on accurate data to make informed decisions in line with the SFDR's requirements. Inaccurate or incomplete reporting can lead to legal liabilities and financial penalties under the CSRD, but it can also result in financial market repercussions as financial market participants and advisers seek to avoid companies with potential ESG risks and negative impacts.

Conclusion: The New Landscape of Corporate Sustainability in Italy

The convergence of the CSRD, SFDR, and CS3D within the EU's regulatory framework is fundamentally altering the landscape of corporate sustainability in Italy. The country's transposition of the CSRD, coupled with the legal actions taken by the Milan prosecutor, signals a new era where sustainability is not just a matter of corporate responsibility but also of legal and financial accountability.

Companies operating in Italy – and indeed across the EU – must now navigate a complex regulatory environment where failure to comply with ESG standards can lead to severe legal and financial consequences. The integration of sustainability into corporate governance and financial markets is no longer optional; it is a mandated aspect of doing business in Europe.

For companies, this means that robust sustainability practices are essential not only for regulatory compliance but also for maintaining investor confidence and market stability. For investors, the evolving ESG framework provides tools and frameworks to make more informed decisions, but it also necessitates a careful assessment of the ESG risks associated with their investments.

In this new landscape, the interplay between legislation, enforcement, and financial markets will continue to drive the integration of sustainability into the core of business practices in Italy and beyond. The ongoing cases, already pending without the application of CSRD, serve as a warning that the cost of non-compliance is rising, both in terms of legal liabilities and market repercussions, marking a significant shift in how sustainability is approached in the corporate world.

NETHERLANDS

Law and Practice

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Contents

Stibbe is a leading, independent, international law firm with main offices in Amsterdam, Brussels and Luxembourg, as well as a branch office in London. It provides the highest-quality service in legal advice, transactions and litigation. The dedicated multidisciplinary teams are trusted legal advisers to clients that range from national and multinational companies and financial institutions to government organisations and other public authorities. The firm handles transactions, disputes and projects across a wide range of sectors. A thorough understanding of clients' commercial objectives enables the team to provide suitable and effective advice on complex legal issues and challenges. Stibbe works closely together with other international top-tier firms on cross-border matters outside its home jurisdictions; the firm's independence allows it to team up with any foreign law firm to suit clients' needs and preferences.

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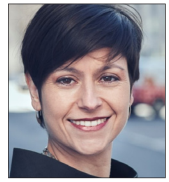

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1. Introduction

1.1 General ESG Trends

The past year has been filled with numerous significant developments related to ESG issues, affecting governments, businesses and investors not only in the Netherlands but all around the globe. ESG legislation has multiplied, with several important regulations entering into force during the past months. Most of these laws have their origin in "Brussels" and thus affect stakeholders not only in the Netherlands, but also in other EU member states.

There has furthermore been a new surge in climate litigation, directed at companies as well as governments. While the ongoing climate lawsuits against Shell and ING Bank serve as test cases for collective actions against companies regarding their climate policies, the recent landmark ruling by the ECHR in the case of KlimaSeniorinnen Schweiz v Switzerland provides NGOs with additional arguments to challenge government policies in court.

Finally, directors are increasingly being held accountable for the ESG compliance of their companies, and there is a trend towards soft law becoming hard law – for example, in the field of business and human rights.

1.2 Environment Trends

There have been several regulatory developments during the past months regarding the environmental aspect of ESG. At the national level, the Dutch Environment and Planning Act (*Omgevingswet*) entered into force at the beginning of 2024. This new law brings together the majority of existing laws and regulations regarding the built environment, housing, infrastructure and the environment, as well as nature and water. It furthermore implements several EU Directives and international treaties.

The Environment and Planning Act introduces several new instruments for the competent authorities to regulate the physical environment, including the programmatic approach, the project decision and the environmental plan. Under the Environment and Planning Act, natural persons and businesses that want to carry out activities that impact the physical environment can apply for one single permit covering all aspects of the activity at one online service counter. In principle, however, all previous environmental permits remain valid and businesses do not have to take any action if the manner in which they operate does not change. However, there will be more environmental rules in local regulation and more duties of care will apply. Many of them apply in addition to the permit and complying with the permit can still lead to enforcement of an evident violation of the duty of care.

Furthermore, new rules will apply to textile producers in the Netherlands under the EPR for Textiles Decree from 2025 onwards. Under the Extended Producer Responsibility (EPR) scheme, textile producers must organise and pay for the waste management of the products they place on the market. These rules are meant to encourage businesses in the textile industry to adopt more sustainable production methods and increase the amount of recycled content in their products.

From an EU perspective, the beginning of the year was marked by the implementation of the revised Emission Trading System (ETS) Directive. Under the new rules, a new emissions trading system has been developed to address emissions from fuel combustion in buildings, road transport and small industry not covered by the first ETS.

Finally, new rules on industrial emissions (the Industrial and Livestock Rearing Emissions Directive, or "IED 2.0") entered into force in Brussels – expanding the scope of the existing legislation to include, for example, pig and poultry farms. The revised law also aims to reduce administrative costs and make permitting for the industrial installations and farms concerned more efficient. In addition, industries must submit a transition plan that is in line with the goals of the Paris Agreement and must report on various environmental topics. EU member states have until 1 July 2026 to implement IED 2.0. There is not yet a draft of the implementation regulation in the Netherlands.

Typically, environmental problems in the Netherlands include the fact that many projects cannot proceed and permits are annulled or revoked because of nitrogen emissions. The water quality and water quantity are not good in the Netherlands. Many governmental bodies have furthermore signed an agreement in which they agreed to tighten permit requirements concerning various emissions to the air.

The Dutch State is making agreements with huge industrial companies in the Netherlands concerning the reductions of carbon dioxide emissions.

1.3 Social Trends

In relation to the social aspect of ESG, a legislative proposal regarding a licensing system for temporary employment agencies is currently pending in the Dutch Parliament. Under this proposal, temporary employment agencies will only be able to provide workers if they meet certain minimum requirements and obtain a licence. Companies will also be required to hire temporary workers solely through licensed agencies. The aim is to improve the position of workers, particularly migrant workers, and ensure fair competition.

As of 1 January 2025, the Dutch tax authorities will begin enforcing regulations against "false self-employment" (*schijnzelfstandigheid*) under the Deregulation of Labour Relations Act (*Wet Deregulering Beoordeling Arbeidsrelatie,* (DBA)), with the aim of improving the position of workers who are unjustly denied employee rights and strengthening the social security system.

This year, the implementation process of the EU Directive on equal pay through pay transparency and enforcement mechanisms has started. A legislative proposal for the implementation was expected in the first quarter of 2024. However, to date, no proposal has been published, indicating that the process is behind schedule. The EU Directive must be fully implemented by 7 June 2026.

From an EU perspective, the Corporate Sustainability Due Diligence Directive (CSDDD) furthermore requires large companies to identify and – where necessary – prevent, end or mitigate adverse impacts of their business activities on human rights. These due diligence requirements will be discussed in greater detail in **4. ESG Due Diligence**.

A legislative proposal on equal opportunities in recruitment was rejected by the Dutch Senate earlier in 2024.

1.4 Governance Trends

Regarding the governance aspect of ESG, 2024 was the second year during which companies worked with the new Dutch Corporate Governance Code. This document explicitly states that directors are responsible for sustainable long-term value creation and that companies should develop policies addressing diversity and inclusion.

Furthermore, a members' bill on Responsible and Sustainable International Business Conduct (Initiative Bill) is pending before the Dutch Lower House, with the same objective as the CSDDD. So far, however, the Dutch Parliament has not discussed and voted on the bill in a plenary session. As such, it is uncertain whether the bill will actually enter into force on the proposed date of 1 January 2025. This seems unlikely, as the proposed law not only needs to pass the vote in the Lower House (*Tweede Kamer*) but also in the Upper House (*Eerste Kamer*) and it concerns more or less the same goals and obligations as the CSDDD. This process could also lead to new amendments to the bill. For further details of the Initiative Bill, see **2.1 Developments in Corporate Governance**.

Finally, the Dutch government is working on several initiatives to establish legal business forms for social enterprises and not-for-profit companies. These include a social private limited liability company (*Besloten Vennootschap met een Maatschappelijk doel*, or BVm) and a legal form for steward-owned businesses. These developments are part of a larger trend, in which the relationship between a company and its shareholders is evolving. These issues are discussed in greater detail in **2. Corporate Governance**.

1.5 Government and Supervision

There has been a recent increase in ESG legislation in the Netherlands. The major share of these regulations come from "Brussels", as they cover issues that are difficult to address at the national level while maintaining a level playing field for companies. As such, regulators play an important role in the promotion and uptake of ESG initiatives.

Supervision authorities such as the Dutch Authority for the Financial Markets (*Autoriteit Financiële Markten*, or AFM) and the Netherlands Authority for Consumers and Markets (*Autoriteit Consument & Markt*, or ACM) are often tasked with the enforcement of (new) ESG legislation, such as the CSDDD. In this regard, these authorities are becoming noticeably stricter in recent years, in order to ensure that companies properly adhere to rules concerning ESG issues.

Next to their enforcement tasks, supervision authorities also play an important role by providing guidance on ESG legislation. The ACM, for example, recently decided that banks are allowed to work together when preparing sustainability reports, and provided insight into the assessment of sustainability agreements between companies under EU competition law.

At the individual level, authorities increasingly tend to take a more cautious approach to ESG matters – for example, by imposing very strict obligations when issuing environmental permits. The authorities seem to prefer to be corrected by the judiciary for being too strict rather than for being too lenient. This might be the result of the outcome of certain lawsuits in which governments were held accountable for their actions/inactions – in the Urgenda case, for instance – and the occurrence of various environmental incidents during the past few years. Corporates can and do actively address this imbalance from a business perspective by engaging in constructive discussions with the authorities and, if the government asks too much, by making sure that the option for compensation is utilised. If this does not lead to a positive outcome, one can appeal against the decision of a supervision authority.

1.6 Market Participants

Companies, industry, and large agricultural farms that fall within the scope of major ESG legislation such as the CSDDD, the Corporate Sustainability Reporting Directive (CSRD), the IED and the ETS will be most affected by the recent regulatory developments. Moreover, the recently adopted Ecodesign Regulation is expected to have a large impact on manufacturers producing goods for the EU market. This new law enables the EC to set performance and information requirements for almost all categories of physical goods to improve circularity, energy performance and other environmental sustainability aspects of products placed on the internal market.

In the coming years, the EC will set out those ecodesign requirements in so-called delegated acts. Requirements may cover various product aspects, such as durability, repairability, or recycled content. The rules mainly target manufacturers, which are responsible for complying with the ecodesign requirements when designing and producing goods. However, the law also places certain obligations on distributors, importers, and providers of online marketplaces. As such, the regulation is expected to have a big impact on the economy as a whole.

Furthermore, recent developments regarding sustainability claims will put pressure on all types of market participants to think carefully before making green claims about their products or organisational behaviour and to properly substantiate public claims regarding environmental impact or performance. In this regard, the recent judgment in the Fossielvrij/KLM case and the EU legislative proposal for a Green Claims Directive provide an interesting outlook for the future.

Finally, the EC and competition authorities increasingly provide more space for market participants (read: competitors) that wish to collaborate in light of sustainability goals. In 2023, the EC published its updated Horizontal Guidelines, including a new section on competition and sustainability agreements, and the ACM updated its Sustainability Policy Rule not much later. Navigating EU competition rules will become increasingly important as more businesses want to enter into environmental collaboration agreements.

1.7 Geopolitical Developments

At the EU level, we observe continuous policy efforts aimed at strengthening competitiveness and improving prosperity. The EC's Strategic Agenda for 2024–29, which sets the EU's priorities for the next five years, stresses the importance of reinforcing Europe's sovereignty in strategic sectors – for example, by reducing certain dependencies and diversifying supply chains. The agenda furthermore calls for significant collective investment efforts and the pursuit of a just and fair climate transition.

In her Political Guidelines for 2024–29, President of the EC Von der Leyen reiterated these ambitions and announced the publication of a Clean Industrial Deal, a new Circular Economy Act, a new chemicals industry package, a Quality Jobs Roadmap, a Gender Equality Strategy and a new approach to competition policy, among other things. These initiatives are expected to affect companies and their ESG policies throughout Europe.

In the Netherlands, the new coalition agreement (2024–28) setting out the priorities for the current government calls for easing the administrative burden imposed on companies, new pension rules, and strategic industrial policy. The agreement furthermore stipulates the need to decrease energy dependence, invest in innovative solutions to reach climate targets (eg, carbon capture and storage and green hydrogen), and conclude tailor-made agreements with large industrial companies in light of sustainability goals.

While the new government seems to be accepting the majority of current climate policies, including the various greenhouse gas reduction targets, it seems unlikely that there will be much additional environmental legislation and initiatives coming from The Hague in the next few years. In that regard, the new coalition is likely to be less ambitious than the previous government. There also seems to be a shift in focus from climate mitigation to climate adaptation in government policies.

2. Corporate Governance

2.1 Developments in Corporate Governance

Corporate Social Responsibility (CSR) and accountability in this respect are hot topics in the Netherlands. National and international trends have developed whereby CSR-related regulations based on voluntary adoption have been replaced by statutory regulations in the areas of transparency and due diligence.

European Initiatives

In December 2019, the EC introduced the European Green Deal – the purpose of which is to transform the EU into a modern, resource-efficient and competitive economy. Several legislative initiatives have since been taken, including the CSRD and the CSDDD.

CSRD

The CSRD entered into force on 5 January 2023. As from FY 2024, companies falling under the scope of the CSRD will have to draw up an extensive sustainability report on the basis of European Sustainability Reporting Standards (ESRS). Although the CSRD focuses on reporting, the CSRD requirements also affect the governance of companies. The requirements under the CSRD may, for example, lead to changes in the role and composition of the management board and the supervisory board. The CSRD is being implemented in the Netherlands in the form of various laws and decrees and has not yet been finalised. The CSRD will be discussed in greater detail in **5. Transparency and Reporting**.

CSDDD

The CSDDD entered into force on 25 July 2024. Under the CSDDD, large companies will need to adopt due diligence policies to identify, prevent or mitigate – and ultimately end – any adverse impact of their operations on human rights, the environment and good corporate governance (including corruption). In-scope companies also need to have a plan in place to ensure that their business strategy is compatible with limiting global warming to 1.5°C in line with the Paris Agreement. The EU member states have two years to implement the CSDDD into national laws and regulations. The CSDDD has not (yet) been implemented in the Dutch regulation.

National Initiatives

The Netherlands already has a specific law on human rights due diligence, but this law has still not entered into force. On 13 November 2019, the Duty to Prevent Child Labour Act (*Wet Zorgplicht Kinderarbeid*, or WZK) was published in the Dutch Bulletin of Acts and Decrees (*Staatsblad*). Under the WZK, every company selling goods or rendering services to Dutch end users must take due care to ensure that those goods or services have not been produced using child labour.

In addition, as mentioned in **1.4 Governance Trends**, a members's bill on Responsible and Sustainable International Business Conduct (Initiative Bill) is pending before the Dutch Lower House, with the same objective as the CSDDD. The Initiative Bill provides for a general duty of care (due diligence) that applies to every Dutch company that knows or may reasonably suspect that its operations or that of its business relations may have adverse effects on human rights and the environment in a country outside the Netherlands. Further, the Initiative Bill requires certain large companies to exercise due diligence in their production chains, including the conduct of the company's business relations, such as suppliers. It is not certain yet whether this bill will enter into force, as it concerns more or less the same goals and obligations as the CSDDD.

2.2 Differences Between Listed and Unlisted Entities

The corporate governance requirements for listed and unlisted companies in the Netherlands differ.

For both listed and unlisted companies, Book 2 of the Dutch Civil Code sets out the duties and powers of the various corporate bodies, as well as rules on representation, conflicts of interest, the liability of managing and supervisory directors, financial reporting, and disclosure.

Listed companies must also comply with the Dutch Corporate Governance Code. The Corporate Governance Code contains principles and best practice provisions regulating the relationship between the management board, the supervisory board and the general meeting/shareholders of Dutch listed companies. The Corporate Governance Code was updated on 20 December 2022. The revised code sharpened the focus on sustainability aspects of companies. Sustainable long-term value creation is the key consideration for management boards and supervisory boards when determining strategy and making decisions, and stakeholder interests should be taken into careful consideration. The requirements (the principles and best practice provisions) of the Corporate Governance Code are based on the "comply or explain" principle.

Additional governance requirements apply to listed companies and certain "large" companies – for instance, in the field of diversity.

Under the EU Non-Financial Reporting Directive (NFRD), large public interest entities (listed companies, banks and certain insurers) must have a diversity policy and provide information on it in the corporate governance statement of the management report. Under the NFRD, diversity is used in the broad sense of the word (nationality, age, gender, educational, professional background and so on). The Dutch Diversity Act (*Wet Ingroeiquotum en Streefcijfers*) introduced a statutory gender diversity quota (one-third men and one-third women) for the supervisory boards of Dutch listed companies on Euronext Amsterdam. This means that, apart from two specified exemptions, any appointment that does not make the composition of the supervisory board of the listed company more balanced is null and void. In addition, large companies (whether listed or not) must set more appropriate and ambitious gender target ratios, draw up an action plan and report on this in the management report and to the Social and Economic Council (SER) within ten months of the end of the financial year.

2.3 Role of Directors and Officers

In 2020, a group of professors of Dutch corporate law called for the introduction of responsible corporate citizenship in the statutory duties of managing and supervisory directors. Managing directors should ensure that the company participates in society as a responsible company. Supervisory directors should supervise this. Thus far, the influence of this proposal has been limited to the Dutch Corporate Governance Code, which includes a principle that the management board of listed companies is responsible for sustainable long-term value creation. The supervisory board oversees this. The proposal in the CSDDD for a duty of care for directors did not make it into the final directive.

The question is whether this proposal represents a broadening of the duties of managing and supervisory directors. Managing and supervisory directors of Dutch companies must be guided in performing their duties by the interests of the company and its affiliated enterprise (the corporate interest). The Dutch Supreme Court has determined that the content of the corporate interest depends on the circumstances of the case and that, as a rule, the interest of companies to which an enterprise is affiliated is determined in particular by promoting the ongoing success of the enterprise. In doing so, managing and supervisory directors must exercise due care in relation to all stakeholders of the company, which may entail that directors must ensure that those interests are not unnecessarily or disproportionately harmed. It could be argued that the corporate interest already implies that companies should behave as responsible companies in society. However, there are different opinions on this among Dutch legal scholars.

The reporting requirements under the CSRD also affect the role and responsibility of the managing and supervisory directors. Companies must provide a description in the sustainability report of the duties and responsibilities of the management and supervisory board with regard to sustainability. Notably, this description covers monitoring the company's impact on sustainability issues (such as climate change), but also how these sustainability issues affect the company (dual materiality). Among other things, the company must make it clear how these duties are laid down in the division of tasks of the management and supervisory board, and in what manner the boards actually perform these duties. The audit committee will have specific duties in the area of sustainability reporting.

As regards stakeholder engagement, there is an upcoming trend whereby managing and supervisory directors are expected to take into account the interests of an increasing number of stakeholders, and also to actually involve those stakeholders in the decision-making process – for instance, in a stakeholder committee or advisory council.

2.4 Social Enterprises

Social enterprises and not-for profit companies do not yet have a specific legal form in the Netherlands. However, the Dutch government is working on a social private limited liability company, known as the BVm. A BVm draft regulation was submitted for consultation on 21 March 2021. In 2024, the Dutch Lower House also adopted a motion requesting the cabinet to develop a new legal form (*rentmeesterven-nootschap*) for steward-owned businesses. Although not yet widespread (the Netherlands currently has about 100 steward-owned companies), steward ownership is gaining increasing attention among entrepreneurs, politicians, lawyers and investors. Steward ownership is an ownership and governance model based on two central principles:

- self-governance by those closely involved in the company and not having a primary financial interest (stewards); and
- profits serve the company's mission and are invested or donated to fulfil the purpose rather than distributed primarily to shareholders.

It is important to recognise that, in practice, a separate legal form is not necessarily needed to make an impact. Even within existing Dutch legal forms (such as the private limited liability company (*Besloten Vennootschap*, or BV), the public limited liability company (*Naamloze Vennootschap*, or NV) and the co-operative), an enterprise can be designed that fulfils that purpose. In addition, companies are also looking for other ways to express their CSR ambitions. By way of example, it is possible to seek alignment with various private codes and quality marks, such as becoming a B Corporation or complying with the Social Enterprises Code.

2.5 Shareholders

In the Netherlands, there is a widespread discussion about CSR and the role that (institutional) shareholders play in it. For decades, Dutch case law has been based on the principle that shareholders are allowed to act in their own interests, while behaving towards each other and the company in accordance with what is required by reasonableness and fairness. However, institutional investors are increasingly expected to take account of ESG issues in their voting and investment decisions as well as the traditional factors (financial return, risk and costs), owing to either legislation and regulation, codes of conduct or voluntary agreements; this is known as sustainable shareholdership.

The Dutch Corporate Governance Code provides that shareholders of listed companies are expected to recognise the importance of a strategy aimed at sustainable long-term value creation. In addition, institutional investors are, for instance, legally required to adopt an engagement policy. Such a policy includes conducting dialogues with investee companies.

In practice, institutional investors deal with shareholder engagement in different ways. A case in point is the famous Letter to CEOs by Larry Fink of Blackrock, which has been calling attention to the importance of sustainability, stakeholders and climate change since 2018 (although, as of 2023, his letter became more cautious). Another form of engagement is the so-called Say On Climate, in which shareholders enter into dialogue with boards so that (voluntary) climate action plans are drawn up and submitted to the general meeting for an advisory vote. In the 2024 Dutch AGM season, Unilever Plc and "new" listed company Ferrovial SE – both listed on Euronext Amsterdam – submitted climate action plans for an advisory vote at this year's AGM. So far there have been no Dutch listed companies that have either voluntarily or obligatorily given the general meeting an advisory or binding voice regarding their climate policy. The growing attention to ESG concerns is further evident in the fact that, like last year, some Dutch AGMs were attended by shareholders affiliated with environmental groups (eg, Milieudefensie, and Extinction Rebellion) in an effort to obtain commitments from the managing and supervisory directors in this area.

3. Sustainable Finance

3.1 Progress in Green Financing

Sustainable Finance Loans, Bonds and Other Investments

The EC has been actively promoting sustainable finance, encouraging the financing of businesses and their assets with green, sustainable and/or sustainability-linked characteristics through various equity and debt investments, debt finance and other financial products. By way of example, in the EC's Recommendation (EU) 2023/1425 of 27 June 2023 on facilitating finance for the transition to a sustainable economy, the EC encouraged the use of green and sustainability-linked loans and bonds and equity and debt investment strategies to finance undertakings that want to contribute to the transition to climate neutrality and environmental sustainability.

Green Bonds

Also, the EU Green Bond Regulation 2023/2631 entered into force on 20 December 2023 and will start to apply on 21 December 2024. The EU Green Bond Regulation sets a gold standard for how companies and public authorities can use green bonds to raise funds on the capital markets on a large scale for green projects. For green bonds to qualify as EU Green Bonds, several requirements need to be met, including the requirement that all funds raised be allocated to projects that are aligned with the EU Taxonomy Regulation – provided that the sectors concerned are already covered by it. A flexibility pocket of 15% will apply to those sectors not yet covered by the EU Taxonomy Regulation and to certain very specific activities. The EU Green Bonds Regulation also includes voluntary disclosure requirements for other environmentally sustainable bonds and sustainability-linked bonds issued in the EU.

