

# IPBA Journal

December 2022

No **108**

NEWS & LEGAL UPDATE

Environmental, Social  
and Governance (ESG)  
in Legal Practice



INTER-PACIFIC  
BAR ASSOCIATION



# One World: Law & the Environment Beyond Covid

## IPBA Dubai 2023

March 7–10, 2023  
Dubai, UAE

We look forward to  
welcoming you to Dubai.

# IPBA Journal

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## The President's Message

**Richard Briggs**  
President



Dear Colleagues, Members and Friends,

It is time for my third message as President of the IPBA. Things are moving quickly now, as the autumn conference season is underway in Dubai. It is currently Dubai Arbitration Week and many lawyers from both the region and the world have convened on our city. Covid is now a distant thing of the past and traffic snarls Dubai's roads and makes each of us late for meetings and social appointments.

It has been a busy time as President. I attended the AIJA Conference in Singapore (22 to 26 August) as well as the very well-organised and attended IPBA Arbitration Day in Singapore on 31 August. I also attended the 32nd POLA Conference in Singapore from 22 to 23 September.

The IPBA Mid-Year Council Meeting in Seoul from 24 to 25 September was excellent, as well as the IPBA East Asia Forum which followed the Mid-Year Council Meeting on 26 September. While numbers were still affected by Covid concerns, a good time was had by all and I would like to thank the Korean Host Committee for their wonderful hospitality, culture and quite excellent food. It is always a pleasure to be in Seoul.

Since that time, a week or so back I attended the IBA Annual Conference in Miami as IPBA President. I was joined by our Secretary-General YJ Chang, Deputy Secretary-General Jose Cochingyan, CTO Riccardo Cajola, Program Coordinator Jan Peeters and Past Secretary-General Caroline Berube, among others. Meetings were held with the UK Bar Council as well as the Law Society of England and Wales. Each of us has been doing our best to promote not just the Dubai Conference from 7 to 10 March 2023, but the culture and style of the IPBA in general.

Numbers for the Annual Meeting and Conference in Dubai next March are now surging. Much work is being done on the Keynote and Concurrent Sessions; we are now finalising the speakers. It is tempting to think that there is always more time to prepare a conference, but time rounds on all of us quickly. I will be heading to the Lalit Hotel in Delhi next week for an IPBA promotion on Monday 21 November. By the time of publication of this message, this and many other promotions will have taken place. India in November is always a particular pleasure, but marketing and promotion never sleeps.

This will be the last President's message before the March 2023 Annual Meeting and Conference. Accordingly, I again express my hope that the Dubai Conference will be well attended and that all members of the IPBA and those who support the organisation will consider attending. This is very much the case for some of those who have not renewed their IPBA memberships during the Covid years. All of us in the IPBA would like to welcome home our lost friends.

The promise for the IPBA Annual Meeting and Conference in Dubai is to experience the IPBA's particular atmosphere and to re-engage at all levels. On behalf of the Host Committee, we are excited to welcome you to Dubai.

Yours sincerely,

**Richard Briggs**  
President



## The Secretary-General's Message

**Yong-Jae Chang**  
Secretary-General



Dear IPBA Members,

It was great to meet many IPBA Officers and other Council members during our Mid-Year Council Meetings in Seoul from 24 to 25 September. It was the first time since the pandemic that the IPBA leadership was able to gather in person and many important and pending issues in respect to the IPBA were extensively discussed and approved at the Mid-Year Council Meetings. Among others, the IPBA Council has approved a proposal to establish a new committee called the 'Environment, Social & Governance Committee' (or 'ESG Committee') and to increase the membership fee for the first time in the last 16 years.

The East Asia Forum was also held in Seoul on 26 September (in a hybrid format) and I would like to especially thank many Korean law firms (BKL, K1 Chamber, Kim & Chang, Lee & Ko, Shin & Kim, Yoon & Yang and Yulchon) and the Korean Bar Association for their support for the Forum. Coincidentally, there was a session on ESG at the East Asia Forum and I am very grateful to our Committee Coordinators and other Committee Chairs (past and present) as well as IPBA members in Korea for the successful outcome of the East Asia Forum in Seoul.

