September 2024

Developments in ESG governance, disclosure, financial regulation and litigation

ESG Matters

Connecting today, shaping tomorrow

In this edition of ESG Matters, we share our views on how M&A transactions may impact the CSRD reporting process. Why should M&A and CSRD reporting teams seek alignment early in the deal-making process? Our Spotlight section updates you on the latest developments in ESG governance, disclosure, financial regulation and litigation.

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1 Highlight – M&A interactions with CSRD reporting

CSRD reporting has quickly become an important element of transparency requirements across the EU. Currently, only the largest listed companies are covered, but more companies will be phased in over the coming years. In our M&A practice, we have observed increased attention for this topic as well. Important questions that arise include how CSRD reporting from the buyer and target company should be combined after the closing of a transaction. For example, CSRD will require companies to assess whether an acquisition or divestment needs to be reflected in their sustainability statement and how this should be done.

This is obviously not a straightforward exercise. Both companies, or groups of companies, will have performed their own Double Materiality Assessment (DMA) and formulated their own KPIs regarding their ESG goals and material topics. While the CSRD framework contains some guidance, the European Sustainability Reporting Standards (ESRS) do not contain a specific disclosure requirement to this effect.

However, several disclosure requirements require considering whether acquisitions or divestments lead to positive or downward adjustments to targets and key performance indicators disclosed in the sustainability statement.

Does every transaction need to be included in the buyer's CSRD report?

Transactions need to be included if they result in material facts and circumstances that affect existing impacts, risks, or opportunities identified during the DMA of the buyer. These changes may ultimately lead to adjustment of specific disclosure requirements or datapoints.

Examples of changed material facts and circumstances arising from M&A are:

- A major transaction leading to a new activity
- Entering a new sector, such as renewable energy
- A significant change in operations, like shifting to fleet electrification or reducing fossil fuel usage
- Divestment of high-intensity emission activities with the potential to shorten pathways towards net zero

Transactions that over time as part of the implementation phase lead to changes in key suppliers and business relationships due to envisaged synergies may also lead to modification of existing impacts, risk and opportunities previously identified by the company. These long-term effects of an M&A transaction are particularly relevant for a CSRD reporting team. Being aware of them enables timely consideration of potential effects for any reporting methodology or metrics applied.

How can the target's CSRD report be used by the buyer?

From a business opportunity perspective, the CSRD reporting team is well-positioned to inform the M&A team about which types of transactions could positively or negatively affect the overall sustainability profile as reflected in the sustainability statement. This includes targets set to reach net zero by 2050. A substantive single acquisition or merger may have such an effect. A series of smaller acquisitions of companies active in more polluting sectors or sectors where resources are becoming scarce might also necessitate adjustments to a previously communicated target in a sustainability statement.

Timing of the transaction and impact on the upcoming report

There are other aspects to consider from a CSRD reporting perspective during the course of a deal. The timing of transactions during a reporting year determines whether to include the effects into the report or not. For example, Dutch implementing legislation allows companies to refrain from including changing material facts in exceptional cases. This applies when disclosing information about an ongoing negotiation could likely endanger the company' commercial position.

Buying a target with totally different DMA/ KPI – How to integrate?

When a target becomes part of the buyer's consolidation group, it must be included in the buyer's CSRD report. This means that all activities and related impacts, risks and opportunities must be included in the buyer's DMA, regardless of whether they are 'greener' or 'less green'. To understand the impact on the CSRD report post-closing, two assessments need to be made. The first is an early stage assessment

whether the different DMA and for example the use of less ambitious KPI's may impact the initial materiality assessment of the buyer. Consequently, these differing targets, KPIs and ambitions will need to be included in subsequent CSRD reports. You also must assess any post-closing actions required to step-up the target's ambitions. This may ultimately necessitate considering an additional investment when pricing the transaction.

Buying a (green) company - how to integrate the target's CSRD-business conduct?