Equity and Debt Securities

In relation to debt and equity securities, the European Securities and Markets Authority (ESMA) published a statement on 11 July 2023 that specifically addresses ESG-related disclosures in prospectuses. Issuers and their advisers must consider ESG-related matters when preparing prospectuses, to the extent that the effects of those matters are considered material. This also includes any sustainability information that the issuer is already required to report in accordance with the CSRD.

Funds and Benchmarks

For fund managers and financial advisers, the EU Sustainable Finance Disclosure Regulation (SFDR) sets out requirements for disclosure of information and investment objectives to investors regarding the promotion of financial products with environmental or social characteristics (Article 8 products) or with sustainable investment as their objective (Article 9 products). The SFDR poses several challenges in its interpretation and application, also in relation to other ESG rules and regulations. ESMA and the Dutch supervisory authority AFM have issued several publications in order to clarify and encourage SFDR compliance and sustainable finance investments. By way of example, ESMA published guidelines on key sustainability concepts under the SFDR, the EU Benchmarks Regulation and the EU Taxonomy Regulation, on the use of ESG or sustainability-related terms a well as on fund names.

3.2 Sustainable Finance Framework

Sustainable Finance Guidelines and Principles

Businesses wishing to raise financing with green and/or sustainability characteristics should consider not only the rules and regulations set out in **3.1 Progress in Green Financing**, but also principles and guidelines developed by industry associations – such as the Loan Market Association (LMA) in the EU, its international counterparts the Loan Syndications and Trading Association (LSTA) in the USA and the Asia-Pacific Loan Market Association (APLMA) in Asia-Pacific, and the International Capital Markets Association (ICMA) – on the basis of general market practices. By way of example, the LMA issues principles and guidelines for green, social, sustainability and transition loans and the ICMA issues principles for green, social, sustainability and sustainability-linked bonds, which set expected market standards.

3.3 Access to Green Financing

See elsewhere in **3. Sustainable Finance**.

3.4 Stranded Assets and Non-bankables

The risk that businesses and assets with a less than favourable ESG footprint may become "stranded" and/or "non-bankable" is a reality in EU financial markets.

Various EU regulations include provisions that act as incentives for financial market participants to orient capital towards green and sustainable finance. Examples are disclosure requirements for financial market participants to publish their Green Asset Ratio and Green Investment Ratio, as well as ESG disclosure under capital requirement regulations for banks. These apply in addition to general sustainability requirements under the CSRD and the CSDDD.

Also, the EC recommends that lenders, fund managers and investors engage with borrowers and investees on how sustainability performance and transition targets and plans of undertakings will be taken into account – including in assessing the risk of stranded assets, and transition risks and physical risks more broadly – when seeking financing.

Development of Transition Finance

The EC sees solutions for businesses and assets in transition finance, which can be understood as the financing of climate and environmental performance improvements to transition towards a sustainable economy, at a pace that is compatible with the EU's climate and environmental objectives and that avoids lock-ins.

Industry associations such as the LMA and the ICMA develop principles and guidance for transition finance. By way of example, the ICMA published a paper on transition finance in debt capital markets following its Climate Transition Handbook in 2024, and the LMA is developing principles for the loans markets in relation to transition finance.

3.5 Challenges Ahead

Greenwashing in Financial Markets

The EU supervisory authorities for the financial markets – namely, the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and ESMA – are concerned about financial market participants engaging in "greenwashing". On 4 June 2024, they published their common high-level understanding of "greenwashing" as a practice whereby sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services. The European authorities stress that financial market players have a responsibility to provide sustainability information that is fair, clear, and not misleading.

Greenwashing and Greenhushing

The risk that financial market participants may not meet expected standards that apply to them or their financial products and disclosures, and may qualify as greenwashing under the broad interpretation of that concept by the EU authorities, has led to a retraction of claims and/or promotion of "green" and "sustainability" characteristics by financial market participants. This is a form of "greenhushing" and may also affect the integrity of financial markets and standards of fair disclosure.

Collision of ESG Interests in Financial Markets

EU rules and regulations require the consideration of the interests of multiple and varied stakeholders, and aim to strike a balance between ESG interests. By way of example, the promotion of environmental purposes may "do no significant harm" to other ESG purposes under various regulations addressed in this chapter. Also, in the EU, ESG and climate risks are treated as a form of financial risk, which financial institutions are expected to manage and control under prudential requirements applicable to financial market participants.

Climate and ESG Litigation and Enforcement in Financial Markets

In addition to increased regulation of the financial markets, there is increased monitoring and scrutiny of prospectus and other financial product disclosures by regulators, supervisory authorities and consumer protection authorities. Climate litigation is furthermore a hot topic in the Netherlands and the EU generally, as climate action groups in particular take litigation action against the Dutch government (as in the Urgenda case) and large corporates and banks (eg, Milieudefensie, against Shell and ING Bank). Those claims are based mostly on human rights and tort law as they apply in relation to climate and environmental interests. However, these interests may conflict with social interests that are promoted by other litigation parties in such cases, for example.

4. ESG Due Diligence

4.1 Soft Law Becoming Hard Law

The nature of the rules is changing. A clear shift from soft law to hard law is taking place. An example of soft law is the OECD Guidelines. Every country has an OECD hotline to which people can report violations. In the Netherlands, for example, there was a case related to the Colombian "blood coal". In April 2024, victims of paramilitary violence in Colombia filed a complaint against four European energy companies, the ports of Rotterdam and Amsterdam, and the Rotterdam storage company HES in connection with the violent eviction of peasant families around Colombian "colazones". However, such a procedure can achieve no more than enabling the OECD to hear the parties and to mediate between them.

4.2 Towards Vertical Responsibilities

The Dutch version of the CSDDD, the bill on Responsible and Sustainable International Business Conduct (Initiative Bill), also contains a due diligence reporting obligation that is enforceable under criminal law. Incidentally, this bill, which has been put on hold pending action at EU level, also includes a reversal of the burden of proof. In such cases, the company will have to prove that the law has not been broken. Such a reversal of the burden of proof is also planned for future environmental EU Directives. Interested third parties will no longer have to prove that there were too many emissions, but it will be up to the company to prove that there were none.

4.3 Partner Selection

It is hard to say at the moment what impact the bill on Responsible and Sustainable International Business Conduct (Initiative Bill) will have on the choices that companies make in working with supply chain partners, given that this regulation is not yet in force. The authors believe it will have an impact in the future, as it is expected that companies will need to have a better understanding of their supply chain first and therefore do the necessary research.

4.4 ESG in M&A Due Diligence

Companies are focusing more on ESG, so it does play a role in M&A. It has an effect on the due diligence investigation and the sale and purchase agreement (SPA) (eg, covenants between signing and closing, warranties and indemnities). Purchasers will want to know whether the target complies with applicable requirements and whether the target will likely be able to comply with requirements that will become applicable under EU Directives which have already been adopted and will become effective in the short term. Companies should have, for example, a better understanding of their supply chain because of the CSDDD. Industrial companies should have a transformation plan in the short term that explains why their activities are in line with the goals of the Paris Agreement.

5. Transparency and Reporting

5.1 Key Requirements

In the Netherlands, companies are subject to several disclosure obligations.

- The CSRD – the CSRD replaces the current requirement for large public interest entities to issue a non-financial information statement. In essence, the CSRD requires companies falling within its scope to prepare and publish a sustainability report as part of the management report. One of the key principles of the CSRD is the principle of double materiality; a company is required to report on sustainability matters that are material from an impact or financial perspective. The CSRD does not require all companies to disclose sustainability information. The requirements apply only to companies of a certain size or of a certain type. All "large" undertakings, all "listed undertakings" (excluding micro-undertakings), and certain insurance undertakings that are "large" and/or "listed" are subject to the CSRD.
  - (a) Under Dutch law, an undertaking qualifies as "large" if it meets at least two of the three following criteria on its balance sheet date for two consecutive financial years:
    - (i) balance sheet total >EUR25 million;
    - (ii) net turnover >EUR50 million; and/or
    - (iii) average number of employees during the financial year ≥250.
  - (b) In addition, the CSRD applies indirectly to non-EU undertakings generating a net turnover of EUR150 million in the EU with at least one subsidiary or branch in the EU. The largest subsidiary or branch of these non-EU undertakings must publish a sustainability report covering the whole group of the non-EU parent undertaking.
- The SFDR – the SFDR applies to regulated financial undertakings offering or advising on investment-related financial products, such as investment firms or asset managers. The SFDR requires these undertakings to enable investors to take into account relevant product- and entity-level sustainability information in their investment decision and monitor the sustainability impact of their investments.

- EU Taxonomy Regulation – the Taxonomy Regulation applies to both CSRD- and SFDR-regulated entities and requires disclosing the extent to which the economic activities performed directly by the undertaking or indirectly through an investment product qualify as environmentally sustainable in accordance with, among other things, a detailed set of criteria.
- Capital Requirements Regulation (CRR) – the CRR requires large listed banks to annually report on ESG risks and report on elements of the remuneration policy.
- Decree on the content of the management report (*Besluit inhoud bestuursverslag*) – this decree requires large companies to report on diversity and targets for the male-to-female ratio of supervisory board members.

5.2 Transition Plans and ESG Targets

Under the CSRD and the related ESRS, companies must disclose their transition plan for climate change mitigation (ESRS E1-1). If the company does not have a transition plan in place, it must indicate whether and – if so, when it will adopt a transition plan.

The CSRD does not require companies to commit to targets, but merely to disclose the targets related to sustainability matters. If a company is subject to a disclosure requirement that relates to targets, but has not set the particular target, it must disclose this to be the case and it may disclose a timeframe in which it aims to have the targets in place.

Furthermore, under the recently adopted CSDDD, companies falling within its scope will need to publish transition plans for climate change mitigation. These plans should include time-bound emission reduction targets for scope 1, 2 and 3, and an overview of planned actions and investments to reach these targets, among other things. For companies that publish a transition plan in accordance with the CSRD, the obligation to adopt a plan under the CSDDD is considered to be met.

5.3 Regulation of ESG Labels

The following restrictions and conditions apply to making sustainability claims and to legally regulated ESG labels.

- Dutch consumer protection law – the ACM is a front-runner in the regulation and supervision of sustainability claims by undertakings providing services to consumers. It has issued guidelines mandating the use of clear and non-misleading sustainability labels. Furthermore, the Advertisement Code Committee (a self regulatory organisation) renders authoritative decisions regarding sustainability advertising upon a complaint by individual consumers or, for instance, NGOs. Such decision could also serve as “stepping stone” to civil proceedings.
- SFDR – the SFDR requires certain regulated financial undertakings to provide investors with sustainability information on financial products if these financial products claim to have sustainability ambitions. Moreover, EU regulators recently adopted guidelines prohibiting the use of sustainability-related terms in the names of financial products without adhering to certain minimum levels of sustainability ambition.
- EU Green Bonds Regulation – bond issuers may adopt the voluntary EU Green Bond label when complying with certain reporting standards, using the funds for projects that are aligned with the EU Taxonomy Regulation, and providing pre- and post-issuance transparency on the use of the funds.

- EU Benchmarks Regulation – providers and users of benchmarks in financial instruments, financial contracts, or on the performance of investment funds are subject to additional requirements if this benchmark is labelled as a Climate Transition Benchmark or as a Paris-Aligned Benchmark.
- ESG Rating Regulation – the recently adopted ESG Rating Regulation is expected to start to apply in 2026. This regulation will require that undertakings providing ESG ratings in a professional capacity obtain a licence from ESMA, are transparent on their ESG rating methodology, and avoid conflicts of interest.

5.4 Supervision

The following regulators monitor compliance with ESG disclosure compliance in the Netherlands:

- the AFM, as a supervisory authority on accounting law and financial markets;
- the Dutch Central Bank (*De Nederlandsche Bank*, or DNB); and
- the public prosecutor.

The regulator monitoring the use of sustainability marketing claims is the ACM.

5.5 Enforcement

Compliance with the CSRD is regulated under the Dutch Economic Offences Act (*Wet op de Economische Delicten*, or WED) and is overseen by the public prosecution service. Companies that fail to publish their sustainability statements on time may face penalties, which can include:

- up to six months in prison;
- community service; and
- a fine of up to EUR25,750.

The primary authority for enforcing sustainability disclosures for listed companies is the AFM. The AFM is responsible for ensuring that companies publish their annual reports, including the required ESG information, in a timely and complete manner. The AFM has certain enforcement powers under the Dutch Financial Reporting Supervision Act (*Wet toezicht financiële verslaggeving*, or Wtfv). Additionally, the AFM has the discretion to initiate annual account proceedings (*jaarrekeningprocedure*) with the Enterprise Chamber of the Amsterdam Court of Appeal to evaluate whether a company's financial and sustainability statements included in the annual reporting comply with legal standards. The AFM also oversees compliance with SFDR requirements.

False or misleading sustainability disclosures can lead to administrative penalties and, in some cases, criminal enforcement if certain conditions are met. Additionally, greenwashing may result in civil claims, intervention by the Dutch Advertising Code Committee (*Reclame Code Commissie*), or penalties from the ACM.

5.6 Expected Progress

In the coming years, companies will need to significantly improve their ability to meet their reporting obligations as the volume and complexity of required information increases. While they are likely to become more proficient in handling these disclosures, there is a risk that the process will become a mere "box-ticking" exercise. The new regulations will have a major impact on companies due to the sheer amount of data required, the level of detail involved, and the tight timeframes for compliance.

6. Climate and ESG Litigation

6.1 Instruments for ESG Litigation

It is relatively easy to start ESG-related cases in the Netherlands. Dutch civil procedure offers various options to initiate (commercially funded) collective proceedings and claim damages for a "class" of claimants (eg, consumers), which also relate to ESG matters. It is also relatively easy for NGOs advocating for environmental interests or minorities' rights, for example, to bring a public interest collective action. For such public interest collective actions, a "light" regime in terms of admissibility requirements applies, as long as they do not claim damages. Nevertheless, these are often long-running, complex proceedings. Such public interest collective actions have proven to be a powerful tool for NGOs.

In addition, at least so far, Dutch courts have been willing to take far-reaching decisions regarding jurisdiction but also on substance – for instance, about the role of human rights in climate litigation. Examples are the landmark carbon dioxide reduction orders against the Dutch State and against Royal Dutch Shell as the top holding of an oil and gas company operating worldwide (an appeal against the District Court's decisions is pending).

Specifically for "greenwashing" claims with regard to advertising by companies, an additional "tool" would be filing a complaint with the Advertisement Code Committee. This is a self-regulatory organisation for the advertising sector in the Netherlands, which renders authoritative decisions about alleged misleading statements of a company (including in terms of sustainability). Such a decision could also serve as a "stepping stone" to a collective action in civil proceedings.

6.2 Climate Activism

NGOs and activists are definitively an important party in ESG litigation in the Netherlands. The landmark carbon dioxide reduction orders against the Dutch State and against Royal Dutch Shell mentioned in **6.1 Instruments for ESG Litigation** were obtained by NGOs (Urgenda and Milieudefensie, respectively). Another example is the civil proceedings against the Dutch airline KLM initiated by FossielVrij, an NGO related to ClientEarth, challenging multiple sustainability-related statements by KLM (represented by Stibbe).

Aside from climate litigation, NGOs have brought proceedings against companies with regard to ESG more broadly. One example is a pending public interest collective action by an NGO named Pharma Accountability Foundation against the pharmaceutical company AbbVie, claiming that AbbVie, charges too high a price for its patented rheumatoid arthritis medicine and thereby adversely affects public healthcare. Unions have been targeting the gig economy in the past few years in ESG collective actions as well. Examples of these are the cases against Temper and Uber (both represented by Stibbe).

6.3 Greenwashing v Greenbleaching

Dutch public authorities – such as the ACM – are actively enforcing (EU) regulation on the provision of information to consumers, including regarding ESG claims. This is enforcement under public law by means of, so far, informal "warnings" that could be followed by a fine.

Dutch public authorities are also involved in the EU-wide enforcement action by the EC and national consumer authorities (the Consumer Protection Co-operation Network) against 20 airlines in relation to (alleged) greenwashing. As far as the authors are aware, the only civil proceedings so far about ESG-claims in relation to greenwashing are not by investors (or public authorities) but by an NGO against the Dutch airline KLM (see **6.2 Climate Activism**).

6.4 A Turbulent Future Ahead

The number of ESG-related proceedings in the Netherlands is predicted to increase in the coming years. This is partly because of the success of previous collective actions regarding ESG matters and partly because of the increasing body of ESG rules, as in other (EU) countries – in particular, rules on reporting on ESG matters by companies. Following EU Directives such as the CSRD, the IED for industrial companies and the CSDDD, (large) companies will have to perform due diligences and will have to start annual disclosures regarding their performance on various ESG aspects. All this is expected to be closely monitored by NGOs, providing them with information that could be used in possible new ESG cases against those companies.

Other developments suggest that more ESG-related cases against companies can be expected in specific fields. Among these developments are the need to decrease nitrogen emissions in the Netherlands, as well as the increasing scarcity of (clean) water as a consequence of climate change (but also driven by future stricter rules on water quality). Another development may be ESG-related civil proceedings by public authorities against industrial companies. Examples include civil proceedings by several Dutch municipalities claiming damages from Chemours, a chemicals manufacturer, in connection with PFAS emissions. Another possibly emerging subfield of civil proceedings on a collective basis with ESG aspects are proceedings relating to privacy and data protection, backed by commercial funders. Furthermore, and outside the collective action procedural framework, various civil proceedings with ESG aspects relating to events in South America were initiated in the Netherlands. Examples are Hydro, Vale (both represented by Stibbe), Braskem and Repsol.

Trends and Developments

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De Brauw Blackstone Westbroek N.V. is an independent and international law firm deeply rooted in the Netherlands since 1871. The firm covers a wide range of practice areas, comprehensively covering the needs of clients with significant international operations. It acts as lead counsel in high-end transactions, disputes and regulatory enforcement matters, co-ordinating the work from Amsterdam or its offices in Brussels, London, Shanghai and Singapore. It acts both independently and co-operatively with other top-tier independent firms across the globe, among whom are its Best Friends – a network of top European law firms. The firm's core values – courageous, curious and collective – form its anchor and compass. To a large extent, they underline the vision and direction of De Brauw, and they distinguish the firm from others.

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ESG Trends in 2024 in The Netherlands

Last year, the firm reported that dynamics in global society are shifting and the role of companies and the scope of their responsibilities towards society at large is under scrutiny. In 2024, this trend has accelerated and decelerated simultaneously. While an anti-ESG trend may be visible across the pond in the United States and is looming in Europe, the European Union has until recently accelerated its efforts to mitigate climate change and to emphasise the role corporations should play in the transition to a more sustainable society. For instance, the adoption of the Corporate Sustainability Due Diligence Directive (CSDDD) may have a profound impact on companies for years to come.

These are legal trends as much as they reflect societal shifts. In 2018, building upon the groundbreaking Urgenda decision against the Dutch State, Milieudefensie, (Friends of the Earth) went after Shell seeking a reduction obligation. After having been ordered by the court to reduce its CO_2 emissions (Scope 1, 2 and 3) by at least net 45% at the end of 2030 (compared to 2019), Shell appealed the first instance decision. On 12 november 2024, the Court of Appeal fully overturned the first instance judgement and all of Milieudefensie's claims have been rejected. However, in summary, the Court did conclude that companies such as Shell have an obligation to take measures to counter dangerous climate change. In addition, Milieudefensie announced that it will initiate proceedings against the Netherlands' biggest bank, ING, arguing that banks and other financial institutions have an absolute emission reduction and strict disengagement obligation. Outside of the court room, NGOs such as Amnesty International and climate activist groups also seem to focus their actions on the financial sector. For example, climate activist Extinction Rebellion joined the action by defacing ING office locations, as well as forcing closures of museums that receive sponsorship from large companies.

On the political front in the Netherlands, the tide seems to be turning. After a right-wing government was installed, questions have arisen about the support for further emission reduction measures. While the new government officially maintained its commitment to the 2030 (55% GHG emission reduction compared to 2005) and 2050 (net zero) climate targets, it emphasised in its government programme that no new, additional requirements on top of EU requirements will be introduced. Existing requirements of this kind will be scrapped as much as possible. The budget available for climate-related measures has decreased significantly and various measures introduced previously have been abolished or postponed. Consequently, the main independent advisory body to the government recently concluded that reaching the 2030 climate goals have become extremely unlikely with current implemented policy.

The polarisation of the climate debate is contributing to making it harder for the various stakeholders to compromise. While the Netherlands was traditionally known for its consensus-driven culture, the debate is now hardening. A recent illustration of this phenomenon is the withdrawal of the trade unions as supporting parties of the Dutch Corporate Governance Code. The unions have resigned from the Corporate Governance Committee because they are dissatisfied with the role of employers' umbrella organisation VNO-NCW and VEUO (which represents the interests of listed companies), arguing that the Committee has degenerated into a vehicle focused on "unlimited self-regulation, satisfying shareholders and profit maximisation".

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2024 And Beyond As Pivotal Years for Climate Transition Planning

Introduction

The key developments currently happen in the field of corporate reporting and substantive climate transition planning through the by-now-well-known Corporate Sustainability Reporting Directive (CSRD) and CSDDD adopted in 2022 respectively 2024. Both pieces of regulation put significant emphasis on reporting on and execution of climate transition planning from a mitigation perspective.

At the same time and as global temperatures have hit records in 2024, transition planning from the adaptation perspective – ie, climate risk management – is gaining attention. Lastly, further regulation stemming from the EU Green Deal plays a role in supporting the green transition.

Disclosures on climate change

In the coming months, the first wave of CSRD reports will come to life. After the CSRD's adoption in 2022, the first wave of companies in scope should be obliged to draw up a sustainability report under the CSRD for the financial year 2024. However, as is the case in many other member states, the Netherlands has missed the implementation deadline for the CSRD as, in view of the legislative process so far, it is uncertain whether the CSRD will have been implemented in Dutch law before the end of the current financial year. As the companies in scope have been preparing their CSRD reports already, the publication of "CSRD-like" reports is expected, irrespective of whether the CSRD will be enacted by early 2025, but how this will enfold is still to be seen.

Companies reporting under the CSRD are obliged to make disclosures on their plans to ensure that their business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5°C in line the with Paris Agreement. The European Sustainability Reporting Standards (ESRS) provide that, should climate change not be a material topic for the company (based on the double materiality assessment laid down in the ESRS), the report must explain why this is the case, including a forward-looking analysis of the conditions that could lead to conclude that climate change is material in the future. The first wave of CSRD reports that become available in early 2025 will likely provide interesting insights into when companies deem climate change to be a material topic from an impact materiality perspective or financial materiality perspective.

The ESRS E1 (Climate Change) provides for a robust reporting standard that is worth an integral read. Notably, disclosures under E1-1 on transition planning and E1-4 on target setting will likely be the most scrutinised, as disclosures on these topics may provide to be relevant for many users of the CSRD report, and will over time provide a robust picture of companies' transition planning efforts, milestones, impediments and achievements – also with a view on the CSDDD that will create climate transition planning obligations for companies in scope from 2027 onwards.

Transition planning from the mitigation and adaptation perspective

The CSDDD was adopted on 5 July 2024. In addition to the extensive due diligence obligations laid out therein, inspired by soft law instruments such as the OECD Guidelines, Article 22 CSDDD requires companies in scope to adopt and put into effect a transition plan for climate change mitigation. This transition plan must aim to ensure, through best efforts, that the company's business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5°C in line with the Paris Agreement and the objective of achieving climate neutrality as established in Regulation (EU) 2021/1119, including its intermediate and 2050 climate neutrality targets, and where relevant, the exposure of the company to coal-, oil- and gas-related activities. The transition planning obligation is hence focused on mitigation (ie, efforts to prevent dangerous climate change).