Our focus is now on Dubai and I understand that the preparation for this upcoming Annual Meeting and Conference is well under way. I am very excited that this will be the first time our Annual Conference will be held in the Middle East and our IPBA members will be able to meet in person for the first time since the Pandemic. The Host Committee are working very hard under the great leadership of IPBA President Richard Briggs and the IPBA will strive to include important topics such as ESG, climate change, diversity and inclusion in its agenda for this important occasion.

The conference will be held from 7 to 10 March with the theme of 'One World: Law & the Environment Beyond Covid' and I have no doubt that our next Annual Meeting and Conference in Dubai will become a great success for the IPBA. Registration for this long-awaited event is already open at the conference web site [www.ipba2023.org/](http://www.ipba2023.org/) and I strongly encourage you to register as soon as you can and look forward to seeing all of you in Dubai in March 2023!

I hope you will enjoy reading this December edition of the IPBA Journal and please stay healthy and safe until we meet again.

Yours sincerely,

**Yong-Jae Chang**  
Secretary-General



## Message to the Reader



Dear Reader,

Welcome to the December issue of the IPBA Journal. The topic we have chosen for this month's issue of the Journal is Environmental, Social and Governance ('ESG') in legal practice. ESG is a practice area that is gaining wide popularity, which is emerging as a significant and specific demand on law firms and corporate legal departments.

ESG is a holistic concept regarding an organisation's ability to create and sustain long-term value in a rapidly changing world and manage the risks and opportunities associated with these changes. ESG is used as a framework to assess how an organisation manages risks and opportunities created by changing market and non-market conditions.

As companies increase their commitment to sustainability and responsible business, so too has the involvement of lawyers. Lawyers (in-house and external advisors) have always played an important role in managing social, ethical and environmental issues for organisations. However, it is now common to observe that lawyers are no longer just reacting to ESG issues but are proactively becoming involved in integrating material ESG risks and opportunities in organisations, their operational policies, and go-to-market strategies. The impact of ESG in the legal sector has been forthcoming. Nowadays, law firms are positioning themselves to respond to increasing demand for ESG expertise from clients, with 50 per cent of law firms across Europe and the United States reporting that they had created an ESG practice area in the past three years (2022 Wolters Kluwer Future Ready Lawyer Survey).

In this issue of the Journal, we are again very fortunate to have received an overwhelming amount of support

and interest from our members. This issue consists of seven articles with topics ranging from the future of ESG, ESG tax, sustainability due diligence, data protection and cyber security, providing different jurisdictional perspectives from China, the EU, India, Thailand and Vietnam.

We sincerely hope to see many of you at the in-person conference in Dubai next March where we will continue to discuss ESG-related issues with the conference theme being 'One World: Law & the Environment Beyond Covid'. As always, thank you for your consistent contributions, both Olivia and I remain grateful. We hope that you will enjoy reading the December issue of the Journal.

Yours sincerely,

**James Jung**  
Chair, Publications Committee



## IPBA Upcoming Events

Event	Location	Date
<b>IPBA Annual Meeting and Conferences</b>		
31st Annual Meeting and Conference	Dubai, UAE	March 7-10, 2023
32nd Annual Meeting and Conference	Tokyo, Japan	1st Quarter 2024
33rd Annual Meeting and Conference	Chicago, IL, USA	1st Quarter 2025
<b>IPBA Local and Regional Events</b>		
Dinner in Paris with IPBA President Richard Briggs	Paris, France	12 January 2023

More details can be found on our web site: <https://ipba.org>  
The above schedule is subject to change.

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We are pleased to accept articles on interesting legal topics and new legal developments that are happening in your jurisdiction. From time to time, issues of the Journal will be themed. Please send: (1) your article to both **James Jung** at [jjung@collaw.edu.au](mailto:jjung@collaw.edu.au) and **Olivia Kung** at [olivia.kung@wellingtonlegal.com.hk](mailto:olivia.kung@wellingtonlegal.com.hk); (2) a lead paragraph of approximately 50 or 60 words, giving a brief introduction to, or an overview of the article's main theme; (3) a photo with the following specifications (File Format: JPG or TIFF, Resolution: 300dpi and Dimensions: 4cm(w) x 5cm(h)); and (4) your biography of approximately 30 to 50 words.