Acquiring a company with a green profile can positively impact the outcome of the DMA and help the buyer meet its targets more quickly. In practice, targets with a green profile and readily available materiality assessment information are becoming more attractive because they can boost a consolidating buyer's overall ability to achieve its ESG goals. It is important to note that companies should not only focus on one single 'green' topic but also consider how other elements, such as corporate culture and business conduct policies, can be integrated.

Divesting (non-green) assets - impact for CSRD report

A positive ESG impact can also be achieved through active divesture of polluting assets or divesture of assets in countries with higher ESG-related risk. This may be the case if the divestment is of such significance that adjustment of the outcome of the DMA becomes merited. Another consideration should be how a divestment will be perceived from a reputational perspective and whether it fits into a well-defined corporate ESG strategy, or whether it may be perceived by stakeholders as a reactive step in an undefined ESG strategy. Having said that, a careful assessment of the impact of a divestment on KPIs, targets and priorities - and therefore on CSRD reporting - can prove very valuable.

What it means for you:

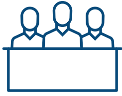
- **Early-stage M&A** - Identify early in the M&A process whether ESG is a driver of the transaction. If so, it is paramount to liaise with the CSRD reporting team and experts to evaluate potential impacts on CSRD reporting and how (timing of) the transaction may impact the ongoing reporting cycle in preparation for an upcoming CSRD report.
- **Due diligence** - Focus during the due diligence process on identifying gaps between the target's sustainability approach - policies in place, targets set and KPI's - and the buyer's approach to determine necessary post-closing actions.
- **Throughout the M&A process** - Consistently engage with the CSRD reporting team throughout acquisitions or divestments while considering any related reputational risks – particularly when dealing with high-polluting asset divestments.

Contact our expert

Suzanne Kröner - Rosmalen | counsel
Corporate Governance
+31 6 29 63 70 19
suzanne.kroner@nautadutilh.com

Michelle Meevis | associate
Corporate M&A
+31 6 29 63 70 85
michelle.meevis@nautadutilh.com

2 Spotlight on ESG developments



Governance & transition

ESMA Report on trends, risks and vulnerabilities, including transition and other ESG funds

On 29 August, ESMA released its biannual report on market risks for 2024. In addition to a discussion of key risk drivers and the market in general, the report also specifically discusses transition funds. According to the report, these funds have doubled the attracted cumulative inflows over the last two years compared to funds investing in already green companies. Market data from the regulator reveal that there are currently 136 EU funds referencing 'transition' in their names, with cumulative assets valued at EUR 39 billion as of June 2024. Nevertheless, the market for transition funds is still significantly smaller than that for other environment-themed funds which comprise a total of 872 funds with managing assets worth EUR 260 billion.

SBTi publishes report on more effective approach for scope 3 emissions

On 30 July, the Science Based Target initiative (SBTi) published research on considerations for a more effective approach to scope 3 greenhouse gas emissions. This is an early step in the review of the Corporate Net-Zero Standard and the guidance remains unchanged until the process is complete.

CSDDD enters into force

On 25 July, the Corporate Sustainability Due Diligence Directive (CSDDD) came into force. Member states now have a two-year period to transpose the directive into national law. Our latest update on the CSDDD offers detailed information, including application timelines.

EC publishes FAQs on CSDDD

On 25 July, the European Commission (EC) released an initial set of frequently asked questions (FAQs) on the CSDDD. The FAQs offer a high-level overview on the directive's objectives, its entry into force, its interaction with other European sustainability initiatives as well as its scope, obligations, enforcement, and anticipated impact. Regarding financial institutions, the EC confirms that they fall under the personal scope of the CSDDD and must adopt a climate transition plan, while "financial services provided in the context of relationships with clients" are excluded from the material scope of due diligence obligations.

EC publishes report on monitoring climate-related risks to financial stability

On 1 July, the EC published a report on the risks posed by climate change to financial stability in the EU. The findings indicate that such risks could result in losses for both financial and non-financial companies. As the EU continues its efforts to mitigate these risks, individuals and businesses can expect changes in how financial institutions operate and invest. Such changes may encompass enhanced transparency and disclosure regarding climate-related risks and opportunities, along with new investment products and services designed to foster sustainable growth.