The design of the transition plan for climate change mitigation referred to in the first subparagraph shall contain: (i) time-bound targets on climate change for 2030 and in five-year steps up to 2050 based on conclusive scientific evidence and, where appropriate, absolute emission reduction targets for Scope 1, Scope 2 and Scope 3 GHG emissions for each significant category; (ii) a description of decarbonisation levers identified and key actions planned to reach the targets referred to in point (i), including, where appropriate, changes in the product and service portfolio of the company and the adoption of new technologies; (iii) an explanation and quantification of the investments and funding supporting the implementation of the transition plan for climate change mitigation; and (iv) a description of the role of the administrative, management and supervisory bodies with regard to the transition plan for climate change mitigation.

Although many EU-based companies already had transition plans in place for their activities, either in part of in whole, and had voluntarily disclosed emission reduction ambitions, this imminent obligation has put climate transition planning high on the agenda of companies and their boards.

Many aspects of Article 22 CSDDD have rapidly become a topic of intensive debate, while key components of the obligation – and essentially the obligation as a whole – are still very much unclear. Article 22 CSDDD provides that companies reporting on a climate transition plan (CTP) under the CSRD are deemed to comply with the obligation laid down in Article 22 CSDDD. However, apart from the fact that "deemed compliance" does not provide clarity on the substantive "best-efforts" requirement, the ESRS do not answer pertinent points of climate transition planning and target setting for GHG emissions and the Commission's FAQ sheet seems to suggest that the "deemed compliance" only pertains to part of the CTP obligation. It is expected that many of these aspects will be crystallised in 2025 and beyond.

Substantive obligations on both aspects, climate transition planning and due diligence were also laid down in an initiative bill on corporate social responsibility in the Netherlands, but the Dutch legislator made the conscious choice to await the outcome of the adoption process of the CSDDD, before moving forward with the Dutch initiative bill. The authors do not envisage any specific Dutch legislation on climate transition planning other than the implementation of the CSDDD into national law. On 18 November 2024, the draft bill implementing the CSDDD in the Netherlands was published. In line with current government policy the draft implementing bill does not contain any provisions other than those necessary for minimum implementation of the CSDDD. It is open for public consultation until 29 December 2024.

Ancillary regulation

The foregoing pieces of regulation are of course interlinked and supplemented with other regulations adopted as part of the Green Deal and the

Fit for 55 package focused on emission reduction, such as EU ETS and CBAM, as well as topical regulations on, inter alia, deforestation, single use plastics and green claims. This framework of regulations should combat climate change in several ways and through several types of policies.

In addition to regulations focusing on transition planning from a mitigation perspective, there is an increased focus in the market on climate change adaptation (ie, managing physical risks and transition risks caused by climate change). The new banking package (CRR III/CRD VI) includes several updates relating to climate change and climate risks. In addition, between January and April 2024, the European Banking Authority (EBA) conducted its consultation round on Guidelines on the management of ESG risks. Both these Guidelines and general views on the managing of ESG risks in the financial sector will likely be further developed in the coming years.

In the Netherlands, a similar trend is emerging amongst Dutch regulators. In recent years, they have issued guidelines on sustainability matters and have communicated that battling, eg, greenwashing and enhancing the availability of reliable and accessible information on businesses' sustainability matters in the Dutch economy, will be one of their priorities in the coming years. Other priorities of the Dutch regulators include the acceleration of the energy transition by monitoring energy networks and suppliers as well as the integration of sustainability aspects in operation and risk management by regulated entities.

Expectations for 2025 and Beyond

Principled discussions around "best efforts" obligations and content of CTPs

In the coming months, there is expected to be significant debate about the ambit and substantive meaning of Article 22 CSDDD and its interplay with other pieces of regulation in coming to a coherent framework through which companies' obligation to adopt and implement a CTP can be distilled.

To start, it will be necessary to further understand the extent of the "best-efforts" obligation included in Article 22 CSDDD and on what basis it is to be determined which efforts can be expected and demanded from companies in scope. It is in the authors' view necessary for the effectiveness of the obligation, and a prerequisite from the viewpoint of the principle of legality, that further guidance is provided on this obligation. For example, it is unclear on what basis companies should determine the emission reduction they will seek to achieve through their CTP and what risk appetite they can show in doing so. It is further unclear whether the obligation can shift and become more stringent in case the 1.5°C goal of the Paris Agreement is deemed to require more invasive action in the future.

Further, terms such as "compatible with", "where appropriate", "significant category" and "conclusive scientific evidence" are not further explicated in the CSDDD or elsewhere. It is unclear whether a CTP can be compatible with the transition in the sense of Article 22 CSDDD by predominantly relying on technological developments and emission reduction outside the company elsewhere in the economy. The CSDDD is silent on the conditions under which (or "where") setting an absolute emission reduction target is considered "appropriate", and when a set of emissions is considered to be a "category" and whether a category is determined to be significant on an absolute basis or a relative basis. None of these evident questions have been answered in the FAQ issued by the European Commission by the end of July 2024, and will likely only be debated and crystallised the coming years. The guidelines foreshadowed in the CSDDD on the obligation under Article 22 CSDDD are only expected in July 2027.

The year 2025 will also be the year against which many Dutch companies have formulated their first incremental emission reduction target. It remains to be seen whether the reductions envisaged by these companies are all achieved, although it is clear that climate transition planning is on the radar of Dutch businesses.

Refinement and better quality of methodologies and transition pathways

In line with the foregoing and the intensive work that is been done globally in the field of transition planning, the authors also expect that, in 2025 and beyond, existing guidance on transition planning, carbon calculation methodologies and emission reduction target setting will be updated and enhanced.

The year 2024 saw the Science Based Targets Initiative (SBTi) to be under intense scrutiny for its internal governance following the position it had taken on offsetting to meet Scope 3 reduction targets. Such principled discussions will likely continue in 2025, including debate on credits, offsetting methods, reliability thereof, and other methods such as carbon capture and storage (CCS).

Likely, more data will become available in the coming years due to in any case CSRD reporting starting over FY2024 in 2025, and other disclosure mechanisms such as SBTi and CDP which can support data availability, quality, and integrity outside the European Union. This, taken together, will hopefully provide more tangible guidance on framework within CTPs operate and provide commonality among them.

Expansion of stakeholder model, stakeholder engagement and activism

Operating under the stakeholder model, directors of Dutch companies do not exclusively owe a fiduciary duty to the company's shareholders as such but, rather, to the company and its enterprise - the latter not only comprising the shareholders' interests, but the interests of other stakeholders too (eg, creditors, employees and others). Moreover, this generally requires boards to focus on the long term.

Under Dutch law, boards of companies have a high level of discretion in identifying and weighing stakeholders' interests. Neither shareholders nor other stakeholders can file a derivate suit on behalf of the corporation against the directors for not having properly considered the interests of the various stakeholders. This wide discretion of the board is illustrated by the fact that the Dutch Corporate Governance Code states that it is entirely at the discretion of the board whether to engage with stakeholders. This approach to engaging with stakeholders is likely to come under increasing pressure. The CSRD already expects the board to engage with stakeholders, and the CSDDD will make this mandatory for various parts of the due diligence process. These developments will have their impact in the boardroom, both in terms of the preparation of the decision-making process and in terms of the communication with stakeholders on the decisions taken.

Institutional investors also increasingly value stakeholder engagement, particularly as part of their stewardship role. In a recently published green paper, Eumedion, the organisation representing the interests of Dutch institutional investors, calls on companies to show a positive attitude towards an open, constructive dialogue with institutional investors and other stakeholders.

Parliament recently passed a motion calling on the government to examine how the traditional Dutch Rhineland model, in which all stakeholder interests are to be taken into account, can be better safeguarded in legislation and protected from Anglo-Saxon influences. However, unlike the Green Paper, this motion seemed to be motivated more by the idea that shareholders have too much influence on company policy.

Furthermore, as the range of stakeholders and their priorities continues to evolve, directors will have to make more policy choices while balancing apparent conflicting interests: the interests of shareholders in a profit margin, the interests of the company's direct stakeholders in its long-term success, and the interests of the wider public and future generations in sustainable business operations. This raises the fundamental question to what extent the pursuit of more "sustainable" business practices in a manner that goes beyond the company's strict legal obligations is permissible if these practices do not directly benefit the company's direct stakeholders such as its shareholders. Even though the company's strategy is in principle the prerogative of the board, it cannot be excluded that a continued disregard for sustainability, may in the future give rise to litigation on the company's affairs and management, whether by shareholders or by other stakeholders such as NGOs.

The disclosures made pursuant to the CSRD may further become a trigger for sustainability-related litigation. Historically, the primary users of annual reports have been those with a financial interest in the company such as shareholders, bond holders and other creditors. With the CSRD, however, the target group of annual reports (at least as far as sustainability information is concerned) has been broadened to include "civil society actors, including non-governmental organisations and social partners, which wish to better hold undertakings to account for their impacts on people and the environment". As the Dutch Enterprise Chamber is the competent authority for enforcing reporting obligations, these actors may also be considered as stakeholders with sufficiently legitimate interest to initiate reporting proceedings before the Enterprise Chamber and challenge a company's CSRD report. This necessitates clear positions on what qualifies as a legitimate interest and to what extent the CSRD and ESRS allow discretionary powers for boards with respect to their sustainability disclosures.

Impact on liability regimes

Civil liability for sustainability issues may also gain further traction in the coming years. Established case law provides that access to information (knowledge) and active involvement of parent companies in the policies of their subsidiaries (control) give rise to a duty of care and liability towards the subsidiary's contractual creditors. Similarly, courts may be willing to consider the responsibility of parent companies for the acts or omissions of subsidiaries in relation to their sustainability objectives. As a result of the CSRD, parent companies will receive an increasing amount of sustainability information on both their own activities and those of their partners in the value chain. Parent companies will be expected to apply appropriate due diligence processes and take action when negative impacts are identified. This may particularly hold true for impacts that have detrimental impacts on the climate, such as deforestation.

In addition, NGOs appear to be actively campaigning to hold directors responsible for

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their organisations' environmental and societal impact. Likewise, insurers see an uprise in ESG-driven D&O liability. Under Dutch law, the threshold for personal liability of directors is high. A serious fault of the part of the directors is required. At the same time, however, it cannot be ruled out that in certain cases a court may conclude that the company's processes and the directors' actions were so inadequate as to give rise to liability. Process integrity is likely to reduce the risk of liability based on a say-do gap, and clear views of the company on how its wishes to conduct its climate transition planning from both a mitigation and an adaptation perspective will be key.

Concluding remarks

The year 2025 – and beyond – will in the context of climate change regulation likely be characterised as the years in which principled discussions are held about the responsibilities in this respect of individual companies. In doing so, this will likely result in further crystallised frameworks that allow for a more objectified determination of a company's obligations in this respect. The authors' hope is that this will make regulation on the topic more effective and the obligation better suited to be executed by companies.

NEW ZEALAND

Law and Practice

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Russell McVeagh

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Russell McVeagh is a top-tier law firm in New Zealand with offices in Auckland and Wellington, and a new office due to open in Queenstown in early 2025. The firm advises on the full spectrum of sustainability and ESG law and policy issues. It brings together market-leading experts from specialist areas to provide tailored, practical advice to help organisations with their governance, risk-management, culture and conduct, and compliance needs. The Russell McVeagh team supports businesses with their ESG transition by drawing on its deep experience navigating change in regulated contexts and an extensive network of relationships with both private sector and government stakeholders. Russell McVeagh also leads the market in advising on sustainability-linked and green-based borrowing, and advises on climate-related projects, including in relation to solar, wind and hydrogen renewable power.

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Hannah Wilson is a partner at Russell McVeagh and advises clients on a wide range of transactions, including domestic and cross-border M&A, complex commercial contracting, joint venture and shareholder arrangements. She has broad experience assisting clients in relation to ESG governance and ESG supply chain risks. Clients value Hannah's combined strengths in M&A and commercial transactions, and her skill at negotiating successful outcomes while understanding the need to build relationships that will last after the deal is done.

John Powell is a partner at Russell McVeagh and and is a specialist in sustainable lending, asset, development, corporate, and acquisition finance, complex debt restructuring solutions, export credit financing and specific asset, lease and supply-chain financing arrangements. John provides expert advice to banks, mezzanine funders and borrowers/issuers. He is leading the way in the innovation and development of the New Zealand sustainable finance market, and is sought out for his expertise in this area.

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1. Introduction

1.1 General ESG Trends

New Zealand's legal and regulatory landscape in relation to Environmental, Social and Governance (ESG) matters is continuing to evolve. To date, regulation of ESG issues has been fragmented, and New Zealand has not, to date, introduced comprehensive sustainability frameworks such as those arising out of the European Green Deal. However, New Zealand is an early adopter of mandatory climate-related disclosures and has an established legislative framework in relation to climate change under the Climate Change Response Act 2002 (CCRA).

In that context, one of the most significant developments in 2024 in relation to ESG and sustainability laws and regulations in New Zealand is that reports under New Zealand's recently introduced mandatory climate-related disclosures regime ("CRDs regime") have begun to be published. In 2021, New Zealand introduced the CRDs regime under the Financial Markets Conduct Act 2013 ("FMC Act") for certain large organisations known as "climate-reporting entities" (CREs). CREs are required to prepare and lodge on a public register climate statements that comply with climate standards issued by the External Reporting Board (XRB). The XRB's Aotearoa New Zealand Climate Standards (NZ CS) follow the four themes originally promulgated by the Taskforce of Climate-related Financial Disclosures, being climate-related governance, strategy, risk management and metrics & targets. CREs also have obligations to keep "CRD records". CREs with subsidiaries need to prepare their climate statements on a group basis.

There have been a number of other key developments over the last year regarding ESG and sustainability laws and regulations, many of which result from New Zealand's change of government at the end of 2023 (see **1.2 Environmental Trends**). For example, in 2023, the prior government had commenced a review of the New Zealand Emissions Trading Scheme (NZ ETS) to assess whether changes were needed to provide stronger incentives for businesses to transition away from fossil fuels, while also supporting carbon removals. A key issue for this review was considering the role that removals from forestry have in the NZ ETS. However, this review has now been abandoned by the new government.

In September 2024 a cross-party Parliamentary Select Committee published a report in relation to an inquiry into climate change adaptation. This report is a first step towards the development of a legislative framework for climate change adaptation (including in relation to managed retreat) in New Zealand.

Details of other changes in ESG laws and regulations are set out below, including in relation to modern slavery (see **1.3 Social Trends** and **4.1 Soft Law Becoming Hard Law**), directors' duties (see **1.4 Governance Trends** and **2.3 Role of Directors and Officers**), and stock exchange listing rules (see **2.2 Differences Between Listed and Unlisted Entities**).

1.2 Environment Trends

Under the CCRA, New Zealand has a relatively stable overarching climate change architecture, including a "net zero by 2050" target (for all gases other than biogenic methane) and a framework for the government to produce emissions budgets and associated emissions reduction plans. The CCRA also provides for the government to produce a rolling series of reports and plans in relation to climate change adaptation. It also establishes an independent Climate Change Commission, responsible for advising the government in relation to climate change mitigation and adaptation.

While the CCRA architecture enjoys a high degree of political consensus, there remain substantial differences between New Zealand's major political parties on the details of how New Zealand should respond to ESG issues. The current government has progressed a number of key changes in relation to climate change and environmental regulation, including:

- producing a draft second emissions reduction plan under the CCRA, which is due to be finalised by the end of 2024;
- commencing a cross-party inquiry into climate change adaptation;
- discontinuing the prior government's review of the NZ ETS;
- committing to pricing agricultural emissions by 2030 (the prior date had been 2025);
- reversing the prior government's ban on offshore oil and gas exploration;
- reversing the prior government's reform of the Resource Management Act 1991, which included reforms relating to climate change mitigation and adaptation as well as natural capital more generally;
- commencing a review of New Zealand's emissions reduction target for biogenic methane (currently set at a 24-47% reduction from 2017 levels by 2050); and
- announcing that it is working with the private sector on a sustainable finance framework, including the development of a sustainable finance taxonomy.

In 2023 and 2024, there were a number of significant case law developments in relation to the "E" in ESG. These include the following.

- In February 2024, the Supreme Court of New Zealand (Supreme Court) issued its much-awaited decision in Smith v Fonterra [2024] NZSC 5, the first case to be brought in New Zealand seeking to hold private parties liable in tort for damage caused by climate change. The Supreme Court determined that the claim can proceed to trial. The question before the Supreme Court was simply whether the claim ought to be struck out (on the basis that it raised no reasonably arguable cause of action), so the decision does not determine whether the defendants are in fact liable to Mr Smith. However, the case is significant because it leaves open the possibility of corporates facing tort-based liability in New Zealand in respect of greenhouse gas emissions produced by their activities.
- In late 2023, the Court of Appeal of New Zealand heard an appeal against the High Court of New Zealand's decision in Lawyers for Climate Action New Zealand Incorporated v the Climate Change Commission [2023] NZCA 443, which relates to the approach adopted by the Climate Change Commission in its May 2021 advice to the government in relation to emissions reduction pathways. A decision in the claim is awaited.
- Following trends overseas, two significant greenwashing claims have been lodged in the High Court (see **6.3 Greenwashing v Greenbleaching**).

1.3 Social Trends

New Zealand already has well-developed legal frameworks for certain components of the "S" in ESG, including in relation to health and safety and employment law. However, other aspects of the "S" in ESG are less developed, or are undergoing evolution, as described further below.

In New Zealand, ESG is often considered as encapsulating matters relating to *te ao Māori* (a holistic world view that emphasises the interconnectedness between people and the environment) and *tikanga Māori* (customs and protocols), which are unique to New Zealand and reflect the worldview, culture and practices of New Zealand's indigenous Māori population. While te ao Māori and tikanga Māori intersect with all aspects of ESG, these concepts are included here as part of the "S" in ESG, given their critical importance to the social fabric of New Zealand life.

While New Zealand law has for some time recognised matters relating to te ao Māori and (in particular) matters relating to the application of Te Tiriti o Waitangi (the Treaty of Waitangi) between Māori and the Crown, the legal recognition of tikanga and te ao Māori is evolving. Two important developments in the last year have implications in the ESG space:

- In September 2023, the New Zealand Law Commission released its study paper "He Poutama", which addresses how tikanga and state law might best engage in a way that mains their individual coherence and integrity. It is an influential report that is likely to shape the way that ESG matters are considered by courts, individuals and businesses in the years to come in New Zealand.
- The Supreme Court's decision in Smith v Fonterra [2024] NZSC 5 briefly considered matters relating to tikanga in the context of a climate-related claim. The decision did not set out detailed principles for the implications of tikanga in the climate change context. However, the Supreme Court noted that the trial would need to grapple with the fact that the claimant purports to bring proceedings not only on behalf of himself, but also as *kaitiaki* (guardian) acting on behalf of the *whenua* (land), *wai* (water) and *moana* (ocean) as entities in their own right.

In July 2023, the prior Government announced plans to establish a modern slavery regime, including a public register to require transparency over organisations' supply chains. This proposal would have required organisations with more than NZD20m in revenue to report on their actions to address the risk of exploitation in their operations and supply chains. Since the 2023 General Election, work in relation to the introduction of specific modern slavery legislation in New Zealand has not been progressed, and comments made by the responsible Minister in July 2024 suggest that this is not a priority for the current Government in the short term.

In relation to case law, in late 2023 the High Court issued its decision in The Christian Church Community Trust v Bank of New Zealand [2023] NZHC 2523. This case followed an earlier decision of the Employment Court, which had found that certain members of the Gloriavale Christian Community were employees from the age of six years old, that ready access to child labour was a significant factor in the success of the Gloriavale Christian Community business model, and that those members were subject to rigorous, and sometimes violent, supervision while working as children. The 2023 case considered the question of whether BNZ was entitled to stop providing banking services to the commercial and charitable entities associated with the Gloriavale Christian Community, in light of BNZ's Group Human Rights Policy. This case is significant, as it is the first time the New Zealand Courts have been asked to consider the circumstances in which a bank can terminate a banking relationship as a result of human rights concerns. The High Court found that it was seriously arguable that BNZ had a contractual discretion rather than an absolute right to terminate, and that it was seriously arguable that BNZ had failed to act reasonably in deciding to cease the provision of banking services to the plaintiffs. It accordingly granted an injunction that prevented BNZ from terminating the banking relationship. This case is subject to appeal.

1.4 Governance Trends

New Zealand has an established framework of governance laws for companies, including (most significantly) through the Companies Act 1993 and, for listed issuers, the NZX Listing Rules. Amongst other things, the Companies Act 1993 sets out in legislation the duties that directors of New Zealand companies owe to companies and their shareholders.

Further details in relation to key recent developments in the regulation of ESG governance are set out in **1.6. Market Participants**.

In addition to those developments, many New Zealand organisations are required to report publicly on matters relevant to the “G” in ESG under the CRDs regime, which requires CREs to report on matters relating to their governance of climate-related risks and opportunities. This has led to many organisations adopting a more sophisticated approach to governance in this area (eg, by maturing risk management systems, embedding regular governance reporting on ESG matters and working towards integration of ESG with core business strategy). This is also contributing to businesses expanding their consideration of ESG matters – for example, nature-related risks have gained more prominence in director and management discussions, in part due to increasing recognition that directors may need to both consider and respond to nature-related risks as part of discharging their directors’ duties.

1.5 Government and Supervision

Regulators play an important role in monitoring and enforcing New Zealand ESG laws and regulations. For example, the Financial Markets Authority (FMA) and the New Zealand Commerce Commission (Commerce Commission) are responsible for monitoring and enforcing key ESG laws and regulations.

In addition, the Environmental Protection Authority is responsible for enforcement of the NZ ETS and other environmental laws.

From a supervisory perspective, the Reserve Bank of New Zealand (RBNZ) is the prudential regulator and supervisor of the New Zealand banking sector. One of the RBNZ’s key statutory objectives is promoting the stability of New Zealand’s financial system. The RBNZ considers that this objective requires it to assess the material risks of the entities that it regulates to understand the resilience of the financial system to shocks, including risks relating to climate change. Accordingly, the RBNZ has provided guidance to the banking sector about the management of climate-related risks and undertook a climate stress test in 2023 to assess the resilience of major New Zealand banks to plausible long-term climate-related challenges.

1.6 Market Participants

Most sectors of the New Zealand economy are likely to be affected by ESG laws and regulations in the coming years, with examples below.

- The CRDs regime applies to most large financial institutions and large listed issuers. Organisations not directly captured by the CRDs regime may also be indirectly affected

by being in the "value chain" of CREs, as the regime indirectly incentivises CREs to work with their suppliers on initiatives responding to their climate-related risks and opportunities.
- In addition, the NZ ETS prices emissions across all sectors of the economy (other than agriculture). As such, most New Zealand businesses are impacted by emissions pricing, either directly through participation in the NZ ETS, or indirectly through the cost of goods and services. Any future changes to the NZ ETS will therefore impact a wide range of stakeholders.
- The financial sector is likely to continue to be affected by ESG laws and regulations, including any sustainable finance taxonomy that emerges.

1.7 Geopolitical Developments

Geopolitics and politics are both important determinants of the approach to ESG in New Zealand.

New Zealand is party to a range of international treaties on ESG-related issues, including the United Nations Framework Convention on Climate Change and the Paris Agreement. This obligation requires New Zealand to prepare, communicate and maintain successive nationally determined contributions (NDCs) towards delivering on the goals of the Paris Agreement. New Zealand's first NDC (as updated in October 2021) equates to a 41% reduction in net emissions by 2030 from gross emissions in 2005. The second NDC is due in 2025 for the period starting from 2031.