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4. The article is concise (2500 to 3000 words) and, in any event, does not exceed 3000 words;
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6. The article is written by an IPBA member. Co-authors must also be IPBA members; and
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# IPBA East Asia Forum 2022

by Jin U Rhi, JCM Korea

The IPBA East Asia Forum 2022 was held in Seoul, Korea on 26 September 2022 following the IPBA Mid-Year Council Meeting held from the 23rd through 25th at the City Air Terminal. The Forum was attended by more than 100 participants on-site and online from all around the world.



Hosted by James Jung, the Chair of the IPBA Publications Committee, the Forum took off with the opening remarks of Jihn U Rhi, the JCM for Korea of the IPBA. In his remarks, Mr Rhi celebrated the return of face-to-face regional forums and expressed his hope that the participants will find the Forum of value and enjoy the friendship building therein. Following this, Kwon Sung Hee, Vice President of the Korean Bar Association, on behalf of Jong Yop Lee, the President, took the floor to give a congratulatory address emphasising the role of lawyers and the support of the Bar Association. Then, Richard Briggs, the IPBA President, gave a welcome address and introduced to the participants the next IPBA Annual Conference to be held in Dubai in 2023.

The Forum proceeded to four substantive sessions, briefly summarised as follows:

## 1. ESG Session: Governance, Risk Management & Compliance (GRC)

- During this session, issues related to governance, risk management and compliance of ESG in different jurisdictions were surveyed under the online moderation of Christopher To (Gilt Chambers, Hong Kong; Chair, IPBA Corporate Counsel Committee).
- Michael Paik, the General Counsel of SeAH Holdings based in Seoul, introduced practical aspects of GRC in the fields he is facing and Jack Li, Past President of the IPBA, presented Chinese practices.
- As Panel Speakers, Jay Son Yang (Yulchon, Seoul) and Dr Yeon Woo Lee (BKL, Seoul) also covered case law and recent legislation on compliance matters.

## 2. IP Session: IP Protection in the Post-Pandemic Era

- Issues as to IP protection that currently emerged were discussed and the panels illustrated real cases in the Asia-Pacific region, including the Philippines, China and Korea, moderated by Lidong Pan (Reiz Law Firm, Shenzhen; Chair, IPBA IP Committee).
- The panel speakers of the session were Eduardo T Genilo (Accralaw, Manila), Xijie Wei (Reiz Law Firm, Shenzhen), Changkwon Kim (Yoon & Yang, Seoul), Bo Kyung Lim (Shin & Kim, Seoul) and Michael P Chu (McDermott Will & Emery, Chicago; IPBA Vice-President).

## 3. International Construction & Arbitration Session: Gazing into the Future—The Practice of International Construction and Arbitration Across the Asia-Pacific Region in the Wake of the COVID-19 Pandemic

- Moderated by Matthew Christensen (Kim & Chang, Seoul; Co-Chair, IPBA International Construction Projects Committee) and Sae Youn Kim (Kim & Chang, Seoul; Co-Chair, IPBA Dispute Resolution and Arbitration Committee), regulatory developments that emerged from the pandemic on the practice of international construction and arbitration were explored.
- Further, the following panelists shared their experiences and views on virtual hearings in arbitration: Richard Briggs (Hadeef & Partners, Dubai; IPBA President), Alexander Gunning QC (One Essex Court, London; IPBA JCM, UK),



Jeonghye Sophie Ahn (Yulchon, Seoul) and David Isidore Tan (Rajah & Tann, Singapore).