Disclosure

ACM: "Banks are allowed to collaborate with regard to sustainability reports"

On 15 August, the Authority for Consumers & Markets (ACM) issued an informal letter permitting Dutch banks to collaborate on their sustainability reports in response to a request of the Dutch Banking Association (NVB). The ACM does not foresee the collaboration having any negative consequences such as price increases or quality reductions. Simultaneously, the NVB announced an initiative where banks will work together on a data project aimed at clarifying certain sustainability criteria on which banks must report. In this context, they assess what data is needed and identify suitable and reliable calculation methods. The collaboration is currently a pilot project, focusing on the transport, agricultural, and real estate sectors.

EC publishes CSRD FAQs

On 7 August, the EC published frequently asked questions (FAQs) to provide additional clarity on the EU sustainability report rules (CSRD) and issued several clarifications concerning the interpretation of certain provisions of the first set of European Sustainability Reporting Standards (ESRS). The FAQs address also key topics such as the scope of the rules, how to determine company sizes, timelines for compliance and applicable exemptions. The EC also clarifies which sets of ESRS should be used while offering guidance about employing estimates when companies cannot obtain value chain data. Furthermore, it outlines sustainability information requests that SMEs should anticipate due to the CSRD. The FAQs also cover audit and assurance-related issues, including auditor approval and training requirements and accreditation requirements for independent assurance providers.

EFRAG publishes study on early implementation of ESRS

On 25 July, the European Financial Reporting Advisory Group (EFRAG) published a study outlining some of the practices and challenges observed in the early stages of ESRS implementation by 28 large EU undertakings. The study covers double materiality assessment (DMA), data points (DP), value chain (VC) and organisational approaches to ESG reporting. Most undertakings recognise the value of a thorough, objective, evidence-based DMA as a strategic exercise. Their approaches range from a more data-driven approach to a more judgment-based approach. Many companies have not yet integrated the DMA outcomes into their gap analysis of DPs to be reported and most of them use Implementation Guidance 3 (EFRAG IG 3) to perform a gap analysis. For VC, several companies have adopted a simplified aggregated value chain mapping and use transitional provisions. The companies agree that CSRD reporting has increased cross-departmental collaboration, highlighted the need to standardise ESG reporting processes, and required some additional skills and resources.

NGFS publishes information note on improving GHG emissions data

On 16 July, the Network for Greening the Financial System (NGFS) published an information note on improving greenhouse gas (GHG) emissions data, with the objective to raise awareness among central banks and supervisory authorities of the challenges associated with the compilation and use of GHG emissions data. The note highlights several issues that should be addressed to improve GHG emissions data, and thereby reduce the climate data gap for different use cases in the financial system. Collaboration, standardisation, the use of new technologies, and the improvement of transparent and comparable disclosure are identified by the NGFS as critical success factors.

GRI publishes Q&A on ESRS and GRI interoperability

On 10 July, the Global Reporting Institute (GRI) released a Q&A on the meaning of the ESRS for organisations that already apply GRI Standards in their sustainability reporting. The document lists existing and new resources to support interoperability between the GRI Standards and the ESRS. Additionally, it specifies how GRI, ESRS and IFRS sustainability disclosure standards align with each other, highlighting their different approaches to materiality.

ESMA publishes measures to support corporate sustainability reporting

On 5 July, the European Securities and Markets Authority (ESMA) published a final report on the Guidelines on Enforcement of Sustainability Information (GLESI) and a public statement on the first application of the ESRS. The GLESI provide guidance on how to align supervisory practices on sustainability reporting. The public statement is intended to assist large issuers in navigating the learning curve associated with the implementation of these new reporting requirements. The documents are accompanied by an explanatory video and visuals.

AFM publishes 10 points to navigate through the CSRD's double materiality analysis

On 4 July, the AFM published a set of 10 waypoints to help companies prepare for the double materiality analysis under the CSRD. To gain insight into how listed companies are already disclosing on key themes in the double materiality analysis in their 2023 annual reports, the AFM conducted research into 29 companies. The waypoints published are based on this research and the ESRS. The AFM will start supervising the application of the CSRD from the 2024 annual reporting cycle, through regular desktop reviews and thematic research.