While meeting New Zealand's first NDC is likely to involve a combination of domestic measures and the purchase of offshore mitigation, the government has indicated that it wishes to prioritise domestic reduction initiatives to mitigate the extent to which New Zealand needs to "write a cheque" to offshore jurisdictions to meet the first NDC.

In addition to multilateral treaties, New Zealand is also party to bilateral free trade agreements that impose obligations on it in relation to ESG. For example:

- a new free trade agreement between NZ and the European Union (EU) includes a number of environmental provisions. It includes an obligation to effectively implement the UNFCC and the Paris Agreement, including commitments with regards to NDCs; and
- the free trade agreement between NZ and the United Kingdom, which entered into force in May 2023, also includes sustainability obligations. This agreement requires the parties to encourage private and public sector entities operating in its territory to take appropriate steps to prevent modern slavery in their supply chains.

Exports play an important role in the New Zealand economy and, accordingly, geopolitical factors that affect New Zealand's exports are very significant in relation to progress on ESG. For example, New Zealand exporters may be affected by regulations such as carbon border adjustment mechanisms, and these international dimensions are an increasingly important driver for decarbonisation of New Zealand exports. New Zealand's imports are also impacted by geopolitical developments, although New Zealand's high levels of renewable electricity insulate it to some extent from shocks associated with oil and gas supply.

Domestic politics also influence the direction of travel on ESG. One key challenge for New

Zealand is that it has a relatively short (three-year) electoral cycle, which means that achieving certainty in ESG-related policies is particularly challenging. Cross-party consensus building on key issues is accordingly critical. As noted in **1.2 Environment Trends**, this cross-party consensus building means that New Zealand does, at least, have a relatively stable climate change legislative architecture, although policy priorities differ significantly across the major political parties.

2. Corporate Governance

2.1 Developments in Corporate Governance

We see several key areas of development in the next 12 months, as follows.

- It is expected that the approach to climate-related governance will continue to evolve, following the introduction of the CRDs regime. One noticeable trend we have seen is the increase in the number of issuers with sustainability committees as standing committees of the board. Thirty percent of the 20 largest entities on the NZX50 now have a standing sustainability committee. We expect climate-related governance to remain a key area of focus in the next 12 months.
- In August 2024, the government announced its intention to progress a package of reforms modernising the Companies Act 1993 and other related corporate governance legislation. This will include a review by the Law Commission of directors' duties and related issues of director liability, sanctions and enforcement more generally. This review may also revisit the amendment to s131 of the Companies Act, introduced in 2023, which states that directors may have reference to ESG factors when determining the best interests of the company (as discussed further in **2.3 Role of Directors and Officers**) and reconsider liability for directors under the CRDs regime (which is currently automatic).

2.2 Differences Between Listed and Unlisted Entities

Entities with securities listed on the NZX must comply with the NZX Listing Rules, which set out a range of governance requirements. Amongst other things, the NZX Listing Rules require issuers to comply with the recommendations in the NZX Corporate Governance Code ("the Code"), on a "comply or explain" basis. This means that issuers of equity securities must provide a corporate governance statement, usually included in the issuer's annual report, on the extent to which it has followed the recommendations of the Code. If an issuer has not followed a recommendation, its statement must identify that recommendation and outline the reasons why the recommendation was not followed and what (if any) alternative governance practice was adopted.

In 2023, the Code was amended to include (amongst other matters) specific recommendations in relation to non-financial reporting, as follows.

- *Gender diversity goals* S&P/NZX20 Index issuers are now recommended to have a measurable objective on gender diversity for board composition, which cannot be less than a target of 30% female and 30% male, within a specified period, which the issuer may determine. This is aligned with changes made in Australia to the Australian Securities Exchange (ASX) Code in 2019, in relation to issuers on the S&P/ASX 300 Index. Issuers (particularly S&P/NZX50 issuers with more

than 50 employees) are also encouraged to disclose gender pay gap information, and to consider diversity beyond gender (eg, ethnicity, cultural background, sexual orientation, age, skills etc) when designing their diversity policies.
- *ESG Reporting* the Code now recommends that issuers provide annual non-financial reporting disclosures on ESG factors and practices. ESG reporting can be presented as part of an issuer's corporate governance report or in a standalone report. The commentary also encourages issuers to disclose the process by which it has ensured its non-financial disclosures are accurate, and whether these have been externally audited. The NZX has issued an ESG Guidance Note, which is designed to assist issuers to implement this recommendation. This includes suggestions as to what issuers may want to report on, including the relevance of ESG factors to their business models and strategy, the ESG risks faced by the business and how they can identify, monitor and manage those risks (noting the overlap of these points with the CRDs regime). While the NZX Corporate Governance Code and ESG Guidance Note do not mandate a particular approach to ESG reporting, many New Zealand issuers adopt international frameworks such as Integrated Reporting and the Global Reporting Initiative.

2.3 Role of Directors and Officers

ESG requirements have become an important component of directors' roles and responsibilities in New Zealand, particularly following the introduction of the mandatory CRDs regime and the Companies (Directors Duties) Amendment Act 2023.

The Companies (Directors Duties) Amendment Act 2023 was passed in August 2023. This sought to clarify the director's duty to act in the best interests of the company, in Section 131 of the Companies Act 1993. The amended duty now includes the words:

"To avoid doubt, in considering the best interests of a company or holding company for the purposes of this section, a director may consider matters other than the maximisation of profit (for example, environmental, social, and governance matters)".

The intention of the proposed reform was to make it clear that directors may consider a wide number of factors when making decisions and should be expected to embed ESG factors into their decision-making as part of their duty to act in good faith and in the best interests of the company. However, the amendment does not appear to impose any additional obligations on directors, as it was already considered clear that directors were not limited in their decision-making to consider profit maximisation and most directors already consider ESG factors in their decision-making. The reform is likely to have more of a "signaling" rather than substantive effect, and could be repealed as part of the package of reforms referred to in **2.1. Developments in Corporate Governance**.

2.4 Social Enterprises

Unlike other overseas jurisdictions that have specific legal business forms for social enterprises (eg, the Public Benefit Corporation in the United States and the Community Interest Company in the United Kingdom), there is no specific legal structure for social enterprises in New Zealand.

Instead, social enterprises and not-for-profits can choose from a wide range of entity structures used for business in New Zealand, which may be for-profit or not-for-profit. Common structures include a limited liability company or a trust, with or without charitable status.

Obtaining charitable status requires an entity to have an established "charitable purpose" and to apply for registration on the Charities Register. Once registered, the entity will need to comply with on-going obligations under the Charities Act 2005, including the requirement to complete an annual return and file financial statements.

2.5 Shareholders

The increasing importance of ESG considerations for shareholders could give rise to future shareholder activism. However, as set out further in **6.2 Climate Activism**, shareholder activism has played a lesser role in New Zealand than it has in some other jurisdictions in relation to bringing ESG-related claims.

One recent example of shareholder activism was a public campaign by the New Zealand Shareholders Association (NZSA) in relation to shares of its members held in Colonial Motor Company, an NZX listed company. The NZSA indicated that it had planned to vote against all of the company's resolutions at the 2023 annual general meeting to encourage the company to improve its ESG governance disclosures and compliance with the Code.

3. Sustainable Finance

3.1 Progress in Green Financing

While the New Zealand government recognises the role that mobilising finance has in the climate transition, few specific legal steps were taken over the last year to promote sustainable finance in New Zealand.

One key development over the past 12 months has been progress on the development of a sustainable finance taxonomy for New Zealand. In early 2024, the government announced the establishment of an independent technical advisory group (ITAG) led by the Centre for Sustainable Finance, to recommend design principles for a New Zealand taxonomy. The potential development of a taxonomy was signaled in New Zealand's first National Adaptation Plan published in August 2022, which indicated that a taxonomy could help protect against greenwashing and (if aligned with best practice) support greater investment in New Zealand's climate-resilient projects.

If introduced, a sustainable finance taxonomy would classify which economic activities are aligned to a sustainable, low-emissions future, with a view to directing investment to the activities required for the transition.

The ITAG has now published its recommendations for the development of the taxonomy, which includes recommendations relating to the principles, purpose and outcomes of the taxonomy. The recommendations report suggests prioritising five sectors, including agriculture, transport, construction/real estate, energy and industrial manufacturing, and aligning with other benchmark taxonomies such as Australia and the EU. The ITAG recommends that the taxonomy be voluntary in its initial phase, with an expectation that it could become mandatory over time following a phase-in approach or grace period. The exact nature of the obligations that could eventually become mandatory are, as yet, unclear. While a key focus of the taxonomy will likely be debt markets, the ITAG recommends that it be designed for a broader range of applications.

Outside of the sustainable finance taxonomy work outlined above, the FMA has consulted on regulatory tweaks designed to grow green bond issuance in New Zealand. This is described further in **3.3. Access to Green Financing**.

3.2 Sustainable Finance Framework

New Zealand does not have a specific regulatory framework for raising and providing sustainable finance. Rather, entities looking to raise or provide finance are required to comply with New Zealand's more general laws relating to financial markets. The primary piece of legislation regulating the offering of, and dealing in, financial products in New Zealand is the FMC Act.

The FMC Act defines "financial products" as including an equity security, a debt security, a managed investment product or a derivative. Sustainability-linked, social and green bonds are caught by this definition, as well as ESG-related investment funds and superannuation schemes. In relation to offers, an issuer of financial products is required to publish a product disclosure statement (PDS) setting out key details in relation to the offer (unless it is able to rely on an exclusion, for example for wholesale investors or for "QFP" offers of financial products of the same class as quoted financial products). For all offers, there are general "fair dealing" prohibitions in the FMC Act on false or misleading conduct and the making of unsubstantiated representations which govern the content of other communications in relation to the offer.

While not mandatory, in practice an important source of guidance for sustainable and green lending in New Zealand are the standards and frameworks published by (amongst others) the Asia Pacific Loan Market Association (APLMA). For example, the APLMA's sustainability-linked loan principles describe the standards against which key performance indicators and targets in sustainability-linked loans should be set, benchmarked and disclosed. Other relevant guidelines include APLMA principles for green loans and social loans, the International Capital Markets Association's principles for green, social, sustainable and sustainability-linked bonds and guidelines for sustainability bonds, Climate Bonds Initiative guidance and standards and guidance from the Sustainable Agriculture Finance Initiative.

3.3 Access to Green Financing

At a general level, to date it has been relatively straightforward for large New Zealand corporates to access the market for sustainable and green finance. Indeed, a large proportion of major corporates in New Zealand now have sustainable or green-borrowing finance frameworks and/or one or more sustainable or green finance products in place, so the focus is now shifting from market establishment to maturing the approach.

Over the past couple of years, the sustainable finance market in New Zealand has been maturing, with more focus on small and medium enterprises (SMEs). SMEs are an important part of the New Zealand economy, but historically have had less access to sustainable finance products than larger organisations. Several New Zealand banks have also set and publicly disclosed sustainable finance targets, which is further incentivising innovation in the products offered as the banks work towards their goals.

On the investor side, the FMA has said that consumers are increasingly prioritising non-financial characteristics when making investment decisions, which means that there is opportunity to grow the sustainable finance market. However, a lack of a comprehensive framework for the way that sustainable investments ought to be described has contributed to confusion for retail investors, and there is scope to grow understanding through the development of a sustainable finance taxonomy described in **3.1. Progress in Green Financing**.

Some of the products available in the New Zealand market are as follows.

- *Green, social, sustainable, and sustainability-linked (GSSS) bonds* these include both use-of-proceeds bonds, where the proceeds are committed to a project that the issuer considers to have a sustainability benefit, and bonds linked to the issuer's progress as against pre-agreed sustainability performance targets. Private issuance of green bonds over the past few years has been comparatively slow and concentrated in a small pool of issuers, owing in part to regulatory complexity associated with retail issuance of these products. The authors are only aware of one sustainability-linked bond having been issued in-market. In April of 2024, the FMA consulted on proposals to reduce the regulatory burden on issuers of green bonds by exempting issuers of certain sustainable bonds from disclosure requirements where the bonds have identical rights, privileges, limitations and conditions to existing quoted bonds (except for a different interest rate, redemption date, and GSSS status). The consultation has closed but no decisions have yet been announced.
- *Green and sustainability - linked loans* the market for sustainability - linked loans in New Zealand is already mature, and there are challenges with continuing to grow this market as a result of several factors including establishment costs and challenges meeting audit/assurance requirements. Nevertheless, there remains scope for diversification in the green loan market.
- *Managed funds* in line with trends overseas, there has been a proliferation of ESG-related investment funds in recent years, reflecting increased consumer appetite for these sorts of products. There is, however, some confusion in the retail market about ESG-related labels, and the FMA has signaled a regulatory focus on greenwashing in the context of managed funds. This is contributing to fund managers maturing the approach to labelling of their funds.

3.4 Stranded Assets and Non-bankables

Like many international counterparts, New Zealand banks and other financial institutions are focused on portfolio decarbonisation initiatives. The CRDs regime is a key driver in this space, as large New Zealand financial institutions are required to report on their Scope 3 (including financed) emissions and the steps they are taking to respond to their climate-related risks and opportunities.

However, tensions arise between the imperative for decarbonisation and broader impacts on New Zealand's economy and society. For example, a sudden shift away from financing traditional New Zealand industries, including agriculture, would have significant effects on New Zealand's economy, as well as having social impacts for many New Zealanders. As such, the general market approach to date has been for the large banks to set emissions-reduction targets and work directly with their clients on proactive steps they can take to manage the transition to a low-emissions, climate-resilient future rather than withdrawing banking services (although most major banks do have some exclusions). The authors understand that some lenders also have caps and collars to manage their ongoing exposure to high-emission industries.

One recent development in this space is that a Parliamentary Select Committee has launched an inquiry into banking competition in New Zealand, and its terms of reference include considering the effect of any bank lending policies relating to borrowers' emissions that result in additional lending costs and/or lending restrictions. The terms of reference also include ascertaining whether bank environmental and sustainability policies have, or are likely to result in, further increases in lending rates to the agriculture and horticulture sectors. This aspect of the inquiry appears to respond, at least in part, to concerns raised by some stakeholders that the large banks' membership of the Net Zero Banking Alliance may be restricting access to capital for some sectors. The inquiry is still underway and no conclusions on this point have yet been reached.

3.5 Challenges Ahead

Key challenges in the sustainable finance market in New Zealand over the coming years include the following:

- litigation and regulatory risk associated with greenwashing, especially in the absence of clear regulatory parameters around when ESG-related labels will be false and/or misleading; and
- likely challenges associated with the implementation of the sustainable finance taxonomy once developed.

A further challenge in the New Zealand market is one of scale. For example, the small size of New Zealand's investment opportunities creates challenges for the provision of bonds to provide funding to low-carbon projects.

4. ESG Due Diligence

4.1 Soft Law Becoming Hard Law

Soft law instruments are not directly enforceable in New Zealand. However, there has been a recent increase in hard law relating to sustainability following the conclusion of the Paris Agreement, with notable examples including the passage of the Zero Carbon Act in 2019 and the introduction of mandatory climate-related disclosures. In addition to these regulatory developments, soft law has the potential to influence judicial reasoning both in the interpretation of domestic statutes and in the development of the common law, and in that way to contribute to the evolution of hard law. The authors expect soft law to continue to be referred to in this way.

4.2 Towards Vertical Responsibilities

As investing with ESG goals in mind becomes more widespread in New Zealand, companies (particularly those that are publicly listed) are coming under increasing pressure to have, and demonstrate that they have, sustainable and ethical value chains.

New Zealand does not have a modern slavery regime that requires upstream due diligence of its supply chain, and it is not clear whether one will emerge under the current government (see **1.3 Social Trends**). However, it is generally considered that a business must have an understanding of its supply chain and be in a position to substantiate any public claims that it makes about its supply chains. Advisors are encouraging companies in New Zealand to think about how to map human rights and environmental risks and what action they might take if negative impacts were identified as part of a due diligence process.

The CRDs regime also has implications for company value chains. The NZ CS explicitly note that CREs must consider the exposure of their value chains to climate-related risks and opportunities, and CREs are also required to report on their Scope 3 (value-chain) emissions. While this regime does not impose direct due-diligence obligations on CREs, in practice, it is influencing organisations to take steps to investigate and respond to climate-related issues in their value chains.

4.3 Partner Selection

The above factors are influencing the choices that companies make in working with supply-chain partners. For example, many New Zealand organisations are considering modern slavery in their supply chains and managing climate-related risks and opportunities in their value chains.

New Zealand is heavily involved in international trade. Given that New Zealand companies are dependent on global supply chains (both imports and exports), overseas trends in selecting supply-chain partners tend to be quickly integrated into New Zealand business practice. Accordingly, there is an increasing trend amongst New Zealand businesses to make decisions on supply-chain partners with reference to ESG factors. New Zealand exporters are facing ESG-related regulations in some jurisdictions that they export to, and large international customers are also demanding a greater focus on ESG. In turn, this is influencing the approach New Zealand businesses are taking to management of their own supply chains.

Increasingly, contracts contain ESG compliance clauses which require supply-chain partners to comply with ESG information disclosure obligations or minimum thresholds, driven by factors such as customer demand and reporting obligations.

4.4 ESG in M&A Due Diligence

Specific ESG due diligence by purchasers in the mergers and acquisitions context is typically quite limited. Purchasers do not generally conduct specific ESG due diligence over and above general environmental and resource management law due diligence. One major exception to this is forestry transactions, in relation to which NZ ETS obligations are a critical component of due diligence.

While ESG due diligence is not currently a major focus for most New Zealand transactions, it is possible that there will be an increasing focus on ESG due diligence as buyer expectations continue to evolve. Similarly, where a transaction involves overseas warranty and indemnity insurers, or there are strong domestic ESG due diligence laws, we expect that ESG due diligence is likely to be a bigger factor.

It is possible that, as ESG law and regulation continues to evolve in New Zealand (including as a result of the CRDs regime), the focus on ESG factors in due diligence may increase.

5. Transparency and Reporting

5.1 Key Requirements

New Zealand's mandatory CRDs regime applies (broadly) to the following CREs:

- registered banks, credit unions, and building societies with total assets of more than NZD1 billion;
- managers of registered investment schemes with greater than NZD1 billion in total assets under management;

- licensed insurers with greater than NZD1 billion in total asset or annual gross premium revenue greater than NZD250 million;
- listed issuers of quoted equity securities where the market price of all of the issuer's equity securities exceeds NZD60 million; and
- listed issuers of quoted debt securities, where the face value of the issuer's quoted debt exceeds NZD60 million.

Provided an entity meets the definition of a CRE, the reporting requirements themselves are generally the same for each type of entity (including groups of entities) above. One major exception to this is that managers of registered schemes are required to report in respect of each scheme they manage rather than in respect of the manager as an entity. Most scheme managers are required to prepare their scheme-level disclosures on a fund-by-fund basis (although common information may be presented at a scheme level).

In addition, the NZX Listing Rules require certain listed entities to make ESG disclosures on a "comply or explain" basis (see **2.2 Differences Between Listed and Unlisted Entities**).

5.2 Transition Plans and ESG Targets

Under the CRDs regime, CREs are required to disclose the transition plan aspects of their strategy. The XRB's climate standards define "transition plan" as an aspect of an entity's overall strategy that describes an entity's targets, including any interim targets, and actions for its transition towards a low-emissions, climate-resilient future. In the first year of reporting, CREs had the option of relying on a first-year exemption from the disclosure requirements relating to transition planning and it is possible that this will be extended for a second year.

The XRB has published some high-level guidance to support CREs getting started on transition plans, and it is expected that additional guidance will be released to support disclosure in this area.

There is no direct legal obligation on organisations in New Zealand to commit to targets. However, the CRDs regime requires CREs to disclose the targets they use to manage climate-related risks and opportunities, and their performance against those targets. The CRDs regime is a disclosure regime and does not require organisations to set one or more targets; however, in practice, it is a powerful incentive for organisations to carefully consider their approach to target-setting. The challenge for organisations in this area is ensuring that their climate-related targets are ambitious enough to reflect the scale of the climate crisis, while ensuring that the targets are achievable to minimise the risks of greenwashing allegations being made.

5.3 Regulation of ESG Labels

New Zealand does not have a specific regulatory regime relating to ESG labelling and sustainability claims. However, these matters are covered by New Zealand's suite of general consumer protection and financial markets laws, as set out further below.

Fair Trading Act 1986

The Fair Trading Act 1986 (FTA) is the primary regulatory framework prohibiting misleading conduct by businesses. The key provision is Section 9 of the FTA, which prohibits any person, in trade, from engaging in conduct that is misleading or deceptive, or is likely to mislead or deceive. In addition, the FTA includes a range of more specific prohibitions on certain types of misleading conduct (eg, conduct that is liable to mislead the public as to the nature, manufacturing process, characteristics, suitability for a purpose, or quantity of goods or services. The FTA also prohibits making unsubstantiated representations in trade which are representations made without reasonable grounds, irrespective of whether they are false or misleading.

While there have not been a significant number of ESG-related cases under the FTA to date, there is an established body of case law under the FTA as to when statements will be considered to be misleading. In particular, whether a statement is false or misleading is a question of fact, considered from the perspective of what a "reasonable person" would understand the claim in question to mean. It is the overall impression that counts, and statements can be misleading either by the express words used or by implication. The use of imagery can contribute to an overall misleading impression if not carefully used.

In 2020, the Commerce Commission (the regulator responsible for enforcement of the FTA) issued "Environmental Claims Guidance" to assist businesses to better understand their obligations under the FTA when making claims about the environmental impact of a good or service. While relatively high level, the guidelines cover a range of green claims, including recyclable, "free-of", sustainable, biodegradable, renewable energy, carbon offset/neutral and organic claims. The guidelines also remind businesses that claims must be accurate, up to date and based on credible evidence at the time they are made, and that consideration should be given to the entire contents of a product and its lifecycle before making an environmental claim.

Fair Dealing

Part 2 of the FMC Act provides for fair dealing in relation to financial products and financial services. The fair dealing provisions of the FMC Act prohibit, in trade:

- engaging in conduct that is misleading or deceptive or likely to mislead or deceive in relation to any dealing in financial products, or the supply or possible supply of a financial service or the promotion by any means of the supply or use of financial services; and
- engaging in conduct that is liable to mislead the public as to the nature, characteristics or suitability for a purpose, or quantity of financial products or services.

The fair dealing provisions also prohibit the making of false, misleading, or unsubstantiated representations, in trade, in connection with any dealing in financial products, the supply or possible supply of financial services, or the promotion by any means of the supply or use of financial services.

As a general rule, the principles relevant to misleading statements in the FMC Act context are consistent with those developed under the FTA.

Climate-Related Disclosures

Under the CRDs regime, CREs are required to prepare climate statements that comply with climate standards issued by the XRB. One of the climate standards, NZ CS 3, includes a principle of "accuracy", which provides that "[i]nformation is accurate if it is free from material error or misstatement".

Since the CRDs regime is new, the courts have not to date considered the application of the accuracy principle. However, it is likely to invoke similar principles to the prohibitions against misleading statements and unsubstantiated representations in the FTA and FMC Act more broadly.

5.4 Supervision

The Financial Markets Authority (FMA) is New Zealand's conduct regulator for financial markets. In relation to ESG, the FMA is responsible for monitoring and enforcement of the FMC Act, including in relation to the CRDs regime and the fair dealing provisions.

Outside of the financial markets context, the primary regulator of sustainability marketing claims in New Zealand is the Commerce Commission, which is responsible for the enforcement of (amongst other things) the FTA.