**4. FinTech Session: Current Legal Developments in the Asia-Pacific Region**

- The panels jointly explored how the FinTech industry and FinTech-related laws have evolved during the pandemic era in different jurisdictions.
- The moderator of this panel was Catrina Luchsinger-Gaehwiler (MLL, Zurich; Co-Chair, (IPBA

Banking, Finance and Securities Committee) and the panel speakers were Chloe Jung-Myung Lee (Lee & Ko, Seoul), Raphael Tay (Law Partnership, Kuala Lumpur; Chair, IPBA Legal Development and Training Committee) and Kenichi Tanizaki (Atsumi & Sakai, Tokyo).

Following the closing remarks by the Secretary-General of the IPBA, Yong-Jae Chang, the Forum was wrapped up by a networking reception enjoyed by the panel speakers and the participants.

# DUBAI – The Jewel of the Middle East



A modern city full of ambition, with more than 150 nationalities, Dubai is arguably one of the most cosmopolitan cities in the world. Unlike Paris, New York or London, Dubai's expats are mainly first-generation, bringing with them a host of different cultural traditions, experiences and food, which gives the city a unique diversity. Dubai is a mixture of cultures with a special international flavour.

Magnificent shiny skyscrapers, state-of-the-art buildings, beautiful beaches and sand dunes, fabulous places to visit, international food options, shopping at the biggest mall in the world, visiting the tallest tower in the world and adrenaline-filled experiences, all make Dubai a fantastic tourist destination—the jewel of the Arab world and the Middle East that one must visit.

Dubai is an easy destination to travel to. It has one of the busiest and most impressive airports in the world. No other place on earth knows development to the same level and speed as Dubai—it is a unique experience.

Interesting Places to Visit in Dubai:

## **Burj Al Arab**

A hotel that is home to cutting-edge engineering, from a unique man-made beach and infinity pool entrance, to one of the tallest grand atriums at 180 metres high, it is a landmark of architectural innovation. Burj Al Arab takes hotel design to a new level of modern luxury and has also redefined the meaning of exceptional hospitality, both in Dubai and around the world. It is the fourth largest hotel in the world and is known as



the world's only seven-star hotel. Burj Al Arab stands on an artificial island and is connected to the mainland by a private curving bridge. The shape of the hotel is designed to resemble the sail of a ship and the hotel boasts a helipad which is sometimes used as a tennis court. Seize the unique chance of entering and experiencing the awesome Burj Al Arab. Join an exclusive 90-minute tour and listen to the most curious stories about this legendary place.

### **Burj Khalifa**

Located in incredible Downtown Dubai stands the Burj Khalifa, the tallest man-made structure on earth. At nearly twice the height of New York's Empire State building, standing tall at 829 metres (2723 ft), Burj Khalifa is the tallest free-standing structure in the world and

towers above the clouds. The building has 163 floors to explore and incredible birds-eye views of the city. Be sure to go all the way to the 128th floor, the Observation Deck. If you are into photography, a night visit provides a unique view of the city, where you can combine both the Burj Khalifa high floors, as well as the gardens that feature the Dubai Fountain, a performing fountain known to be the tallest fountain in the world.

### **Dubai Mall**

At over 12 million square feet (equivalent to more than 50 soccer fields), the Dubai Mall is the largest shopping mall in the world based on total area. It is the most visited retail and lifestyle destination in the world—welcoming over 100 million visitors every year. People travel to Dubai to indulge in retail therapy and visit the

attractions built into the shopping centre, such as the Dubai Aquarium. The Aquarium, located in the Dubai Mall, showcases more than 300 species of marine animals, including sharks and rays, and is literally an underwater zoo with walk-through tunnels that give you the chance to admire the various species of marine life.

Dubai Mall serves as an entrance to Burj Khalifa. It is a great place for eating as it has a variety of restaurants from different parts of the world. Be sure to visit Burj Khalifa, Dubai Mall and the Aquarium and then have dinner in one of the lavish outdoor restaurants while enjoying the fantastic fountain show. An ideal choice to maximise your time if your stay in Dubai is a short one.