EFRAG issues new Q&A with explanations of the ESRS

On 26 June, EFRAG released an updated version of its Compilation of Explanations for January-July 2024, adding 23 new explanations and bringing the total number to 93. Noteworthy additions include explanations on: (i) the 'may' and 'shall' reporting requirements; (ii) the entity specific and ESRS 2 disclosure requirements; (iii) the use of appendices in the structure of the sustainability statement; (iv) the overlap between ESRS 2 and topical standards; and (v) GHG emissions and annual update and disaggregation of total emissions.

Financial institutions & regulation

AFM publishes guidance on additional mortgage credit aimed at specific sustainability measures

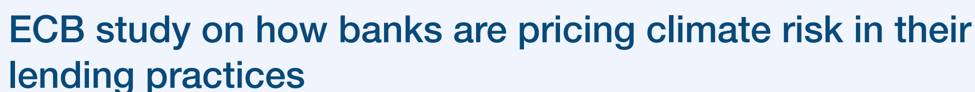
On 29 August, the Financial Markets Authority (AFM) issued guidance (in Dutch) on providing advice or customised services to obtain additional mortgage credit for specific sustainability measures. The AFM clarifies that comprehensive advice is not always necessary. Often, tailored services/advice will suffice. Advisers can use information collected during the initial mortgage application process. Additionally, the AFM provides guidelines on key topics advisers should address in the application process.

DNB publishes working paper on understanding financial risk repercussions of nature degradation

On 27 August, the Nederlandsche Bank (DNB) released a working paper presenting a new framework for integrating dependence on nature (ecosystem services) and the extent of nature degradation into credit risk loss estimations for banks. The framework advances the field of nature-related financial risks by proposing a capital-based sensitivity indicator to nature degradation, thereby moving from an 'exposure' to a 'financial risk' approach. The formulated ecosystem service degradation sensitivity indicator (EDSI) demonstrates how much a bank's available capital buffer - above its minimum requirements - is lost due to a nature shock. The findings suggest that incorporating nature degradation into financial risk estimates adds an important – and currently missing – layer of risk while providing further differentiation in capital impacts across banks and countries. While this paper uses hypothetical nature shocks to generate current comparative sensitivity indicators, once calibrated for different ecosystem services, the framework can be used to stress-test various aspects of financial institutions' solvency position.

ESMA publishes translations of its Guidelines on funds' names

On 21 August, the European Securities and Markets Authority (ESMA) released translations of its Guidelines on funds' names using ESG or sustainability-related terms in all official EU languages. The guidelines will come into effect three months after publication, i.e., on 21 November 2024. Funds existing before the application date will have a transitional period of six months following that date, i.e., until 21 May 2025. New funds established on or after the application date must comply with the guidelines immediately.



ECB study on how banks are pricing climate risk in their lending practices

On 6 August, the European Central Bank (ECB) published a working paper combining euro-area credit register data with carbon emission information to explore the intersection of finance and climate change. The study reveals that banks are factoring climate risk into their lending decisions. Firms with higher carbon emissions face higher interest rates, while those committed to reducing emissions benefit from lower rates. In line with the risk-taking channel of monetary policy, tighter policies prompt banks to raise both credit risk premia and carbon emission premia, while reducing loans more significantly for high- emission firms compared to low-emission ones. While restrictive monetary policies raise borrowing costs and curtail lending across all firms, their contractionary impact is less severe on companies with low emissions or those committed to decarbonisation.

ESAs publish updated version of SFDR Q&As

On 25 July, the European Supervisory Authorities (ESAs) published an updated version of the consolidated Q&As on the Sustainable Finance Disclosure Regulation (SFDR) and the accompanying Commission Delegated Regulation. Notable clarifications include: (i) the calculation of principal adverse impact indicators should be conducted on a pass/fail basis; (ii) the methodology for calculating and disclosing what proportion of sustainable investment qualifies as environmentally sustainable; and (iii) when making a sustainable investment in another financial product, financial market participants must examine underlying investments.