In addition, NZX (as the licensed market operator of New Zealand's securities exchange) is responsible for monitoring and enforcing the rules under which the NZX's markets operate. This function is carried out by NZ RegCo, which is an independently governed entity. Part of this function includes enforcing compliance with the NZX Listing Rules and the Code, which requires certain issuers to make non-financial disclosures on a "comply or explain" basis, as set out in **2.2 Differences Between Listed and Unlisted Entities**.

The Advertising Standards Authority is the advertising industry's self-regulator for responsible advertising and enforces the Advertising Standards Code (and relevant sector-specific codes). The Advertising Standards Code includes principles relating to greenwashing, including a general principle that advertisements must not mislead or be likely to mislead, deceive or confuse consumers. If an advertisement is found to be in breach of the Advertising Standards Code, the ASA can order that it be changed or removed, although compliance is voluntary.

5.5 Enforcement

The penalties for non-compliance with the CRDs regime and for false or misleading ESG disclosures are potentially significant.

In relation to the CRDs regime, the CRE is primarily liable for breaches of the relevant requirements. However, directors also have automatic liability for non-compliant disclosure, and civil liability may also be imposed on any person "involved in a contravention". Certain defences to liability are available under the FMC Act.

The principal civil sanctions available under the FMC Act include pecuniary penalty orders and compensatory orders. The maximum pecuniary penalty is NZD1 million in the case of an individual or NZD5 million in any other case. The purpose of compensatory orders is to compensate aggrieved persons (and this could include investors).

The FMA has confirmed that it is taking a "broadly educative and constructive approach" towards compliance with Part 7A of the FMC Act in the first years of the CRDs regime, but misleading disclosures or failure to report are likely to attract enforcement action.

In relation to the fair dealing provisions in the FMC Act, a breach of these provisions may also give rise to civil liability. Again, both compensatory and pecuniary penalty orders are available. The maximum pecuniary penalty is the greatest of: i) the consideration for the relevant transaction; ii) three times the amount of the gain made or loss avoided by the person who contravened the provision; and iii) NZD1 million (for individuals) or NZD5 million (in any other case).

In some circumstances, criminal liability can also arise under the FMC Act. For example, CREs (and their directors) commit an offence if they knowingly fail to comply with an applicable climate standard. The FMC Act also provides for a general offence of knowingly making false or misleading statements. The FMC Act provides for a range of penalties for the FMC Act offences described, including significant fines (up to NZD500,000 in the case of an individual or up to NZD2.5 million in any other case) and terms of imprisonment (up to five years).

Civil and criminal liability can also arise for breaches of the FTA. In relation to criminal liability, the maximum penalty is NZD200,000 for an individual and NZD600,00 for a business (per offence). In addition, businesses that breach the FTA can be required to pay compensation to affected consumers and certain other enforcement mechanisms (eg, injunctions) are also available.

5.6 Expected Progress

Companies are likely to make substantial progress in meeting their reporting obligations as New Zealand's CRDs regime beds in, market practice evolves and expertise continues to improve.

There remain, however, a number of substantial challenges, including in relation to:

- data availability and quality, for example with respect to financed emissions;
- resource constraints in implementing the regime;
- assurance of greenhouse gas emissions disclosures (assurance of these disclosures is currently required from Year 2);
- quantification of the financial impacts, climate-related risks and opportunities, in circumstances where these impacts are (in many cases) highly uncertain;
- alignment with international reporting frameworks, particularly for organisations with parent companies or other group structures that mean that they are required to report in multiple jurisdictions;
- a wide degree of variation in the approach to compliance across the market; and
- varying degrees of buy-in at the board level for climate-related disclosures.

6. Climate and ESG Litigation

6.1 Instruments for ESG Litigation

It is relatively straightforward to commence ESG-related cases against companies in New Zealand.

One way to attempt to start an ESG-related claim in New Zealand is to make a complaint to one of the regulators responsible for enforcement of a relevant regime, such as the FMA or Commerce Commission. These complaints could be made by a competitor. However, these regulators have limits on their resourcing, and there is no guarantee that any individual complaint will be progressed.

Accordingly, it is also possible to take claims directly to the New Zealand courts. One key issue for claimants in considering whether to take such a claim will be whether the claimant has standing to sue the relevant counterparty. Some types of claims, for example, will only be able to be brought by shareholders in a defendant company. However, other avenues (such as claims under the FTA) are more easily brought by other stakeholders.

6.2 Climate Activism

Activists and NGOs are increasingly important in the New Zealand ESG litigation landscape.

Over the past couple of years, several significant pieces of litigation have been commenced by activist and NGO groups. This includes several judicial review challenges against government decision-making on climate change issues (see, for example, **1.2 Environment Trends** for our discussion of Lawyers for Climate Action New Zealand Incorporated v Commerce Commission). Lawyers, acting on a pro bono basis or as part of a climate action collective, have played a significant role in bringing climate-related cases to the New Zealand courts in recent years. While, to date, most of the claims brought by activist groups or NGOs in New Zealand have not succeeded at trial, these pieces of litigation have a wider significance in influencing both public perception and corporate action on climate change and other ESG issues.

One dynamic of the New Zealand market that distinguishes it from some other jurisdictions is that many New Zealand corporates are owned by offshore (especially Australian) parent companies or have other ownership structures that are different from a traditional diversified shareholder model. As such, shareholder activism has played a lesser role in New Zealand than it has in some other jurisdictions in relation to bringing ESG-related claims.

6.3 Greenwashing v Greenbleaching

Both the FMA and the Commerce Commission have signalled a regulatory focus on greenwashing. To date, formal enforcement action has focused predominantly on product-level claims (such as claims relating to the extent to which products can be recycled or composted) rather than entity-level claims (such as claims relating to the approach that an entity is taking to climate action). However, both regulators are sharpening their focus in this area and have been using a range of regulatory and non-regulatory tools to engage with the market. For example, the FMA undertook a review of integrated financial products relating to managed funds in July 2022 and, while the review fell short of finding instances of greenwashing, the FMA did identify "weaknesses in information disclosure".

In the private litigation sphere, while no greenwashing cases have been brought by investors, two significant cases have recently been lodged, as follows.

- In late 2023, a group of NGOs lodged proceedings in the High Court seeking declarations that Z Energy has breached the FTA by misleading New Zealanders with its public claims on emission reduction and climate change mitigation. For example, the claim alleges that claims made that Z was "in the business of getting out of the petrol business" and associated claims about its progress on emissions reductions were false and/or misleading.
- In September 2024, Greenpeace New Zealand lodged proceedings in the High Court against Fonterra (a major dairy co-operative and one of New Zealand's largest companies) in relation to claims made on "grass-fed" claims on its butter packaging.

Both of the above cases are yet to proceed to trial.

6.4 A Turbulent Future Ahead

ESG-related proceedings are likely to grow in New Zealand, in line with developments overseas. Over the past few years, ESG-related cases in New Zealand have gradually proliferated, and there are now several major ESG-related cases that are awaiting hearing or decision in the New Zealand courts. Further, it is possible that developments such as the Supreme Court allowing Smith v Fonterra to proceed to trial will increase the attractiveness of New Zealand as a jurisdiction that is potentially open to the development of the law relating to ESG.

PORTUGAL

Law and Practice

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Contents

VdA is a leading international law firm with more than 40 years of history, recognised for its impressive track record and innovative approach. The excellence of its comprehensive legal services covers several industries and practice areas, including agribusiness; aviation; banking and finance; competition; corporate and M&A; defence; digital frontiers; energy and natural resources; the environment; governance; healthcare; information, communication and technology; infrastructure and mobility; insurance; investigations and white-collar crime; IP; life sciences; litigation and arbitration; mining; oil and gas; private equity and venture capital; public law and administration; rail infrastructure; real estate and regulatory entities; restructuring and insolvency; social economy and human rights; and tax. VdA offers robust solutions grounded in consistent standards of excellence, ethics and professionalism to help its clients overcome increasingly complex challenges. The excellence of VdA's work is acknowledged by clients and stakeholders, and leading professional associations, legal publications and academic entities, with the firm and its lawyers receiving numerous international accolades and awards.

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1. Introduction

1.1 General ESG Trends

In the last few years, European lawmakers have continued to improve the European Union ESG frameworks by adopting important ESG legal acts that can be considered a roadmap for all stakeholders on ESG issues.

The Corporate Sustainable Reporting Directive (CSRD)

One of the most anticipated legal regimes, the Corporate Sustainable Reporting Directive (CSRD), which replaced the Non-Financial Reporting Directive, was adopted at the end of 2022 and came into effect in January 2023. Mandatory reporting obligations cover approximately 50,000 companies and are applicable to both EU and non-EU companies that meet the target number of employees and annual turnover. The first reporting period will start in 2025, with information for the 2024 financial year.

The European Sustainability Reporting Standards (ESRS)

European Sustainability Reporting Standards (ESRS) were also adopted during 2023 as the unified instrument for CSRD reporting obligations. Unlike the CSRD, which needs transposition into national legislation (which has not yet occurred in Portugal), the ESRS is a regulation that can be applied directly to the member states. Consequently, it is expected that companies will start reporting according to the calendar stated by the CSRD, despite the omission of the national legal transposition act. The reporting standard has set a list of specific information that companies must disclose regarding their material impacts, risks and opportunities in environmental, social and governance matters. The ESRS consists of two cross-cutting matters and ten thematic standards that cover ESG issues. The adoption of the European Commission's standards for sector-specific companies and for non-EU companies has been delayed until 2026.

The Corporate Sustainability Due Diligence Directive (CSDDD)

Discussions on the Corporate Sustainability Due Diligence Directive (CSDDD) started in 2022 and the directive finally came into force in July 2024. The CSDDD represents a major step as it imposes a due diligence obligation on companies, which are obliged to identify, mitigate and report on the impact of their own operations and supply chain on human rights and the environment.

The Regulation on European Green Bonds

On the financial side, the Regulation on European Green Bonds, adopted in 2023, aims to address the challenge of increasing financial flows towards green technologies and energy-efficiency projects. This regulation creates an effective financial instrument for investors, thereby contributing to the fight against climate change and having a positive impact on society and the environment.

The Proposal of Regulation

The new Proposal of Regulation on the transparency and integrity of ESG ratings activities was proposed in 2023. It recognises a general legal regulatory approach to strengthen the principles of the reliability, transparency and credibility of an ESG rating by setting specific rules of organisation and conduct for ESG rating providers. The proposal was passed in the European parliament in the first reading in 2024 and is now awaiting approval by the European Council.

1.2 Environment Trends

The Regulation on Deforestation-free Products (EUDR) and the Nature Restoration Law

Portugal, as a member of the EU, implements EU ESG legislation. A few examples of the development of EU legal acts in parts of the environment can be highlighted, such as the Regulation on Deforestation-free products (EUDR) and the Nature Restoration Law which were adopted recently. Both legal regimes aim to protect nature and biodiversity.

Decree-Law No 11/2023

At the national level, the main environmental legislation approved in 2023 was related to administrative simplification of licensing in the fields of the environment, green public procurement, water resources use and waste management, through the approval of Decree-Law No 11/2023, which aims to simplify administrative procedures for companies, with a special focus on the environmental area.

The National Strategy for Public Procurement

The National Strategy for Public Procurement has been updated in line with EU policy in this area and in compliance with the Climate Framework Law (Law No 98/2021), which provides for preference for the contracting of services that comply with the principles of the EU Taxonomy on environmentally sustainable activities.

Decree-Law No 69/2023

Decree-Law No 69/2023 established the legal framework for the quality of water intended for human consumption, in line with European directives.

Management of Waste

Finally, comprehensive amendments to waste management legislation were approved (including the legal regime for the landfilling of waste and the regime for the management of specific waste streams subject to the principle of extended producer responsibility), as well as the Strategic Plan for Urban Waste 2030 and the Strategic Plan for Non-Urban Waste and the National Waste Management Plan 2030.

1.3 Social Trends

The year 2023 was a transformative one for the social aspect of ESG in Portugal. Enhanced regulatory frameworks and significant case law developments are helping to foster a more equitable and inclusive corporate environment. Companies in Portugal are now more accountable for their social impact, working conditions, and community engagement practices, reflecting a broader European trend towards comprehensive ESG compliance.

Regulatory Framework

In regard to regulations and legislation, Portugal has continued to advance gender equality and regulations that are non-discriminatory. This includes measures to ensure equal pay, reinforce anti-discrimination laws, and promote female representation in corporate leadership roles. The existing regulatory framework has seen enhanced monitoring and enforcement mechanisms this year.

In turn, Portuguese companies have been making an effort to comply with inclusion regulations, namely concerning disabled people.

In matters of harassment at work, employers have been putting in place codes of conduct and regulations on the prohibition and prevention of such behaviours, which encompass not only victims, but also witnesses and whistle-blowers.

Measures taken for parenthood protection and work-life balance were mostly in view of employees' mental health and engagement, with the development and enforcement of more regulations on absences from work, flexible schedules, and social benefits, among others.

Finally, the Portuguese government has put forward new regulations aimed at improving working conditions. This includes stronger enforcement of labour rights, increased minimum wages, and more stringent rules on temporary and precarious employment.

Case Law Developments

When it comes to case law, several notable cases on labour rights have been brought before the Portuguese courts in relation to unfair labour practices. These cases highlight issues such as unjustified dismissals, workplace harassment, and violations of contract terms. The outcomes of these cases are shaping employer practices and reinforcing the importance of adhering to fair labour standards.

Portuguese courts have also seen an increase in cases related to employee data privacy, due to the enforcement of the General Data Protection Regulation (GDPR) across the EU. Companies are being held accountable for misuse or mishandling of personal data, emphasising the importance of robust data protection measures in the workplace.

The types of cases are mostly related to:

- discrimination, with significant cases related to workplace discrimination based on gender, race and sexual orientation – the rulings in these cases are helping to build a more inclusive and equitable work environment in Portugal; and
- worker safety, with occupational health and safety violations being most prominent – companies found negligent in ensuring a safe working environment have faced substantial penalties, underlining the critical importance of health and safety protocols.

1.4 Governance Trends

The general feeling regarding the relevance of corporate governance, as the "G" in ESG, has evolved significantly in the past year, following an overall trend that had already been occurring in previous years.

The essential pillars of Portuguese legislation related to corporate governance, the Commercial Companies Code and the Securities Code, have not undergone significant changes in this matter, but two events partly explain this trend in Portugal.

Firstly, the approval in 2023 of a new version of the Corporate Governance Code (soft law) by the Portuguese Institute of Corporate Governance, which for the first time prominently and significantly addressed ESG matters.

Secondly, the fact that the application of the CSRD Directive (Corporate Sustainability Reporting Directive) is approaching. Despite the delay in transposition, which is expected to be completed by the end of 2024, many of the companies that will be impacted by it are already preparing for its implementation.

1.5 Government and Supervision

Currently, in Portugal, there is no single regulatory or supervisory entity that globally assumes responsibility for the ESG transition. In global terms for all economic activity, it is only the Portuguese government that assumes responsibility through policy measures that promote the ESG transition. Specifically, regarding climate, it has since 2021 enacted the Climate Framework Law, which reflects deep concern about the transition and primarily targets public entities, but private companies are also in its scope.

Regulatory and supervisory bodies oversee sets of entities based on their sectors or nature and have ESG impacts within their respective areas. Some specific supervisory bodies stand out.

The Portuguese Securities Market Commission

The Portuguese Securities Market Commission (*Comissão do Mercado de Valores Mobiliários* – CMVM) supervises entities with securities admitted to trading on a regulated market. These are mostly companies with extended ESG reporting obligations, whose compliance is subject to oversight and sanction by the regulatory entity. The CMVM has dedicated significant attention to ESG matters and even published, in 2024, a "Sustainability Guide for Issuers, Asset Managers, and Financial Intermediaries" under its supervision.

The Bank of Portugal

The Bank of Portugal (BP), responsible for supervising credit institutions, also has a supervisory role with ESG relevance, shared with the European Central Bank, depending on the characteristics of the credit institutions. Credit institutions have a set of specific ESG disclosure obligations resulting from the Taxonomy Regulation and Pillar III obligations approved by the Commission Implementing Regulation (EU) 2022/2453 of 30 November 2022. These obligations are very broad and are subject to supervision by the regulatory authority.

Other Regulators

There are other regulators of significant activities in the transition process that impact the covered companies, such as the Insurance and Pension Funds Supervisory Authority (*Autoridade de Supervisão de Seguros e Fundos de Pensões* – ASF) and the National Tourism Authority (*Turismo de Portugal*).

The future transposition of the CSDDD will bring new developments in this matter, as countries will be required to designate an oversight authority with specific competencies not only in the supervision of due diligence matters but also in climate transition plans.

1.6 Market Participants

Portugal has a strong industrial ecosystem mainly composed of small and medium-sized companies, which act as first or second-tier suppliers to large companies located in other countries (EU and non-EU). The main sectors of activity consist of garment and footwear (textile sector), food and beverages (agricultural and food sector), metalworking, the automotive industry and mobility (manufacturing sector), with other fast-growing sectors such as the aerospace industry, ICT and corporate shared services, such as data centres or centralised operational hubs for back-office activities. Although many ESG laws and regulations will not be directly applicable to the Portuguese industrial sector due to the small size of the companies involved (the application thresholds of those laws and regulations will not be met, as is the case with the recently adopted CSDDD, which only affects a reduced number of Portuguese companies), the fact that most of the market addressed by Portuguese companies is composed of large companies which are subject to those legal requirements will undoubtedly have an impact. ESG concerns, although not yet fully widespread in the industrial ecosystem, are becoming more and more inescapable due to the pressure originating from the market. Therefore, it is expected that all sectors and industries with an export component will have to adjust to ESG requirements and reshape their business practices or otherwise they will be at a competitive disadvantage and may even lose some of their market share. Finally, the attractiveness of foreign investment and access to traditional financing will increasingly be reliant on ESG criteria, which means that those sectors targeted by investment funds (eg, the energy sector, where the role of renewable energies is relevant) or with business models highly dependent on financing (eg, construction and the real estate sector) will have to adapt their operations and strategies to be ESG compliant.

1.7 Geopolitical Developments

Extraordinary events and the increased number of natural disasters of the last few years have been relevant in the ESG-related process.

The invasion of Ukraine by Russia and the subsequent disruption of the global energy market have caused the EU to adopt several measures to cope with this new situation. Among these, it has launched a programme under the name "REPowerEU" to promote the phasing out of Russian fossil fuel imports and to overcome EU dependency on them.

Under this programme, several reforms have been made in Portugal, such as:

- the implementation of one-stop shops for energy efficiency and renewables;
- the development of a regulatory framework for renewable hydrogen management; and
- the creation of the National Energy Poverty Observatory.

Amendments were also made to energy efficiency in residential, service and public buildings; on energy transition to support the development of green industry; and on decarbonisation of public transport.

In turn, the climate policy remains among the priorities of the EU and other countries worldwide, as evidenced by the policy statements of various governments at 2023's UN Climate Change Conference (COP28). These statements, aimed at combating global climate change, can be found in the domestic public policies of central banks, the fiscal system, and the energy-resilience system.

In Portugal, it is worth noting the adoption of the Climate Framework Law, which came into force in January 2022. With widespread scope (covering topics such as green finance, companies' governance, health, security and foreign policy, energy transition, adaptation to climate change, a just transition, sustainable mobility and transport, agriculture and the food chain, international co-operation, etc) it set ambitious targets and obligations for accomplishing climate neutrality even before the 2050 goal set by the EU. Finally, brief mention needs to be made about the creation in 2021 of a national mechanism of just transition in order to guarantee the maintenance of the wages of workers who lost their jobs due to the process of the closing, in 2021, of the Central do Pego, which used to produce electricity from coal. It will continue to run until these workers can find a new job or, at least, until the end of 2024.

2. Corporate Governance

2.1 Developments in Corporate Governance

The main developments expected in terms of corporate governance are the continued implementation of the new version of the Corporate Governance Code by the Portuguese Institute of Corporate Governance (*Instituto Português de Corporate Governance* – IPCG) and the adaptation to the requirements of the CSRD Directive, both of which will impact the systems and processes of various companies.

The IPCG dignified ESG with a new first chapter for the Corporate Governance Code, dedicated to stakeholders and sustainability. This move represents a shift in corporate governance towards giving importance to sustainability matters, in line with the 2023 G20/OECD Principles of Corporate Governance. The principles approved in Portugal include the duty to contribute to the UN Sustainable Development Goals, environmental and social impact due diligence, and the need to consider stakeholders in the decision-making process. The recommendations are essentially focused on disclosure.

The CSRD Directive is focused on the fulfilment of ESG reporting obligations, but its construction and implementation strategy was designed with the objective of pushing companies towards the transition (and not only disclosure), and this force is being felt. Simply complying with reporting obligations is forcing many companies to reorganise themselves and change governance processes to meet new requirements. The inevitable comparison and pressure from stakeholders is generating a set of other corporate governance changes at three levels: (i) supporting environmental or social initiatives; (ii) structuring the bodies, committees and general competencies of the company; and (iii) addressing very specific governance matters related to business conduct.

The value chain implications of the CSRD Directive, coupled with a broader general diffusion of corporate governance concerns and ESG in particular, have led to a clear trend for smaller companies, which are not directly obliged by any legal instrument, to begin their sustainability journey too.

2.2 Differences Between Listed and Unlisted Entities

The basic governance framework of both listed and unlisted companies results from the Commercial Companies Code (*Código das Sociedades Comerciais*).

Listed companies, in addition to special relevant rules in terms of corporate governance stemming from the Securities Code (*Código dos Valores Mobiliários*) and regulations from the CMVM, are subject to a specific obligation to disclose detailed information about their corporate governance regime and to report in relation to a corporate governance code chosen on a "comply or explain" basis. This has generally been done by referring to the IPCG Corporate Governance Code.

As for specific ESG information obligations, the situation is different. The distinction to be made is not just between listed and unlisted companies, but between those that are large enterprises, of public interest, with more than 500 employees, and the others. Listed companies are by definition companies of public interest. For these companies, there are already specific ESG information disclosure obligations under the Commercial Companies Code.

With the CSRD Directive fully in force, the relevant distinction will no longer be between public interest or listed companies and the others. Instead, it will become a more complex system that will essentially cover all companies that qualify as "large" (see **5.1 Key Requirements**).

2.3 Role of Directors and Officers

The general context of the development of ESG, with specific environmental norms, significant developments in employee rights, and specific governance duties, such as those related to bribery and corruption or whistle-blowing, as well as reporting responsibilities, has created various direct obligations for companies.

In the case of climate, a specific governance obligation has been introduced by the Climate Framework Law. This requires companies to incorporate climate change considerations into their corporate governance and include climate risk analysis in their decision-making processes.

The fulfilment of all these obligations is the responsibility of the directors, which stems from the fact that they are bound by duties of care, availability, technical competence, and knowledge of the company's activities, and they must act with the diligence of a prudent and orderly manager.

The impact of general ESG factors on directors' liability, when these factors do not yet constitute direct legal obligations, will only exist to the extent that it can be concluded that the directors' actions did not respect the criteria of business rationality (business judgement rule). This reasoning is always complex and includes elements of subjectivity. The specific circumstances of the company's activities and the particular case must also be integrated with the interpretation of who are the relevant stakeholders in terms of the actions and responsibilities of the directors.

2.4 Social Enterprises

Portugal does not have specific legal business forms for social enterprises and/or non-profit companies. Social entrepreneurs wishing to incorporate social enterprises or non-profit corporate structures, generally opt to incorporate a regular commercial company, with carefully drafted articles of association that reflect the social venture of the company. These companies frequently have non-profit organisations as founders.

2.5 Shareholders

Shareholders are responsible for assessing the administration, proceeding with dismissals, and claiming liabilities whenever they deem it necessary. Presently, there are specific obligations within the ESG scope, and the impact of these concerns on all companies is unequivocal. The directors' ESG choices, like all other decisions, are subject to shareholder scrutiny.