### **Dubai Frame**

The latest addition to the already impressive skyline of the city is Dubai Frame, a stunning frame located in Zaabeel Park. Dubai Frame is 150 metres (492 feet) high, from where you will be able to enjoy a 360-degree view, spanning from the Arabian Gulf to the sand dunes of the Arabian Desert, all the way to Dubai Marina. You will find a 93-metre (305-foot) long glass bridge with a 25-square-metre glass panel that connects the two towers. Do not miss the chance to visit this incredible attraction.

### **Desert Safari**

Among the coolest places to visit in Dubai are the desert dunes. Make sure to go on a Desert Safari. A Desert Safari allows you to take a trip into the vastly unexplored wilderness, giving you a unique view of the world as we know it. In essence, a Desert Safari involves a jeep drive through enormous mounds of sand (called 'dune-bashing'), and a stop at a campsite where you will have the opportunity to ride camels, go sand boarding, get henna tattoos and be entertained by a belly dancer during dinner. The real draws are the ride and subsequent view in the middle of the Arabian Desert. Dubai is a city where anything is possible.

### **Madinat Jumeirah**

Inspired by an Arabian citadel, Madinat Jumeirah is a mini-city in Dubai, comprising five-star hotels, ornate souks and beachfront hotspots. A destination within a destination, you'll find several grand hotels, including Jumeirah Al Qasr, Jumeirah Mina A'Salam and Jumeirah Al Naseem, alongside a cluster of traditional summer houses at Jumeirah Dar Al Masyaf and seven grand homes at Jumeirah Malakiya Villas. There is an entire river system, five kilometres in length, complete with its

own fleet of traditional abra boats. You can take a tour around the whole property on one of these in-house abras and stop along the way.

### **Museum of the Future**

The Museum of the Future combines elements of exhibition, immersive theatre and themed attraction, inviting you to look beyond the present to the possible. Located in the Financial District of Dubai, the goal of the Museum of the Future is to promote technological development and innovation, especially in the fields of robotics and artificial intelligence. The Museum of the Future seeks to foster solutions to the challenges that future cities face, in addition to housing innovations and being a hub that brings researchers, designers, inventors and financiers under one roof.

### **Palm Jumeirah**

Modern Dubai is all about having the biggest, the best, the largest, the tallest and the most spectacular things on earth. Palm Jumeirah, built between 2001 and 2006, is one of the world's largest artificial islands. It is home to multi-million-dollar mega mansions and a host of five-star luxury hotels, including the renowned Atlantis, The Palm and recently constructed St Regis Hotel.

### **Old Dubai (Bastakia)**

Bastakia Quarter (which also goes by the name of Al-Fahidi) is one of the best places to visit in Dubai to get a feel of early Dubai. Known as 'old Dubai', it is in the eastern part of Bur Dubai and was built in the late nineteenth century. The area was originally the home of wealthy Persian merchants (the buildings follow the typical architectural style of Persian coastal houses) who enjoyed the tax-free trading. It is located near the Dubai Creek.

Bastakia derives its name from the South Iran town of Bastak and consists of restored mud and stone houses, squares and narrow alleys as it existed in the 1890s when Dubai was a tiny pearl diving centre of world trade. Buildings in the area are beautifully preserved. Wind towers, adjoined to houses, provide a cooling system, trapping the wind and funneling it down into the houses. Don't miss Majlis Gallery, also located in Bastakia, which has a great collection of traditional Arab ceramics and furniture, and other contemporary art collections.

### **A Boat Ride Along Dubai Creek**

Dubai Creek marks the border between Deira, to the north, and Bur Dubai to the south. It is a nice place to visit

Old Dubai as it has some historical heritage. Due to the presence of the creek, people started living in the area as they could go fishing or pearl diving. Located north of Al-Maktoum Bridge, one of its best attractions is the Dhow Wharfage, where you can spot some beautiful dhows that are more than 100 years old. Other boats are still in use for trading.

Along Dubai Creek, on the Bur Dubai side, you will also find the Al Seef district—a unique area with beautifully kept buildings, shopping opportunities and a floating market. You can get there by dhow or by abra (small wooden ferry).