ESMA publishes opinion on Sustainable Finance Framework

On 24 July, ESMA published an opinion outlining a holistic long term vision for securities market regulators that considers both the overall architecture of the Sustainable Finance Framework and its various interlinkages. ESMA believes that this framework has the potential to evolve, facilitating investor access to sustainable investments and supporting effective functioning of the sustainable investment value chain. In this context, ESMA offers several key recommendations to the European Commission. These encompass recommendations on consumer and industry testing, the EU Taxonomy as a central element of the framework, effective transition support, adapting transparency requirements, implementing a product categorisation system, ESG data quality and the conduct of actors in the sustainable investment value chain.

UNEP FI provides guidance to help banks operationalise links between a circular economy and sustainability impact

On 18 July, the UN Environment Programme Finance Initiative (UNEP FI) published two reports: Leveraging the Nexus between Circularity and Sustainability Impact and Circular Solutions to Achieve Climate Targets. The first report outlines how the circular economy can enable responsible banking practices by connecting circularity with environmental and social impact considerations. The second report looks at circular solutions for achieving climate targets, offering banks practical insights into integrating circularity in their climate transition plans. This includes increasing financing for such solutions, as well as advocating for and partnering with policymakers to enhance circularity. Two sectoral supplements published alongside the reports guide banks in developing sector-specific financing strategies that promote circular economy principles in the building & construction and the textile sector - two high-impact sectors with significant circularity potential.

FSB publishes stocktake on nature-related risks

On 18 July, Financial Stability Board (FSB) published a stocktake of member financial authorities' initiatives related to the identification and assessment of nature-related financial risks. The report reveals that financial authorities are at different stages of evaluating biodiversity loss and nature-related risks as financial risks. Financial authorities that are analysing these risks categorise them into physical and transition risks, similar to climate-related financial risk analysis. Furthermore, there is a consensus on the need for a holistic approach that considers the interdependencies between climate- and nature-related financial risks. The report underscores the necessity for more expertise within supervisory bodies, central banks, and the private sector to address nature-related risks effectively, highlighting ongoing capacity-building initiatives worldwide.

NGFS publishes two reports on nature-related risks

On 2 July, NGFS published its framework for nature-related financial risks and a report on nature-related litigation. The framework introduces minor revisions to its September 2023 beta version, focusing on alignment with other recently implemented frameworks. By taking an integrated approach, the framework acknowledges the strong interconnectivity between climate-related and broader nature-related financial risks. Illustrative cases related to forest and freshwater ecosystems demonstrate how central banks and financial supervisors can operationalise the framework. The litigation report highlights emerging trends. It states that nature-related legal actions are likely to increase and urges central banks, supervisors, and financial institutions to closely monitor developments in this field of litigation.

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Litigation

South Korean court orders government to improve climate law

On 29 August, the Constitutional Court of South Korea decided on a landmark climate case brought by, among others, young children against the government. The court acknowledged that South Korea has a duty to protect its citizens' fundamental rights by addressing the climate crisis through measures to mitigate such risks by reducing greenhouse gas emissions and adapting to its consequences. It held that the Korean Carbon Neutrality Framework Act and the First National Plan for Carbon Neutrality and Green Growth infringed the plaintiffs' fundamental constitutional rights by failing to provide quantitative reduction targets for GHG emissions from 2031 to 2049, thereby shifting an excessive burden onto future generations.

NGOs file claim against EU Commission over green labelling of planes and ships

On 28 August, a coalition of NGOs, backed by 35,000 citizens, announced that they are taking the EC to court over the decision to include polluting fossil fuel planes and ships in the EU Taxonomy. The new criteria classify fossil fuel planes and ships as 'sustainable' if they meet certain efficiency criteria (i.e. producing slightly less CO2). The NGOs argue that these criteria contradict the requirements of the Taxonomy Regulation because they are not based on conclusive science, do not support a 1.5°C pathway, and will hamper developing low-carbon alternatives in these sectors. In January 2024, the NGOs launched a legal challenge requesting the EU Commission to review the criteria. This challenge was rejected by the EU Commission in June 2024. The NGOs are now filing a case in the European Court of Justice to compel it to review these criteria.