Particularly relevant in this assessment is the understanding of Portuguese law regarding stakeholders, in terms of the duties of loyalty and the interests that directors must uphold. The duties of loyalty exist for the interests of the company itself. Shareholders and other stakeholders have different levels of relevance in this construction. Those duties of loyalty must reflect the long-term interests of shareholders and, with distinct relevance, also consider the interests of other stakeholders who are relevant to the sustainability of the company, such as workers, clients and creditors.

It is therefore clear that under Portuguese law the company itself and its shareholders come first, but the complexity of the reasoning comes from the fact that it is unquestionable that the consideration of the interests of other stakeholders is also in the interest of the company itself and its shareholders.

3. Sustainable Finance

3.1 Progress in Green Financing

Portuguese supervisors have been making a concerted effort to promote sustainability with local asset managers, investors and stakeholders. This has been achieved primarily through the provision of information to the market, participation in public events, and the organisation of surveys to assess how market operators are incorporating sustainability into their activities.

New IT tools that will simplify the ESG analysis carried out for clients and prospective clients, along with the increased regulatory attention devoted to ESG, should continue to propel the integration of sustainability within the local market.

3.2 Sustainable Finance Framework

Currently, the main guidelines for companies seeking and/or providing finance stem from:

- the EU Green Bonds Regulation (even if on a prospective basis, considering that this act will only come into effect on 21 December 2024);
- internationally recognised standards such as those from the International Capital Market Association; or
- sustainable finance frameworks created by each institution.

These frameworks aim to disclose to the market how they incorporate sustainability demands into their financing activities.

3.3 Access to Green Financing

There are several local institutions and operators making green financing available to borrowers. The offer of green financing is expanding, and this trend is expected to continue in the foreseeable future due to the need for lenders to report their own alignment with the EU Taxonomy.

Regarding green banking loans, several of the major Portuguese banks already offer green options to borrowers under their sustainable finance frameworks. As expected, the financing granted under this option offers special conditions to borrowers; however, it imposes additional constraints on their activities and use of proceeds.

In terms of sustainability bonds, sustainability-linked bonds, or green bonds, Portuguese entities that had a particular focus on the energy sector started successfully resorting to these instruments to finance their activities several years ago.

3.4 Stranded Assets and Non-bankables

Although the shift of focus towards green financing is becoming clearer each day, it is still possible for companies operating with stranded assets or other non-bankable assets under the ESG landscape to obtain financing for their activities.

Nevertheless, as financing increasingly favours more desirable sectors under the ESG landscape, concerns regarding old economy borrowers and issuers will likely rise on the list of issues to address in the transition to a greener economy.

In any case, in Portugal, it is noticeable that even companies with a significant business in stranded assets are making an effort to adapt to

ESG principles. For example, they are investing in more suitable projects, diversifying their portfolios, and making investments to reduce their carbon footprint.

3.5 Challenges Ahead

With the ever-increasing presence of sustainable finance and ESG at the top of the agenda for public supervisors, lenders, borrowers, investors and stakeholders, the market is now being urged to move from the initial formal approach to the inclusion of ESG in their activities – perceived more as a burden than an opportunity – to truly embody and adopt ESG principles.

This change in attitude will require a broader and better comprehension of the status of ESG adoption by local companies and their plans. In this regard, it is already noticeable that local financial institutions, acting in a co-ordinated manner, are taking the first steps to collecting and sharing ESG data from their clients and to facilitating easier access to green financing.

For now, the local market is adopting a positive outlook on ESG, and no significant anti-ESG movement has been perceived.

Finally, after the initial push for the adoption of and compliance with the ESG framework by financial institutions, according to public statements from financial sector supervisors, it is expected that regulatory awareness will start focusing on the materiality of public ESG statements, classification of products, and distribution of green products.

4. ESG Due Diligence

4.1 Soft Law Becoming Hard Law

In recent years, there has been a notable global trend of soft-law principles evolving into hard law. Portugal reflects this broader global trend, influenced by its commitment to international and European standards, and the evolving needs of governance and regulatory frameworks. This tendency may be observed in several areas, including environmental law, corporate governance, human rights, and digital regulations. The United Nations Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises on Responsible Business Conduct, which have informed recent EU legislation such as the CSDDD, are good examples.

4.2 Towards Vertical Responsibilities

Due diligence requirements for companies operating in Portugal are indeed increasing, especially for those forming part of the value chain of large companies. This is a trend emerging from EU legislation, such as the recently adopted CSDDD, as well as from market pressures and consumer expectations. Companies are expected to adopt more comprehensive due diligence practices to ensure compliance, assure the traceability of products supplied to the market, manage risks, and meet the demands of various stakeholders. The recently adopted National Action Plan on Business and Human Rights, promoting responsible business practices and calling for enhanced due diligence measures to prevent human rights abuses, is a good example.

4.3 Partner Selection

A noticeable trend that is being observed is that due diligence requirements are reshaping how companies engage with their supply chain partners, with a visible shift towards more responsible and transparent supplier relationships, despite the fact that 99% of Portuguese companies are small and medium-sized enterprises (SMEs), which makes it more difficult to implement effective due diligence requirements in supply chains. Market-driven pressure and increasing awareness of the importance of protecting human rights, adopting fair labour practices, and abiding by ethical sourcing of materials, just to mention a few, are becoming increasingly widespread as criteria for selecting suppliers, emphasising compliance with ESG standards. Suppliers are increasingly required to demonstrate that they meet these criteria through certifications and documented practices.

4.4 ESG in M&A Due Diligence

ESG considerations are playing an increasingly central role in M&A activities in Portugal. From due diligence and valuation to post-merger integration and regulatory compliance, ESG factors are reshaping how deals are structured and executed. While there are still challenges to overcome, such as reliable and comparable ESG metrics and data availability, the trend is clear: companies and investors are placing growing importance on sustainable and responsible business practices in their M&A strategies.

Due Diligence

ESG-related due diligence is now a standard part of the M&A legal due diligence process, which includes examining environmental practices, social policies and governance structures to identify any potential red flags or areas of improvement as part of their overall assessment of the target company. Level of compliance with environmental laws, labour rights and workplace safety, and meeting anti-corruption legal requirements, as well as potential liabilities related to past non-compliance, can impact the valuation and terms of the deal, including determining a go/no-go decision.

Contractual Provisions

M&A agreements increasingly include specific warranties and indemnities related to ESG issues, and in some deals, contingent payments or earn-out clauses are tied to achieving specific ESG targets and milestones post-acquisition.

5. Transparency and Reporting

5.1 Key Requirements

Currently, specific sustainability reporting obligations only apply to companies that simultaneously:

- are of public interest, such as certain financial institutions and companies with securities admitted to trading on a regulated market;
- are large, by meeting at least two of the following three criteria –
  - (a) turnover above EUR40 million;
  - (b) balance sheet total exceeding EUR20 million; and
  - (c) more than 250 employees; and
- have more than 500 employees.

With the transposition of the CSRD Directive, these criteria will be progressively altered so that the obligation will fall on all large companies and on small and medium-sized companies (that are not micro-entities) if they have securities admitted to trading on a regulated market.

There is also a general legal obligation applicable to all companies requiring non-financial performance references, including information on environmental issues and issues related to employees, to be included in the annual reports to the extent necessary to understand the evolution of the business, its performance, or the position of the company. Additionally, there are some specific general information obligations in terms of climate resulting from the Climate Framework Law.

5.2 Transition Plans and ESG Targets

Currently, in the Portuguese jurisdiction, there is no cross-cutting obligation to publish transition plans or to commit to targets. Even the Climate Framework Law refers to the setting of a "carbon budget" as being optional.

With the transposition of European ESG legislation, this situation will evolve. Under the CSRD Directive it is not mandatory to have a transition plan, but it will be necessary to declare that one does not exist or if it does, to provide information about its content. Companies that fall under the scope of the CSDDD, which will only be very large companies, will be required to adopt and implement a transition plan to mitigate climate change.

5.3 Regulation of ESG Labels

During the past few years, the EU has initiated a revision of consumer law, as announced in the New Consumer Agenda and the Circular Economy Action Plan. This has resulted in the adoption of the Empowering Consumers for Green Transition Directive (ECGT Directive), the Ecodesign Regulation, the Right to Repair Directive and the issuing of the Proposal of Green Claims Directive, which together will cover the issues of sustainable claims and combat misleading environmental claims known as "greenwashing".

The ECGT Directive

The ECGT Directive amends the Unfair Commercial Practice Directive (2005/29/EC) and Consumer Rights Directive (2011/83/EU) and will be implemented in Portuguese legal regimes Decree-Law 57/2008 and Law 47/2014 respectively within two years. Protection of consumers from unfair commercial practices, non-transparent sustainability labels, and untruthful advertising, and the mandatory indication of information on the durability and repairability of a product will ensure consumers are better informed and help them decide in favour of truly sustainable products.

The Ecodesign Regulation

The Ecodesign Regulation aims to ensure that the products or services placed on the EU market meet the requirements that cover the entire cycle of the products. The development of a digital product passport, providing information about a product from its origin, materials used, its environmental impact, and disposal recommendations, will be mandatory for all producers in the EU and outside the EU before placing a product on the EU market.

The EC's Proposal of Green Claims Directive

The European Commission's Proposal of Green Claims Directive is still under legislative procedure. The directive proposes to set a number of requirements for the substantiation of explicit environmental claims and environmental labels, ensuring their reliability, comparability and verification.

5.4 Supervision

The main entities in Portugal responsible for monitoring corporate sustainability reporting are the CMVM for entities with securities admitted to trading and some funds, the BP or the European Central Bank for credit institutions, and the ASF for insurance and pension fund activities.

The entry into force of the national act that transposes the CSDDD will possibly lead to the designation of a new entity responsible for the global supervision of certain ESG matters covered by that directive, specifically the due diligence process and transition plans.

In Portugal, "sustainability marketing claims" involve a direct relationship with consumers, and therefore have different supervisory entities.

Unfair commercial practices are under the responsibility of the Directorate-General for Consumers (DGC), as well as the BP, the CMVM and the Insurance Institute of Portugal, which are considered competent administrative authorities for unfair commercial practices in the financial sectors.

5.5 Enforcement

The failure to comply with reporting obligations firstly results in consequences within the general liability rules for companies and management. They are responsible for the damages caused as a result of the breach of a legal provision.

In addition to these general legal rules, there are specific consequences for regulated companies, which include the possibility of ancillary sanctions and fines. For example, in the case of listed companies, breach of information duties can be classified as a very serious offence with a fine ranging from EUR25,000 to EUR5 million.

Under the CSDDD, there is a specific sanction regime for some of the matters covered, which can reach up to 5% of the global turnover of these companies.

With regard to banks, despite the lack of a specific sanctioning regime for these situations, the general rule, provided for in the Portuguese general regime of credit institutions and financial companies, that sanctions violations of the mandatory precepts of the legislation (including EU legislation) governing the activity of credit institutions, financial companies, financial companies and mixed financial holding companies, may apply.

First-time offenders should be sanctioned with the minimum penalties.

5.6 Expected Progress

Formally, the most relevant time milestone on the horizon of sustainability reporting is the year 2025, which is the reference for the reporting that will take place at the beginning of 2026. For the first time, all large companies will be covered by this obligation, significantly increasing the number of Portuguese companies. Considering that sustainability reporting often has a value chain perspective, this coverage will have much broader impact than just on the directly involved companies.

Some of the companies that will be covered during this phase have already begun their adaptation processes. The main challenges encountered relate to data access and the necessary adaptations of processes and governance models not only to meet reporting requirements, but also to align the company's reality with more robust reporting content.

There is a general awareness that it will not be possible to transition instantly from almost nonexistent ESG information to the sophisticated reporting required by the CSRD. However, companies that have started the process are motivated by the beginning of this journey.

The fact that the CSDDD is now also appearing on the horizon, with its different sets of obligations, is motivating some companies to have a combined approach to the ESG implications resulting from both regulations.

6. Climate and ESG Litigation

6.1 Instruments for ESG Litigation

The Portuguese Constitution consecrates the right to intervene and participate in administrative procedures, and the full and effective protection of legally protected rights and interests are recognised, including the right to popular action and the right to promote the prevention, cessation and remediation of offences against public health, consumers' rights, quality of life, the protection of the environment and cultural heritage protection.

The Climate Framework Law (Law No 98/2021) has been in force since 1 February 2022, recognising the right of all citizens to climate balance, which consists of the right to demand that public and private entities comply with their duties and obligations regarding climate change, including the right to request the immediate cessation of any activity threatening or causing damage to climate balance.

The effectiveness of the law will greatly depend on the use that citizens and collective organisations (associations, foundations and even private companies) make of it, as well as the position of the national courts asked to apply the relevant law.

6.2 Climate Activism

The environmental non-government organisations (ENGOs) in Portugal have benefited since 1998 from a special legal status and, among other rights, have the right to consult or be informed by administrative authorities on documents and administrative decisions affecting the environment. ENGOs are also recognised as having legitimacy to initiate legal actions related to acts performed by public or private entities and to constitute themselves as assistants in proceedings for crimes against the environment.

Recently, a group of environmental associations appealed to the Supreme Court of Justice in a lawsuit against the Portuguese State for non-compliance with the Climate Framework Law, after the Civil Court of Lisbon rejected the initial petition, delivered in November 2023. On 19 September 2024, the Supreme Court of Justice overturned the first instance decision and proposed that the associations concretise their claims. This is the first lawsuit against the Portuguese State targeting taking measures to protect from climate change.

In turn, the case of Duarte Agostinho and Others v Portugal and 32 Other States is a clear example of Portuguese activists' actions. In 2020, six Portuguese youngsters filed a complaint with the European Court of Human Rights against 33 countries. The applicants' main claim concerned human rights violations resulting from the failure to take sufficient measures to combat climate change, and to demand more ambitious measures to reduce greenhouse gas emissions and fulfil commitments under the Paris Agreement to combat rising global temperatures. The European Court of Human Rights, however, decided that the complaint was not to be upheld because the applicants had failed to exhaust the remedies offered by the Portuguese legal system.

6.3 Greenwashing v Greenbleaching

The DGC is the competent national authority responsible for consumer protection and advertising supervision. The DGC has the competence to deal with misleading or false claims and has the power to impose fines on non-compliant companies. It has opened several administrative procedures against companies accused of misleading advertising of their products.

At the time of publication, no lawsuit had been filed by investors or a regulator in Portugal in relation to greenwashing. In 2022, a judgment was handed down by the Court of Appeal of Lisbon in a case against two companies engaged in the manufacture of cars and two companies engaged in the importation and sale of cars in Portugal filed by a civil society organisation for false and misleading environmental claims.

It is expected that there will be an increase in the number of cases dealing with greenwashing claims and it is possible that such lawsuits will represent the majority of ESG-related litigation in the near future.

6.4 A Turbulent Future Ahead

In Portugal, the ESG framework is based mainly on EU legislation. It is therefore expected that the development of ESG-related proceedings in Portugal will follow the full implementation of EU legislation and its transposition into national law that is still to be fulfilled.

Major changes in European legislation directly related to corporate reporting suggest that the number of ESG-related claims will increase, especially as the deadline for transposition into national jurisdictions is reached and all the due information is disclosed by the companies.

The evolution of greenwashing legislation in Europe and the future adoption of the Green Claims Directive, establishing clear rules for all participants, will also influence the number of climate greenwashing cases.

Trends and Developments

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Climate Neutrality at the Centre of the ESG Framework

As a member of the EU, Portugal is part of the great effort – and committed alongside other European leaders to settling the legal framework – to achieve climate neutrality by 2050 at the latest. Climate issues play a crucial role in the robust European ESG framework.

Driven by a sense of urgency, European ESG legislation provides a central ground for climate change concerns, particularly mitigation. From a legal perspective, Portugal aims to move even faster, as this text highlights.

The approval of the European Climate Law in 2021, under the Portuguese Presidency of the EU, made it legally binding for the EU to achieve:

- an intermediate target of reducing net greenhouse gas emissions by at least 55% by 2030 compared to 1990 levels;
- climate neutrality by 2050, through the balance between greenhouse gas emissions and removals; and
- the aim of negative emissions from 2050 onwards.

Moreover, after the first global stocktake at COP28, a legislative proposal was adopted to include the target of 90% reduction in GHG emissions by 2040 in the European Climate Law.

Therefore, companies operating in the EU are under growing pressure to disclose a clear commitment to decarbonisation and environmental concerns, as the environmental, social and governance (ESG) framework within the EU is establishing the way forward.

Within this framework it should be mentioned that European Taxonomy, the Sustainable Finance Disclosure Regulation (SFDR), the Corporate Sustainability Reporting Directive (CSRD), and the Corporate Sustainability Due Diligence Directive (CSDDD) are some of the most prominent instruments already put in place to promote transformation in the business ecosystem.

This legal framework, directly applicable to large companies and the financial system, will also have a significant impact on small and medium-sized enterprises due to a value chain approach (ie, scope 3 carbon-disclosure obligations).

In regard to the specific case of the CSRD, it should be noted that the European Commission has already adopted a delegate act establishing the European Sustainability Reporting Standards (ESRS). The ESRS cover increasing value topics for investors such as biodiversity, which can help companies to manage their sustainability performance more efficiently, and to communicate their policies and actions in a comparable way, which, in turn, can grant them better access to sustainable finance.

Moreover, these ESG regulations also apply to some non-EU companies with branches in the EU (depending on their net turnover in the EU) and are combined with other broader tools such as the Carbon Border Adjustment Mechanism (CBAM). Aligned with the Emissions Trading System (EU-ETS), the CBAM aims to create a level playing field by putting a price on the carbon emitted during the production of carbon-intensive goods that are entering the EU.

All this legislative architecture aims to ensure that Europe becomes the world's first climate-neutral continent by achieving its climate-neutrality goal by 2050.

The Portuguese Climate Framework Law

In the very same year that the European Climate Law came into force (2021), converting the Green Deal political goals into actual legal obligations and establishing targets to achieve climate neutrality, Portugal adopted its domestic Climate Framework Law encouraging the government to go even further than the European ambition and anticipate achieving climate neutrality by 2045.

This represents a greater step towards reinforcing Portugal's commitment to achieving carbon neutrality faster, but it puts a lot of pressure on all the public and private players in the market to comply with these goals within the established deadlines. Achieving climate neutrality by 2045 requires not only the rapid decarbonisation of the electricity generation system and urban mobility, but also a significant increase in the country's carbon sequestration potential.

In addition, the Portuguese Climate Framework Law covers a wide spectrum of diverse topics, from domestic mitigation targets to the national strategy for climate change adaptation, going through agriculture and forests, transport and mobility, carbon sequestration and green finance.

Among all these topics, two main innovations that the Climate Framework Law creates in the domestic legal system, which might lead to an increase in climate and business litigation cases, are discussed below.

The recognition of the right of all citizens to climate balance

The right to climate balance consists of the right to demand that public and private entities comply with their duties and obligations regarding climate change, including the right to request the immediate cessation of any activity that threatens or causes damage to climate balance.

Under this new right, a lawsuit has already been filed against the Portuguese State. A group of environmental associations appealed to the Supreme Court of Justice in a lawsuit against the Portuguese State for non-compliance with the Climate Framework Law, after the Civil Court of Lisbon rejected the initial petition, delivered in November 2023. On 19 September 2024, the Supreme Court of Justice overturned the first instance decision and proposed that the associations concretise their claims. This is the first lawsuit against the Portuguese State that targets taking measures to protect from climate change.

The obligations established for commercial companies

Since the Climate Framework Law came into force on 1 January 2022, commercial companies in Portugal must assess and include in their management reports:

- the role of climate change and climate risk analysis in their decision-making processes; and
- the economic, environmental and social dimensions, as well as the carbon impact, of their activities (for each financial year).

They might also develop a carbon budget, establishing a total maximum limit on greenhouse gas emissions, that considers the targets set out in the Climate Framework Law.

Furthermore, it also established the duties of care, loyalty and management reporting and the accountability of managers or directors and members of governing bodies with oversight functions. These duties include transparently sharing information about the risks that climate change poses to the company's business model, capital structure and assets, in accordance with double-materiality assessment logic.

Although the Climate Framework does not itself provide a specific liability regime, it is arguable that failure to comply with these new legal obligations and duties may give rise to the liability of managers and directors for damage caused to the respective company under the Portuguese Commercial Companies Code general obligations.

It should also be kept in mind that companies can be indirectly affected by the rules established in the financial system. In fact, the Climate Framework Law explicitly determines that failure to consider climate risk and the impact on climate in the financing decisions of public and private agents and institutions constitutes a violation of fiduciary duties.

On the other hand, lack of transparency or the non-sharing of information, including in the relationship between investments and climate change with respect to European Taxonomy, constitutes an inappropriate sale under the Markets in Financial Instruments Regulation.

The Portuguese Voluntary Carbon Market Legal Regime

When reporting activities carried out with a view to cancelling their carbon footprint, companies may mention the measures adopted to reduce emissions or, where this is not possible, the measures foreseen to compensate for emissions, namely by offsetting them through a voluntary carbon market (VCM) scheme.

The VCM has gained increased interest in view of the conclusions of the Intergovernmental Panel on Climate Change (IPCC), in its Climate Change Report 2022, that "carbon dioxide removals are also necessary to achieve net zero CO_2 and GHG emissions, both globally and nationally, counterbalancing residual emissions that cannot be avoided".

The growing relevance of the VCM and the need to ensure a favourable environment for investment, through a system that ensures transparency and a robust level of legal certainty for investors, has led to the drafting of legislation in Portugal to set minimum rules for the better functioning of this market.

While EU institutions were discussing the regulation for the certification of carbon removals, the latest version of which is still to be adopted and published, Portugal moved faster in the approval of rules to create a regulated market at the national level through Decree-Law No 4/2024, which came into force on 6 January 2024 and set the rules for the operation of the VCM.

This new legal framework establishes:

- the fundamental principles, such as additionality and permanence, and the qualification criteria;
- the requirements for the generation of carbon credits;
- the types of projects – ie, reduction and sequestration projects, natural or technological based, and credits included ("carbon credits" and "carbon credits+" when they contribute to biodiversity and natural capital, and verified and future carbon credits);
- the development of methodologies and a procedure for their approval;
- the monitoring, reporting, and verifying system; and

- the creation of a public platform for registration of carbon credits, from their generation to their elimination.

Some distinctive aspects of Decree-Law No 4/2024 deserve a closer look:

- Additionality – contrary to what is provided for in other legal regimes, the "principle of additionality" in Portuguese law does not require that the development of a project depends exclusively on the carbon market, allowing the accumulation of different sources of funding.
- Future carbon credits (credits issued before an actual reduction of greenhouse gas emissions, or carbon sequestration) – the purchase and sale of "future carbon credits" by the project, based on an estimate submitted by the project promoter and duly validated by an independent verifier, allow the anticipation of 20% of the total carbon credits estimated to be generated by a project to be in the offsetting of emissions in the short term, which provides a relevant opportunity for funding the launch of the project itself.
- Methodologies – the methodologies that define the rules for each type of project can be submitted by any interested party to the competent authority for its approval and, when developed by it, they are always subject to prior public consultation, which allows market agents to actively participate in their regulation and anticipate a more appropriate scenario for investments.

The publication of Decree-Law No 4/2024 stirred the interest of several market players for investments in carbon projects with the potential to generate tradeable credits in accordance with the principles and rules of this new national regulation. It is expected that the approval of the complementary regulation necessary to the effective operation of the Portuguese VCM (eg, the rules for the qualification of independent verifiers, applicable fees for registering projects on the VCM Platform and carbon credit transactions, or insurance conditions and their minimum capitals) will happen shortly.