On the northern banks of Dubai Creek, Deira is the most multi-cultural part of the city and home to some of the most famous souks. The Gold Souk of Deira is the world's largest gold bazaar. A visit to Dubai isn't complete without a visit to the famous Gold Souk, one of the oldest and most fascinating traditional markets in the Emirate. Whether you are just browsing or genuinely on the hunt for even the smallest amount of precious gold, walk through the glittering bazaar to find designs from around the world crafted with a variety of carats.

The Spice Souk is also a perfect place to wander around. The Spice Souk is particularly renowned among food enthusiasts, food professionals and chefs! It is a treasure trove for those who absolutely adore cooking and experimenting with flavours. You will be astonished at the number of different spices that you will be able to find—and even though different shops at the Souk do sell similar stuff sometimes, you will be able to bargain your way into getting an incredible deal on some of the spices. Be sure to buy oils and saffron—the top-rated goods from here!

### Dubai Museum

Located in Al Fahidi Fort, which was built in 1787 with the aim of protecting Dubai Creek and last restored in 1995, Dubai Museum is the city's most well-known museum and one of its most popular tourist attractions, with an exhibit of old maps of the area, weapons, local musical instruments and other artifacts that will give you a bit more insight into Emirati life. Some of the collections originate from the Al Qusais archeological site. What is interesting about this museum is that for a long time the building was used as the residence of the local governors, as the seat of the government as well as a prison.

### Alserkal Avenue - An Art Lover's Paradise

If you are a lover of art, head straight to Alserkal Avenue, in the Al Quoz industrial district. Alserkal Avenue is an industrial compound hosting warehouses in the industrial zone of Al Quoz, in Dubai. The area is an arts and culture district for Dubai with a line-up of galleries, facilities and platforms, such as Alserkal Avenue that houses residencies for local and global artists. The area is also known for its local designer boutiques, pop-up restaurants and, in general, the place has a very welcoming, youthful vibe.

### Deluxe Experiences:

#### Dubai: Sightseeing Helicopter Ride from The Palm

Fly along the Persian Gulf coast and across World Islands on a 17 or 25-minute helicopter tour from Dubai. Soar over iconic sights like Atlantis, The Palm, Burj Al Arab and the Golden Mile.

Duration: 40 to 45 minutes

#### Dubai Speedboat Tour: Marina, Atlantis, The Palm and Burj Al Arab

Departing from the famous Dubai Marina, take an exciting day-time sightseeing tour with an English-speaking guide. Capture pictures and enjoy the ride around all of Dubai's top spots. Drinking water and safety equipment provided.

Duration: 1.5 hours

#### Dubai: Mega Yacht Cruise with Buffet Dinner

Cruise by Dubai's famous Dubai Marina, with panoramic views of the skyline, Atlantis, The Palm Hotel, and Palm Jumeirah from the comfort of a luxury mega yacht.

Duration: 3 to 3.5 hours

### Travel in Dubai

Dubai is an incredibly easy city to get around. You will have the option to travel by taxi, but if you are looking for something more budget friendly, you can count on the many efficient buses, which are all air conditioned. You can also travel by bike, train and boat. Finally, consider investing in a hop-on hop-off bus pass to easily reach all the main attractions in town. The hop-on hop-off bus pass is a great way to see the city. The Dubai Metro is also another option.

For further information, please do not hesitate to reach out to the registration desk at the event or the concierge at your hotel.

# The Future of Environmental, Social and Governance Law and Practice

It would be difficult to have missed the emergence of the discussions over environmental, social and governance issues over the past year. Environmental, social and governance ('ESG') practice has emerged from the post-Covid pandemic period as a significant area of legal practice. In some ways, this is a belated recognition by the legal profession that environmental and social factors matter to clients. In other ways, it reflects the significant legal challenges posed by the triple-planetary crises of climate change, pollution and biodiversity collapse.