German court held future statements TUI Cruises misleading

On 9 August, the Landgericht Hamburg ruled on a case brought by the Deutsche Umwelthilfe against TUI Cruises for misleading advertisements. The court held that the '2050 Dekarbonisierter Kreuzfahrbetrieb (Net-zero) statement published on TUI Cruises' website qualified as misleading. Although these statements outlined TUI's future goals, the court found them unclear and emphasised that a company's future goals can influence consumer decisions.

Australian superannuation fund to pay USD 11.3 million greenwashing fine

On 2 August, the Australian Federal Court ordered the Australian superannuation fund Mercer to pay USD 11.3 million to settle a greenwashing case brought by the Australian Securities and Investments Commission (ASIC) in 2023. The court approved a settlement reached between Mercer and ASIC at the end of 2023. As part of this settlement, Mercer admitted that it violated Australian law by making false and misleading statements claiming that it excluded investments in fossil fuel, gambling and alcohol sectors when it actually had extensive holdings in these sectors.

ACM addresses sustainability claims of energy supplier

On 25 July, the Dutch Authority for Consumers and Markets (ACM) announced that the energy supplier Vattenfall will remove the claim ‘Fossil free living within one generation’ (in Dutch: ‘*Fossielvrij leven binnen één generatie*’) from its communications with consumers. The ACM assessed this claim as potentially misleading. The announcement follows ‘normative discussions’ between ACM and Vattenfall. While Vattenfall’s climate plans are concrete and verifiable, the slogan does not describe these plans in a concrete and verifiable way. Consequently, Vattenfall will state its climate ambitions in a more concrete manner. In its announcement, the ACM refers to its guidelines on sustainability claims.

Greenpeace notices Energy Transfer of anti-SLAPP case

On 23 July, Greenpeace International sent a notice of liability to the US-based energy company Energy Transfer. The notice relates to a letter sent in 2016 by the NGO and over 500 other organisations to banks, urging them to stop financing Energy Transfer’s oil pipeline project. In response to this letter, Energy Transfer initiated a lawsuit against the organisations. After this lawsuit was dismissed, the energy company initiated a new lawsuit solely against Greenpeace, again seeking damages amounting to approximately USD 300 million. Greenpeace’s notice now asserts that the latter case is unlawful under Dutch law, considering the recently adopted anti-Strategic Lawsuits Against Public Participation (anti-SLAPP) directive. It demands that Energy Transfer halt its lawsuit and compensate Greenpeace for its costs. This marks the first time that an NGO has publicly invoked the anti-SLAPP directive (which does not apply yet).

Do you have any questions or comments on a specific ESG topic? Do not hesitate to contact our Sustainable Business & Climate Change team. If you or members of your team would like to receive our updates, please subscribe.

Key contacts

Frans van der Eerden | **partner Financial Law.** Focus on financial regulatory & sustainability

Maartje Govaert | **partner Employment & Pensions.** Focus on social pillar of ESG (employment law matters)

Harm Kerstholt | **partner Corporate M&A.** Focus on Energy, ESG due diligence, and human rights

Iris Kieft | **partner Public Law & Regulatory.** Focus on public regulatory, energy, climate change and the circular economy

Suzanne Kröner-Rosmalen | **counsel Corporate Governance.** Focus on sustainable corporate governance, ESG disclosures and strategy

Jens Mosselmans | **partner Public Law & Regulatory.** Focus on energy transition and public regulatory

Geert Raaijmakers | **partner Corporate Governance.** Focus on sustainable corporate governance

Freerk Vermeulen | **partner Dispute Resolution and head of the Supreme Court Litigation Team.** Focus on climate litigation and sustainability strategy

David Wumkes | **partner Real Estate.** Focus on real estate, substainability and energy projects

Meet the whole team

Editors: Kim Heesterbeek, Erik van Engelenburg & Dorine Verheij