The Portuguese VCM could be especially relevant to companies wishing to compensate for hard-to-abate emissions, that is, emissions that are impossible to reduce with the current available technology, or where the cost of their reduction is so high as to make it unviable to maintain industrial activity in the sector.

The VCM framework in Portugal has been approved under the belief that voluntary carbon markets can generate economic incentives for reducing emissions or increasing carbon sequestration, enhancing the cost-effectiveness of GHG mitigation measures, promoting transparency and certainty in carbon projects and credits, and fostering innovation. In this sense, the VCM makes an important contribution to:

- supporting the achievement of national climate action objectives;
- fighting greenwashing cases; and
- promoting the alignment of the carbon price in the VCM with that of the regulated markets, namely of the EU-ETS.

The VCM also allows the unlocking of financial resources for projects that would not otherwise be feasible, in line with the Paris Agreement objectives and, at the same time, it helps to catalyse investments from the private sector, complementing the public effort to accelerate and promote mitigation actions in Portugal.

The focus on nature-based solutions

The VCM in Portugal comprises both GHG emissions-reduction projects and carbon sequestration projects developed in the national territory, but it prioritises nature-based solutions to contribute to other national public policies, notably, reducing the territory's vulnerability to the risk of forest fires, and conserving biodiversity and natural resources.

This is especially important considering the following:

- The reformed national legislative framework and related operational proceedings to make the prevention of risks, namely the risk of wildfires, more effective. It should be taken into consideration that Portugal has suffered several large forest fires that have burnt considerable forested areas, in addition to causing a great deal of material damage and the loss of human life. Consequently, the reforestation investments on burnt areas, at least in the first phase, are a priority of carbon removals solutions for forests with a view to compensating for GHG emissions. However, up until the time of writing, this has taken place at a much slower pace than desirable and the situation that existed before the forest fires is still far from being restored. It is therefore not surprising that the national authorities have started by developing a methodology for forest sequestration projects that should be open to public consultation very shortly. Another sector specifically mentioned by the law is blue carbon, with reference to the engagement of relevant public entities in welcoming pilot projects.
- The recommendations from the National Strategy for the Conservation of Nature and Biodiversity call for action to restore ecological systems and sustainably develop coastal and marine ecosystems. Alongside these, the objectives detailed in the EU Law on Nature Restoration emphasise the urgent necessity for projects rooted in nature-based solutions to not only stop the ongoing loss of biodiversity, but also to actively work towards its recovery. Both guidelines underscore the critical importance of environmental remediation and sustainable practices in preserving the natural world.

Nonetheless, the vulnerability of these nature-based solutions raises concerns and the legislator has been obliged to include mechanisms to address the exposure of nature-based projects to nature and climate risks, such as pests and invasive alien species, or such as major fires, floods or severe droughts.

If a project's sequestered emissions are unintentionally released (eg, due to wildfire), the responsible party must cancel any corresponding, untraded credits from the public register. When cancelled credits are insufficient to match the emissions released, the promoter has three options under Decree-Law 4/2024:

- purchase an insurance policy;
- contribute to a public Guarantee Fund; or
- employ a combination of both insurance and the Guarantee Fund.

It is worth noting that any reversal of emissions that may occur over the duration of the project has no impact on the carbon credits already issued by the project that have been transacted between the promoter and third parties.

Carbon projects promoting biodiversity conservation and restoration

The Decree-Law 4/2024 determines that carbon projects must not harm biodiversity and, where possible, should promote its conservation and restoration, which favours forestation or reforestation projects that combine both dimensions.

This might even allow either short-term revenues derived from the faster evolution of biodiversity actions, or longer-term revenues associated with tree growth and carbon sequestration. In the end, the combination of carbon projects with biodiversity benefits might result in increasing the profitability of investments.

In this regard, it should be noted that Decree Law No 4/2024 includes a specific type of carbon credit, identified in the register as “Carbon Credit+”, for projects which, in addition to carbon sequestration, incorporate significant additional benefits in terms of biodiversity and natural capital, provided that a methodology can be developed to determine and monitor that benefit.

Those looking for a highlight within this market should consider that the objectives of effective nature conservation and restoration can be relevant in accurately valuing carbon projects.

The Way Forward

Commercial companies operating in the EU market are obliged to disclose their actions regarding climate neutrality, reporting the measures adopted for reducing or compensating for their emissions.

Carbon credits are a viable tool to compensate for emissions when complying with principles and rules that assure high-integrity credits and avoid greenwashing. The recently approved Portuguese voluntary carbon market legal regime (Decree Law No 4/2024) offers a safe framework for investments in carbon projects.

In accordance with the basic principles and rules of this regime, carbon projects may not harm nature and biodiversity conservation. In turn, it determines that carbon projects with benefits for nature and biodiversity, in terms of halting its loss or promoting its conservation, can generate “Carbon Credits+”, allowing the market to assign them a higher value compared to other carbon credits.

The priority of reforestation projects, as set out in Decree Law No 4/2024, together with the fact that Portugal is a biodiversity hot spot in Europe, suggests the development of carbon projects that combine forest sequestration with the promotion of nature and biodiversity-generation higher-valued carbon credits.

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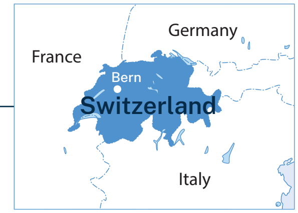

Trends and Developments

Contributed by:
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Kellerhals Carrard

Kellerhals Carrard is one of the largest business law firms in Switzerland, and one of Switzerland's thought leaders in ESG matters, shaping the legislative process and contributing to the development of law and practice. The firm serves as the executive legal partner to Sustainable Switzerland through NZZ (environment), is a co-founder and partner of the Swiss Venture Club (social) and is a founding member of idée coopérative (governance). Kellerhals Carrard's ESG practice, which includes both advisory and litigation services, continues to grow. The firm advises listed companies on ESG strategy and reporting obligations, assists companies and public entities on a range of ESG topics, including environmental law, energy law, supply chain, and waste management, and advises banks on ESG-related investment funds, financing, and capital market transactions. The firm also represents clients in ESG-related disputes, such as environmental litigation and public procurement.

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ESG Framework in Switzerland

The ESG framework in Switzerland is constantly expanding. Switzerland has ratified the Paris Agreement and is implementing the goals of the treaty in various national laws. In late 2022, the Federal Council declared its intention to position the Swiss financial sector as a leader in sustainable development; since then, the regulation of sustainable finance is gaining momentum. New self-regulation to combat greenwashing in the financial sector entered into force in September 2024 and a new provision applicable to all sectors will come into effect on 1 January 2025. Swiss companies operating in the European Union must comply with specific sustainability requirements set out in the Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CSDDD), and work is underway to align Swiss law with these and other European regulations.

The most important developments are outlined below.

Sustainability Disclosure Requirements

Assessment of the first reporting year

Large listed companies and companies subject to the supervision of the Swiss Financial Market Supervisory Authority (FINMA) were required to publish a non-financial report for the first time in 2024 for the 2023 financial year, in accordance with Articles 964a et seq. of the Swiss Code of Obligations (CO). The Ordinance on Mandatory Climate Disclosures has also been applicable to these companies since 1 January 2024.

The Swiss foundation Ethos, which specialises in socially responsible investing, conducted an evaluation of this first year of non-financial reporting. Ethos found that the reports received a high level of support from shareholders, with all of them being approved by an average of over 97% of votes. However, Ethos raised several concerns about the quality and transparency of the reports, including the following key points:

- internationally recognised standards were applied in only half of the cases;
- the reports were not audited or verified by independent external auditors; and
- there was a lack of transparency, particularly with regard to certain climate-related information.

Preliminary draft amendment to the Swiss Code of Obligations

On 26 June 2024, the Swiss Federal Council published a preliminary draft amendment to Art. 964a et seq. CO in order to strengthen the obligations imposed on companies regarding sustainability disclosure requirements and to align Swiss law more closely with the CSRD.

Key proposed amendments include the following.

- *Expanded scope of reporting* the draft amendment extends disclosure obligations to companies with at least 250 employees (instead of 500 under the current legislation). Additionally, it will be sufficient for companies to meet two out of three criteria (number of employees, turnover, balance-sheet total) for two consecutive years to fall within the scope. This change could significantly increase the number of Swiss companies required to disclose sustainability information.
- *Detailed report content* companies will be required to report on environmental, social (including human rights), and governance (ESG) issues based on the principle of double materiality (the extent to which this principle already applies under the current regulation

is controversial, and is clearly emphasised in the draft amendment).

- *Standards and equivalence* the draft amendment allows companies to report in accordance with the European Sustainability Reporting Standards (ESRS) or other standards deemed equivalent by the Federal Council, such as the International Financial Reporting Standards (IFRS) on sustainability disclosure and the Global Reporting Initiative (GRI) Standards.
- *Assurance and audit* the draft amendment requires sustainability information to be assessed by an auditor or an accredited conformity assessment body, in line with the requirements provided under European law. The Swiss Federal Council will need to determine the scope of the assessment in an Ordinance.
- *Abolition of the "comply or explain" principle* the draft amendment abolishes the "comply or explain" principle, which currently allows companies to choose not to disclose certain information if they provide an explanation.

The preliminary draft is based on an impact analysis commissioned by the Swiss Federal Council, which indicates that up to 50,000 Swiss companies could be affected by the European rules on sustainability disclosure.

The consultation procedure on the preliminary draft ended on 17 October 2024. The changes made as a result of this procedure will still have to be adopted by the Swiss Parliament.

Trends in Sustainable Finance

Climate- and nature-related risks

In addition to the disclosure requirements imposed on large banks and insurance companies by Article 964a CO, banks and insurers subject to supervision by the FINMA are required by prudential regulations to disclose specific information on climate-related financial risks. The scope of the disclosures has been specified in various FINMA Circulars (such as Circulars 2016/1: "Disclosure – Banks" and 2016/2: "Disclosure – Insurers", which impose specific disclosure requirements on the largest institutions (supervisory categories 1 and 2 for banks, and supervisory category 2 for insurers), amended in 2021) and FINMA Guidance 01/2023 (Developments with regard to the management of climate risks).

FINMA is of the view that an integrated approach to climate risks and other nature-related risks would be appropriate, and has enacted a new Circular on nature-related risks that will enter into force on 1 January 2025. This new circular is based on the recommendations of international standard-setting bodies (in particular, the Basel Committee on Banking Supervision (BCBS) and the International Association of Insurance Supervisors (IAIS)). It will apply to all supervised entities, irrespective of their supervisory category, and explicitly requires the integration of nature-related risks into governance processes and structures. FINMA refers to these nature-related risks as "risk drivers" that affect traditional risk categories, including credit risks, market risks, liquidity risks, operational risks, and reputational risks.

Furthermore, the Ordinance on Mandatory Climate Disclosures that entered into force on 1 January 2024 will be revised next year to include minimum requirements for the transition plans of financial institutions.

Self-regulation

The regulatory approach to sustainable finance is based on principles such as the primacy of market-based solutions and the subsidiarity of government action. However, due to the growing demand for ESG Investments and transparency, coupled with the developments in the European Union, specific rules are becoming increasingly necessary. In 2022, the Swiss Federal Council published its position on the prevention of greenwashing in the financial sector and outlined the key points that it expected the financial sector to implement through self-regulation.

On this basis, the Asset Management Association Switzerland (AMAS), the Swiss Bankers Association (SBA) and the Swiss Insurance Association (SIA) have recently revised (or published) their self-regulatory provisions to establish inter alia uniform standards for labelling sustainable investment products.

AMAS

The AMAS initially published a self-regulation on transparency and disclosure for sustainability-related collective assets, which came into force on 30 September 2023. This self-regulation establishes binding guidelines for AMAS members that manage and produce collective investment schemes in relation to sustainability. The AMAS seeks to enhance transparency and governance in asset management, thereby contributing to a more sustainable financial landscape.

In response to identified gaps in relation to the prevention of greenwashing, the AMAS amended this regulation by introducing Self-Regulation 2.0 on transparency and disclosure for sustainability-related collective assets, in force since 1 September 2024.

SBA

The SBA implemented two self-regulations in the field of sustainable finance, effective from 1 January 2023. These include the guidelines for the financial service providers on the integration of ESG preferences and ESG risks into investment advice and portfolio management, which aim to ensure that all advisors possess sufficient understanding of ESG issues and integrate them into the advisory process. The second regulation is the Guidelines for mortgage providers on the promotion of energy efficiency, which obliges mortgage providers to ensure that their client advisors and mortgage specialists undergo appropriate and regular training on procedures to maintain long-term property value and improve energy efficiency.

The revised version of the guidelines on the integration of ESG preferences and ESG risks entered into force on 1 September 2024 and includes provisions on the prevention of greenwashing.

SIA

The SIA adopted a self-regulation to prevent greenwashing in sustainability-related unit-linked life insurance. This self-regulation outlines requirements for organisational structures, product development, and distribution processes. It will enter into force on 1 January 2025.

New provision on green claims in the Unfair Competition Act

As part of the revision of the Federal Act on the Reduction of CO2 Emissions, the Swiss parliament has amended the Unfair Competition Act (UCA) to introduce a new provision (Article 3 para. 1 lit. x), specifically addressing Green Claims. This new provision will enter into force on 1 January 2025. It provides that anyone who gives information about themself, their goods, their work or their services concerning the impact on the climate which cannot be proven on objective and verifiable bases is acting unfairly. In other words, any climate claims about a company's impact, products, or services must be supported by objective, verifiable evidence in order to be considered fair. This provision is likely to be applicable, among other areas, to corporate communications, information published in non-financial reports, or advertisements.

Under the UCA, any person who is threatened in any way, or suffers damage to their customer base, their credit or professional reputation, their business operations or to their economic interests may take legal action. This right also applies to the following:

- customers whose economic interests are threatened or damaged;
- professional and trade associations authorised under their articles of association to safeguard the economic interests of their members;
- organisations of national or regional importance which, in accordance with their articles of association, are dedicated to consumer protection; and
- the Swiss Confederation, if it deems it necessary in order to protect the public interest.

Non-compliance may result in the civil or criminal penalties already provided for under the UCA.

Contrary to the European proposal for a Green Claims Directive, adopted in March 2023, Switzerland does not (at least for the time being) require ex ante verification by an independent body.

Further Initiatives and Outlook

Other initiatives have emerged, such as the parliamentary proposal introduced in September 2023 to establish a voluntary "Sustainable Enterprise" status. This initiative was based on a white paper published by B Lab Switzerland in May 2023, entitled "Sustainable Entrepreneurship in Switzerland: The Opportunity for a New Legal Framework". Broadly speaking, the proposal aimed to provide Swiss small and medium-sized enterprises (SMEs) with the voluntary option to incorporate social, environmental, and governance considerations into their statutes and strategies, in line with the 2030 Agenda for Sustainable Development. The goal was to create an optional legal status for SMEs making particular efforts in these areas.

The initiative has been rejected for the time being, pending the results of another initiative concerning the potential impact of European directives on Swiss SMEs.

The possibility of aligning Swiss law with the European Corporate Sustainability Due Diligence Directive (CSDDD) remains under consideration. Swiss companies are already affected by the CSDDD both directly, due to its extraterritorial scope (applying to enterprises generating more than EUR450 million in turnover within the European Union), and indirectly, by being part of the value chain of a European company directly subject to the CSDDD. The Swiss Federal Council has confirmed its intention to pursue corporate sustainability regulation that is coordinated at international level. It also plans to first analyse the effects of the CSDDD on Swiss companies and to look at how it is implemented by European member states.

ESG Litigation and Enforcement

Association KlimaSeniorinnen Schweiz vs. Switzerland

The association KlimaSeniorinnen Schweiz and four of its members brought lawsuits against the Swiss Federal Department of Environment, Transport, Energy and Communication, which were dismissed by the Swiss Federal Administrative Court and the Swiss Federal Supreme

Court for lack of standing. They subsequently filed individual complaints with the European Court of Human Rights (ECtHR) in Strasbourg.

The plaintiffs argued that Switzerland's climate-protection measures were not sufficient to achieve carbon neutrality by 2050 and to limit global warming to 1.5°C. They claimed that climate change posed a particular threat to elderly individuals and that Switzerland's inaction, as well as denial of standing before national courts, violated their rights under the European Convention on Human Rights (ECHR).

On 9 April 2024, the Grand Chamber of the ECtHR ruled in favour of KlimaSeniorinnen Schweiz in a landmark judgment.

The ECtHR found that climate change has the potential to impair the exercise of Convention rights, particularly the right to respect for private and family life and potentially the right to life, which member states are under an obligation to protect. Consequently, by failing to take adequate measures to combat climate change, Switzerland violated the applicants' right to private and family life under Article 8 of the ECHR.

Despite the particularly stringent requirements for victim status under the Convention, the ECtHR recognised that environmental associations may have the right to sue, provided that they meet the following criteria:

- they are lawfully established or have standing in the relevant jurisdiction;
- they demonstrate that they pursue a specific purpose, in accordance with their statutory objectives, in defending the human rights of their members or other affected individuals within the relevant jurisdiction; and
- they demonstrate that they are genuinely qualified to act on behalf of members or other affected individuals within the jurisdiction who face specific threats or adverse effects of climate change on their lives, health, or well-being as protected under the ECHR.

On 28 August 2024, the Swiss Federal Council declared that it considered Switzerland to be in compliance with the requirements of the climate policy ruling. With the revision of the Federal Act on the Reduction of Greenhouse Gas Emissions ($CO2$) on 15 March 2024, Switzerland has defined measures to achieve its climate objectives by 2030. The ECtHR did not take this development in Swiss climate policy into account in its ruling, nor did it consider the Swiss Federal Act on a Secure Electricity Supply from Renewable Energy Sources (approved on 9 June 2024).

The Swiss Federal Council is also opposed to the extension of the right of appeal of NGOs in climate matters. In its view, this would further complicate the construction of urgently needed infrastructure. However, the Swiss Federal Department of Justice and Police (FDJP) has been instructed to draw up a report for the Federal Council by the end of 2025 on the impact of this ruling on the practice of the federal administration and the courts regarding the right of appeal of associations. In so doing, the Swiss Federal Council will also be able to take into account any subsequent developments in case law and the actions of other states parties to the ECHR.

THAILAND

Law and Practice

Contributed by:
Jessada Sawatdipong, Sarunporn Chaianant, Jongkotchakorn Phantophas and Supawin Pongthananikorn
Chandler MHM Limited

Contents

Contributed by: Jessada Sawatdipong, Sarunporn Chaianant, Jongkotchakorn Phantophas and Supawin Pongthananikorn, **Chandler MHM Limited**

Chandler MHM Limited has a history of representing clients as an independent law firm in Thailand for over 50 years. Clients also benefit from Mori Hamada & Matsumoto's (MHM's) presence in China, Indonesia (ATD Law in association with MHM), Myanmar, Japan, Singapore, Vietnam, and the United States. In the Philippines, MHM established a strategic relationship with Tayag Ngochua & Chu. With over 100 lawyers, Chandler MHM is internationally recognised for expertise in antitrust, aviation, banking and project financing, data protection, dispute resolution, energy and natural resources, ESG, insurance, labour and employment, M&A, real estate, REITS/capital markets, restructuring and insolvency, and TMT.

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1. Introduction

1.1 General ESG Trends

In 2024, there have been significant developments in the ESG space across various dimensions. These include regulators attempting to strengthen the ESG disclosure requirements, public policy initiative linking ESG with investment instruments to boost the economy, and the private sector collaborating more actively to drive society towards a sustainable economy.

Guidelines for ESG Disclosure

Earlier this year, the Stock Exchange of Thailand (SET) published guidelines for ESG disclosure which are in accordance with international standards, such as the GRI standards and the SDGs. These guidelines are tailored for eight different sectors: agricultural and food, consumer products, financial, industrial, property and construction, resources, services, and technology. These guidelines include disclosure of ESG metrics specific to each sector, annual progress report tables, etc. Listed companies are encouraged to disclose their ESG aspects based on these guidelines on a voluntary basis.

The Office of Insurance Commission (OIC) has also released ESG disclosure guidelines for life and non-life insurance companies. Although not mandatory, the OIC encourages life and non-life insurance companies to disclose their ESG information, covering their value chain, and the principles for sustainable insurance (SPI).

ESG Symposium

On 30 September 2024, an ESG Symposium event was held in collaboration with various sectors, both public and private, under the concept “Driving Inclusive Green Transition”. The aim of the ESG Symposium is to promote a transition to a low-carbon society and to seek actions against the global warming crisis. There were discussions over energy-saving technologies, transitioning to renewable energy sources, developing decarbonisation technologies, and fostering a sustainable value chain. The main drivers of the energy transition in Thailand are (i) a supportive legal framework, (ii) the promotion of green financing, (iii) the development of green technology and infrastructure and (iv) boosting SME competitiveness.

ESG Model and Bio Circular Green Model

The SET has introduced the concept of the BCG model and the ESG model, based on the philosophy of sufficiency economy. The BCG model includes bioeconomy (focusing on optimising bioresource production through technology), circular economy (maximising resource use), and green economy (an economy minimising environmental impact). Various sectors are encouraged to adopt these models alongside ESG principles on a voluntary basis.

Tax Incentives for Investment in ESG Funds

In order to promote ESG investment in Thailand, tax incentives have been introduced for those who invest in ESG funds (Thai ESG Funds), including tax deductions of up to 30% of the investor's assessable income, with an investment amount not exceeding THB100,000, provided that the investors maintain the investments for at least eight years from the purchase date. This not only represents the significance of ESG alone but also highlights how ESG can serve as a powerful tool to boost the economy in Thailand.

Responsible Lending

After a public hearing in 2023, the BOT implemented responsible lending guidelines applicable to financial institutions, asset management companies, credit card operators, personal loan, or nano loan business operators under its supervision. The Bank of Thailand (BOT) notification aims to provide measures for responsible lending throughout the debt cycle, promote a culture of good credit and financial discipline, and address household debt issues.

1.2 Environment Trends

Developments in Thailand's Climate Change Bill and Clean Air Bill

The Department of Climate Change and Environment and the Ministry of National Resources and Environment have made progress with the draft Climate Change Act, following the conclusion of public hearings in 2024.

The bill represents a major step forward in Thailand's efforts to reduce GHG emissions in line with global targets. In addition to establishing a legal framework to address GHG emissions, it also introduces the integration of a taxonomy and financial-related instruments such as the Emissions Trading System (ETS), carbon credits, and a carbon tax aimed at encouraging private sector participation in GHG-reduction efforts.

Moreover, in 2023, the Thai cabinet approved the draft Clean Air Act as part of a broader effort to reduce pollution systematically. This bill marks a significant milestone in Thailand's environmental and public health policies, with a focus on recognising the right to clean air as a fundamental right. It emphasises public participation, stringent control mechanisms and the use of economic instruments and measures.

1.3 Social Trends

Thailand has made significant progress over the past year in areas such as labour rights, human rights, and corporate social responsibility. One of the most important regulatory changes was the amendment of labour laws aimed at improving workers' rights and conditions, particularly for migrant workers who form a substantial part of the labour force. These amendments introduced stronger protections against unfair dismissal and enhanced workplace safety standards. Additionally, Thailand has pushed forward its National Action Plan on Business and Human

Rights (NAP), encouraging companies to implement human rights due diligence, especially in industries like agriculture and manufacturing, where social impacts are significant.

In terms of case law, human rights cases have continued to highlight the need for stronger social governance. For instance, in the garment industry, a court ruling required companies to compensate workers who were laid off without proper severance during the pandemic, reinforcing the importance of labour rights even in times of economic hardship. These legal and regulatory developments reflect Thailand's increasing focus on social governance, with companies being held more accountable for their social impact and encouraged to integrate social considerations into their operations to meet both national and international expectations.

1.4 Governance Trends

The Securities Exchange Commission (SEC) has continued to promote stricter adherence to the Corporate Governance Code (CG Code), which emphasises transparency, ethical behaviour, and accountability to build long-term stakeholders' trust. The enforcement of the Personal Data Protection Act (PDPA) has also marked a key shift in governance, placing greater responsibility on businesses to manage personal data securely and aligning with global data protection standards.

Moreover, the SET is set to enhance its oversight of listed companies through a comprehensive process initiated on 25 March 2024. This includes stricter listing qualifications by increasing profit and shareholder equity requirements, to strengthen financial status and performance. Investor warnings will be enhanced with new criteria for financial risks, auditor's refusal to express an opinion, and non-compliance with specified standards, replacing the current C (Caution) sign. Furthermore, delisting criteria will be tightened for companies lacking continuous business or failing to rectify free float issues. Additionally, the standards for backdoor listings and resuming trading will be made to be in line with the standards for new listings. These measures, developed in collaboration with the SEC, aim to improve the quality of listed companies, ensure comprehensive information disclosure, and maintain the market's confidence and stability.

1.5 Government and Supervision

The ESG framework in Thailand is dispersed across a combination of various laws and regulations, with relevant regulatory bodies showing increasing commitment to the integration of ESG. Relevant regulatory bodies include the following.

- The BOT – responsible for monetary policy, financial stability, and overseeing and regulating the country's banking system and financial institutions, the BOT plays a vital role in promoting sustainable finance. For instance, it develops the Thailand Taxonomy in collaboration with a working group, including the SEC.
- SEC – responsible for overseeing and regulating the capital markets, enforcing securities laws, and regulating securities trading and financial products in the capital markets, the SEC also oversees the disclosure of information by listed companies, ESG ratings, and sustainable financial products in the capital market, etc.
- SET – the centre for trading listed securities and being responsible for providing systems necessary for securities trading and conducting any businesses relating to securities trading, such as clearing house, securities

depository, securities registrar, and similar activities.

Apart from the above, there is also a sector or industry-specific regulator who normally oversees the usual operation of the businesses in that industry, such as the Energy Regulatory Commission (ERC), who is responsible for overseeing and regulating the energy sector in Thailand, including electricity, natural gas, and other energy sources. Its primary functions involve overseeing energy tariffs, ensuring fair competition, and promoting efficient and sustainable energy use within the country.

Each of these bodies monitors the laws and regulations implemented in other countries as well as market trends, adopting best practices through mandatory measures and voluntary guidelines.

1.6 Market Participants

ESG laws and regulations will affect business sectors in general but are likely to have the greatest impact on the industrial, transportation, and oil and gas sectors, due to their significant contributions to carbon emissions. Companies in these sectors may need to adopt cleaner technologies, improve transparency, and implement more sustainable practices in order to align with ESG principles.

Financial institutions are also keen to engage in ESG-related transactions, and companies from various sectors are increasingly promoting ESG to foster more sustainable business practices.

1.7 Geopolitical Developments

Although ESG initiatives are being shaped by state policies, regulations, and private sector efforts, they may encounter further adjustments due to prevailing political instability. For instance, regarding the new environment law currently in the drafting process, the incoming government may take economic factors into account and determine which sectors will be subject to such law, as well as the extent to which the law will be enforced.

2. Corporate Governance

2.1 Developments in Corporate Governance

SET ESG Ratings

The SET has renamed the list of sustainable securities of listed companies from THSI (Thailand Sustainability Investment) to SET ESG Ratings. Listed companies can voluntarily participate and obtain the SET ESG Ratings if they pass at least 50% of each test on ESG aspects, including corporate governance reporting (CGR).

To promote ESG practices, the SET has introduced the SETESG Index, allowing investors to compare the ESG ratings of listed companies and make more informed investment decisions. Note that from 2026, the SET may replace SET ESG Ratings with FTSE Russel ESG Scores in order to enhance transparency and align with global benchmarks and standards.

Enhanced Standards for Listing

As mentioned above, the SET is raising the standards for overseeing listed companies, focusing on strengthening financial health and transparency. New rules will impose stricter listing criteria (such as increasing the proportion of profit and shareholders' equity), enhance information disclosure to investors, and include warnings for companies facing financial risks, in order to ensure greater market stability and investor confidence.

2.2 Differences Between Listed and Unlisted Entities

While unlisted companies, including limited liability companies and public limited companies, are generally required to prepare mandatory reports; eg, financial statements or annual reports (as applicable), listed companies are required to report annually in Form 56-1 (One Report). Pursuant to the SEC's Form 56-1 reporting guide, environmental aspects are on a "comply-or-explain" basis. If a listed company does not disclose their GHG emissions, the company must provide a rationale for not making this disclosure. On a further note, the SEC and the Thailand Greenhouse Gas Management Organisation (TGO) have published a guideline for reporting GHG emissions including the companies' policies to reduce the negative impacts of GHG emissions with quantitative goals, measures and strategy.

2.3 Role of Directors and Officers

Directors of companies are required to comply with their fiduciary duties and conduct their roles and responsibilities as directors in accordance with the Civil and Commercial and the Public Limited Company Act, B.E. 2535 (1992), as applicable. These laws set forth the roles, duties, and responsibilities of directors in general and do not specifically address ESG requirements.

The BOT regulations govern the roles and responsibilities of directors and the management of financial institutions. At a higher standard, directors and the management of financial institutions must set the direction for sustainable banking, integrate ESG factors into their decision-making processes and risk management practices, and ensure transparent sustainability disclosures in accordance with acceptable or international standards.

For other entities committed to ESG obligations, directors and the management should also observe and ensure compliance with ESG obligations. For instance, companies may be required to comply with ESG requirements set out under the green loan or bond principles, or under relevant agreements.

2.4 Social Enterprises

Non-profit entities can be formed as foundations or associations. Social enterprises can be registered in accordance with the Social Enterprises Promotion Act B.E. 2562 (2019). The social enterprises must have objectives that include, among others, promoting the employment of the deserved targets and addressing community, environmental or social issues, noting that they must use at least 70% of their profit for such objectives.

2.5 Shareholders

Under Thai law, directors are empowered to manage the business operations of a company under the control of the general meeting of shareholders. Although shareholders can influence or control the company's direction at a higher level or during certain instances, this does not ensure that the company will conduct its operations in a sustainable manner. Should companies voluntarily adopt ESG standards or comply with ESG-related laws and regulations, shareholders can be more confident in the company's commitment to sustainable practices, which can mitigate operational risks. Companies that adhere to ESG obligations may become more attractive to investors, as they demonstrate a proactive approach to sustainability and risk management.

3. Sustainable Finance

3.1 Progress in Green Financing

The BOT, as a key financial regulatory body, has set a strategic direction for the financial sector's sustainable development in Thailand.

The BOT has established standards for the business operations of financial institutions (eg, standards for lending practices, management and corporate governance, and disclosure) to ensure financial stability, enhance transparency, and promote responsible management within the sector. As the BOT also promotes the transition toward financial sustainability, it has introduced developments to the regulations and guidelines. Earlier in 2023, the BOT published guidelines on financial business operations considering environmental and climate change aspects. The guidelines seek co-operation from financial institutions to implement sustainable governance, strategy, risk management, and disclosure, taking into account the environmental and climate change factors. For instance, financial institutions should target sustainable financing based on science-based criteria and may involve experts in evaluating financial products to prevent greenwashing. The BOT has begun to monitor the implementation of these guidelines from 2024 onwards.

The BOT has also implemented responsible lending guidelines, which are supplementary to the market conduct criteria, aiming to address household credit issues, encourage a good credit culture, and foster financial discipline.

3.2 Sustainable Finance Framework

When raising or providing sustainable finance, corporate entities such as lenders or borrowers are expected to comply with laws and regulations with respect to each ESG pillar as a basic requirement. Compliance with applicable laws and regulations is a common condition and obligation under finance documents. The fundamental laws include, among many others, the Constitution of Thailand, the Civil and Commercial Code, the Enhancement and Conservation of the National Environmental Quality Act, the Factory Act, the Hazardous Substance Act, the Occupational Safety, Health, and Environment Act, the Public Health Act, the Labor Protection Act, the Public Limited Company Act, and the Act Supplementing the Constitution Relating to the Prevention and Suppression of Corruption.,

In addition to fundamental requirements under laws, lenders may impose stricter requirements and standards for a borrower to comply with such as equator principles (EP), global reporting initiative (GRI), and the United Nation's sustainable development goals (SDG), etc.

3.3 Access to Green Financing

Initiatives by the BOT, the SEC, and the SET to promote green financing have been steps toward sustainability. Many Thai banks and financial institutions are increasingly interested in engaging in sustainable financial products, such as green loans or bonds, sustainability-linked loans or bonds, and ESG-focused investment options. Investors and companies are also seeking to align with ESG principles.

In order to access sustainable finance, companies are required to meet the relevant standards and regulations; eg, green loan or bonds principles, the SEC's criteria for sustainable bonds or sustainability-linked bonds. Smaller corporate entities may find it more challenging to meet the ESG criteria or access sustainable financial products due to limited expertise or resources.

3.4 Stranded Assets and Non-bankables

While the Thai financial sector is promoting the transition towards sustainable financing, financing or investment in the assets which are less compatible with sustainability goals has not been entirely discontinued. However, financial products or projects with stronger sustainability credentials may be offered with more favourable commercial terms (eg, more favourable interest rates) compared to those with lower alignment, due to market trends and lower associated risks.

It may be worth noting that, pursuant to Thailand's power development plan (PDP), the state aims to promote renewable energy. However, the country still relies on energy sources that are less compatible with sustainability goals, such as natural gas, albeit in reduced quantities. As these fossil fuels are not entirely phased out, projects related to these fossil fuels may continue to generate revenue and maintain their bankability.

3.5 Challenges Ahead

Recently, there has been an increasing interest in sustainable finance products such as green bonds, green loans, and sustainability-linked loans, particularly those with an aim to fund projects that support sustainable development. These financial instruments often come with stringent requirements, including the need to produce detailed reports, action plans, monitoring systems, and maintenance of ESG scores or ratings. These obligations necessitate significant efforts and costs, which typically only large corporations can afford. Smaller enterprises often lack the resources to meet these rigorous standards, limiting their access to sustainable finance products.

As ongoing obligations as required by financiers, companies are subject to continuous monitoring of their financial and operational performance. This scrutiny ensures that they adhere to the set ESG criteria, but it also introduces the risk of greenwashing – where companies falsely claim that their environmental and social compliance are all in order and falsely state that sustainability performance appears to be better than what it actually is. This deceptive practice can undermine the credibility of sustainable finance and erode investor trust.

Against this backdrop, the SET, which oversees the trading of investments in the secondary market in Thailand, has publicised and raised awareness of greenwashing practices, especially when carried out by large companies that usually claim better performance in dealing with ESG practices. The SET has also warned the corporations to be mindful about the accuracy and transparency of the information reported by their businesses, which must be verifiable. It is the businesses' obligation to balance the level of the disclosure to provide the clear, consistent and comprehensive disclosures, with not overclaiming or exaggerating the disclosed information. Meanwhile, investors must remain vigilant against greenwashing, being able to conduct thorough due diligence. They should be able to critically assess the authenticity of ESG claims and ensure that the companies they invest in are genuinely committed to sustainable practices.

4. ESG Due Diligence

4.1 Soft Law Becoming Hard Law

Currently, several papers and guidelines issued by regulators and officials serve as a guide for business operators to implement ESG practices, such as ESG disclosure and reporting, operational action plans, the maintenance of good governance, etc. While these guidelines are to be implemented by businesses on a voluntary basis, regulators and governments strongly encourage their adoption. Companies with international headquarters or partnerships are often mandated to comply with certain standards, reflecting the global shift towards more stringent ESG requirements. Even in the absence of formal sanctions, market pressure and investor expectations are compelling companies to become more proactive and involved in their practices. This evolving landscape suggests that what is now considered soft law in the realm of ESG is gradually hardening, as voluntary guidelines increasingly influence mandatory regulations and corporate behaviour.

4.2 Towards Vertical Responsibilities

Setting ESG goals is not just the agenda of one organisation alone; it involves all stakeholders, business partners, and contracting parties throughout the value chain. It is essential to maintain a consistent approach and align standards for ESG compliance from the starting point of the raw materials of products to the last where products are completed, ready to be delivered. Conducting due diligence is one method for businesses to ensure their partners meet the same ESG standards and to identify any gaps or inconsistencies. To avoid unintentional non-compliance, global companies increasingly require due diligence before any official engagement with partners, particularly those in local jurisdictions. Domestically, companies especially in the agribusiness, often provide support to involved parties throughout the value chain, such as farmers, local communities, etc, to ensure sustainable responsibility is duly observed from upstream to downstream operations. This comprehensive approach helps ensure that all parties are committed to sustainable and responsible business practices.

4.3 Partner Selection

Conducting a thorough study of potential business partners provides greater clarity on their ESG policies and identifies any gaps compared to standard requirements. This ESG due diligence process allows companies to assess whether potential partners align with their own ESG goals. Identifying these gaps early on helps companies understand what additional measures or improvements are needed to bring potential partners up to the desired ESG standards.

Selecting the right partner through ESG due diligence assessment not only enhances a company's image but also significantly increases the likelihood of achieving its ESG goals. A partner that aligns well with a company's ESG objectives can contribute positively to the overall sustainability and ethical practices of the supply chain. This alignment fosters a collaborative environment where both parties work towards common goals, such as reducing environmental impact, improving labour conditions, and ensuring good governance. Moreover, it mitigates risks associated with non-compliance and potential reputational damage, thereby creating a more resilient and sustainable business collaboration and partnership.

4.4 ESG in M&A Due Diligence

Considering how ESG plays a pivotal role in business operations and serves as a link for the benefit of all relevant stakeholders including shareholders, directors, business partners, customers, and employees, ESG due diligence is extremely crucial in M&A transactions.

First, ESG due diligence has become increasingly prominent, especially for foreign investors, as it helps identify potential risks in the target business. These risks range from environmental concerns such as oil and gas or energy industries, social and human rights issues such as industrial or construction industries which rely heavily on labour and governance issues particularly for those financial institutions, insurance companies, and public companies which often face stringent governance and transparency requirements.

Once risks are identified, the due diligence exercise will include imposing appropriate mitigation measures for those risks. This could involve implementing stricter environmental controls, enhancing labour practices, or improving governance structures. For example, companies might adopt international standards or comply with specific jurisdictional requirements to address identified gaps as required or preferred by investors.

The result of ESG due diligence is a critical component in the decision-making process and value assessment of the transaction. A thorough ESG evaluation ensures that investors are informed of the risks for making decisions and that the target company is not only compliant with current regulations but also well-positioned for long-term sustainability. This is increasingly important to investors who would like to have a sustainable and responsible business. Companies that are well-equipped with ESG practices are often seen as more resilient, making them financially desirable in the long run.

5. Transparency and Reporting

5.1 Key Requirements

Based on the type of company, listed companies are required to submit an annual report (Form 56-1 (One Report)). However, environmental aspects are reported on a "comply-or-explain" basis. If a listed company does not disclose its GHG emissions, the company must provide a rationale for not making this disclosure.

5.2 Transition Plans and ESG Targets

Companies are generally not mandated to publish transition plans. However, in the case of financial institutions, the top-level strategy should incorporate transition plans towards sustainable banking. This reflects the growing expectation for financial institutions to lead by example in adopting sustainable practices. Currently, companies are not penalised for failing to meet their ESG targets, as compliance remains largely voluntary. However, as regulatory frameworks evolve and investor pressure increases, there may be greater accountability in the future for not achieving the stated ESG targets, including legal consequences, reputational damage or financial repercussions tied to investor confidence and market trends.

ESG targets may vary among companies in different industries. For instance, an energy company, which has achieved AA rating from the SET ESG Ratings, has set its ESG target to reduce carbon intensity by 25% by 2030 and to increase the proportion of renewable energy in its portfolio to at least 40% by 2035. A major financial institution has also set its net zero goal for its headquarter office within 2030.

5.3 Regulation of ESG Labels

Currently, Thai laws do not specifically impose restrictions or conditions on sustainability claims or ESG labels made by companies in general.

On an activity basis, in the case that the companies engage in sustainability-linked bond transactions as issuers, the bonds should comply with the disclosure requirements set by the SEC. For example, issuers should disclose their compliance with international standards, such as ASEAN SLBS and ICMA SLBP. Also, the framework for bond issuance should be based on scientific indicators and benchmarks, and reviewed by an external reviewer.

Moreover, companies listed on the SET are required to disclose ESG-related information in line with the Sustainability Reporting Guidelines. ESG claims must be accurate and align with the disclosed information.

5.4 Supervision

As the ESG legal framework remains largely dispersed across the laws and regulations of the region, different regulatory bodies monitor ESG disclosure and compliance or ESG marketing claims; eg, the BOT, the SEC, the SET, and the Office of Insurance Commission.

Although the carbon credit market in Thailand is a voluntary market, the TGO, a public organisation under the Ministry of Natural Resources and Environment, is established to manage the voluntary carbon market, and oversee the issuance and trading of carbon credits. Additionally, the TGO provides technical support and capacity building to various sectors, helping them align with low-carbon practices and national climate targets, including Thailand's Nationally Determined Contributions (NDCs) under the Paris Agreement.

5.5 Enforcement

As discussed in **5.1 Key Requirements**, the disclosure of ESG is not mandatory for companies in general. Therefore, there is no penalty under general laws for non-disclosure. However, as a general principle, if a company deceives a person with the assertion of a falsehood or the concealment of facts in order to obtain any benefit/property from such person, the company may be considered to have committed fraud under the criminal law and the damaged parties may be entitled to claim for any damages.

If companies engage in specific ESG-related activities, such as issuing sustainability-linked bonds, the Securities Act, B.E. 2535 (1992) (as amended) imposes fines and/or imprisonment for any person who makes a false statement or conceals the facts which should have been disclosed in the registration statement, filed prospectus, or the periodic/annual report. This does not limit the investors' rights to file for any damages from the issuers with respect to such false statements.

5.6 Expected Progress

In the coming years, companies will make significant strides in meeting their reporting obligations, particularly with the implementation of the 56-1 One Report, which aims to streamline and standardise corporate disclosures. However, they will face several challenges in this effort.

One major challenge is the complexity and variety of ESG reporting standards. Navigating these diverse frameworks to select the most relevant ones for their operations can be difficult. Additionally, the cost implications of developing and maintaining robust ESG reporting systems can be substantial, posing a particular challenge for smaller companies with limited financial resources.

The dynamic nature of the regulatory environment further complicates matters, as companies must continuously adapt to new and evolving regulations. Moreover, there is a risk of greenwashing, where companies might make misleading claims about their environmental practices in an attempt to meet reporting obligations quickly. This not only undermines the credibility of their reports but also exposes them to reputational damage and potential legal consequences. Despite these challenges, companies that successfully navigate these obstacles will be better positioned to demonstrate their commitment to sustainability and corporate responsibility.

6. Climate and ESG Litigation

6.1 Instruments for ESG Litigation

Currently, Thailand does not have a specific framework for ESG-related litigation. State authorities or any persons bringing litigation in court must rely on existing laws which serve as the basis for such claims; eg, criminal law, tort law, employment law, or environmental law. There may be cases related to each pillar of ESG; however, the authors are not aware of any cases brought based on ESG as a consolidated approach. The complexity of each case depends on the basis of the claim, the evidence provided, and the facts involved.

In Thailand, class action lawsuits are allowed in cases where multiple persons are affected by the same causes or the same grounds for damage. Lawsuits typically involve tort, breaches of contract, and claims of legal rights, such as under environmental law, consumer protection law, securities and exchange law, and trade competition law. For instance, investors can file a class action lawsuit against a securities issuer if the issuer submits a prospectus containing false statements or provides misleading information in financial statements which deceive investors.

Note that a company may be delisted from the SET ESG Ratings due to allegations of misgovernance by state authorities.

6.2 Climate Activism

NGOs and activists play a significant role in environmental and climate-related matters in Thailand, and they are important stakeholders to consider. Groups like Greenpeace Southeast Asia are highly active in campaigns promoting renewable energy and opposing pollution, influencing both public opinion and policy discussions. Another key organisation is the Wildlife Friends Foundation Thailand (WFFT), which focuses on wildlife conservation and habitat protection, addressing environmental concerns through rescue operations and advocacy.

Beyond environmental issues, organisations like Thai Lawyers for Human Rights (TLHR) and EarthRights International work at the intersection of political and environmental activism. TLHR provides legal support to those affected by political oppression, including environmental activists. EarthRights International, on the other hand, combines legal action for environmental protection with human rights advocacy, often representing communities impacted by large corporate projects that harm ecosystems.

These groups exert pressure on government bodies and private entities to adopt more sustainable and environmentally conscious practices. The work of such NGOs and activists contributes to broader governance and policy reforms.

6.3 Greenwashing v Greenbleaching

In Thailand, the issue of greenwashing – where companies make misleading claims about their environmental practices – has garnered increasing attention from both regulatory authorities and investors. While specific legal claims or lawsuits due to incorrect, incomplete, or misleading ESG claims are not extensively documented, the BOT and SEC have been proactive in addressing greenwashing through the development of the Thailand Taxonomy. Released in June 2023, this taxonomy is designed to provide a clear framework for sustainable finance, drawing from established guidelines such as the EU Taxonomy, ASEAN Taxonomy, and the Climate Bond Initiative. The primary goal is to align Thailand's financial sector with its national strategy to achieve net-zero carbon emissions by 2050, initially focusing on high-impact sectors like energy and transportation.

The guidelines for applying ESG criteria involve an initial assessment of the intensity of ESG use by product issuers who are partners. This is done through questionnaires, reviewing the full prospectus, and interviewing about the use of ESG in the investment process to evaluate the overall ESG score of the product. This score helps decide whether the product will be selected for investors.

6.4 A Turbulent Future Ahead

A rise in ESG-related legal proceedings can be anticipated due to several factors, including progressive legal developments, proactive enforcement, and globalised trends.

Progressive Legal Developments

New regulatory frameworks particularly on environmental matters such as the Clean Air Bill and Climate Change Bill are set to impose mandatory obligations on business operators. Companies will be required to limit their emissions and pollution levels and provide detailed information on these emissions to government to be stored in the database. These regulations will establish a legal basis for companies to hold accountable for their environmental impact, leading to more active cases as businesses strive to comply with stricter standards.

Proactive Enforcement

Regulators are taking a more proactive role in enforcing legal violation, particularly against those which are listed companies that affect the interests of the wider public. This heightened scrutiny means that non-compliance will be more readily identified and acted upon, resulting in an increase in legal proceedings. Regulatory bodies may make an accusation, impose penalties and implement sanctions on companies that fail to comply with regulatory requirements which, in turn, drives the need for businesses to strictly adhere to these regulations.

Global Trends and Stakeholder Activism

Global trends are also influencing the local landscape, as stakeholders including investors, consumers, and NGOs have become more vigilant and attentive to ESG issues. This increasing awareness is encouraging activism, where stakeholders are more willing to pursue lawsuits against the companies that commit malpractices or violate laws. The global push for sustainability and ethical business practices is resonating in Thailand, leading to a more robust approach to ESG compliance and enforcement.

As these factors converge, one can expect to see more litigation proceedings related to ESG issues. Companies will face lawsuits not only from regulatory bodies but also from affected stakeholders. This potential increased legal activity will compel businesses to adopt more rigorous ESG practices to mitigate risks and avoid potential legal challenges.

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