## Introduction

The articles in the recent IPBA Journal No 104 highlighted the enormous challenges facing the planet and confronting lawyers engaged in advising clients on projects and investing with environmental, social and governance risks.<sup>1</sup> In an article that appeared in issue 104, I wrote about the need for lawyers to be familiar with risk assessment and due diligence to better advise clients

The UN Global Compact is a non-binding pact designed to encourage sustainable and socially responsible business practices.

on the impacts of the changing face of risk.<sup>2</sup> It seemed that ESG investing was becoming more profitable and acceptable during the Covid crisis. However, this year has seen multiple attacks on the principles and practices of ESG investing. The Economist magazine argues that 'the fundamental contradictions of ESG are being laid bare'<sup>3</sup>. Acknowledging that more than US\$35 trillion of assets worldwide are under a sustainability lens, The Economist argued that the contradictions are becoming 'brutally clear' with the corporate mission of generating long-term value for investors conflicting with the pledges offered by companies to reduce carbon emissions and to be more ethical in supply chains and materials sourcing. The Economist cited two companies: Blackrock and Unilever. Blackrock, with an investment portfolio of US\$8.5 trillion, has been targeted by US Republican attorneys-general in 19 States due to its support for ESG investing.<sup>4</sup> It has also been the target of the New York Office of the Comptroller over claims it was 'backtracking' on its climate commitments.<sup>5</sup> Despite its clear commitments to ESG investing, Blackrock is still one of the US's largest investors in fossil fuels. On the other hand, The Economist has targeted Unilever as its shareholder returns have lagged behind rivals, despite being focused on sustainability.<sup>6</sup>

The Economist also presented a special issue on ESG investing on 23 July 2022, arguing that the ESG approach to investing is broken with a need to be focused and streamlined.<sup>7</sup> The Economist has also argued that ESG should concentrate only on decarbonisation. But to focus on climate change is to deny the reality of investing and the real-world problems facing investors and their advisers.

Currently, the ecological world, the planet on which we live, is facing three global and interrelated crises: climate change, pollution and collapsing biodiversity. These global issues have real-world implications, both in the short and longer term. These are each serious, multi-faceted problems that require complex, interrelated solutions. This interrelationship of environmental, social and governance risks has been highlighted in the most recent Germanwatch Global Climate Risk Index 2021.<sup>8</sup>

'The Covid-19 pandemic has reminded us that risk-affectedness and vulnerability are systemic and interconnected. ... Globally, 51.6 million people had to simultaneously deal with the impacts of floods, droughts or storms whilst trying to contain the pandemic and deal with its consequences. It

is therefore important to strengthen the resilience of the most vulnerable against different types of risk (i.e., climatic, geophysical, economic and health-related risks).<sup>9</sup>

### International Approaches

The growing discussion over the right to development and the need for the protection of the planet has led to the creation and adoption of several global approaches to the issue of business, human rights and the environment. Of most relevance to the development of major projects, including linear infrastructure, are the UN Guiding Principles on Business and Human Rights ('UNGP') and the UN Global Compact.

The UNGPs are a statement on the relationship between business and human rights, recognising that while governments have the primary duty to protect and promote human rights, companies have a distinct responsibility to respect human rights. This responsibility is addressed by 31 non-binding principles relating to the corporate responsibility to respect human rights.

The UN Global Compact is a non-binding pact designed to encourage sustainable and socially responsible business practices. It incorporates ten principles covering human rights, labour, the environment and anti-

corruption and is consistent with the UNGP<sup>10</sup> (see Table 1 below). The principles are derived from various sources, including the Universal Declaration of Human Rights, the International Labor Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

### Environmental, Social and Governance Standards

From a financing and operational perspective, there are increasing efforts to utilise ESG investing to strengthen the sustainability of infrastructure. ESG investing is broadly understood as 'an approach that seeks to incorporate environmental, social and [corporate] governance factors into asset allocation and risk decisions, so as to generate sustainable, long-term financial returns.'<sup>11</sup> While there is limited clarity and consensus around what ESG investing means in practical terms, it is commonly used as a framework for reporting and disclosing information on how enterprises incorporate these factors in their processes and decision making, as well as on how financial institutions consider these factors when making investment decisions. The International Finance Corporation ('IFC') has summarised the ESG factors and examples of common issues under each factor as replicated at Figure 1.

**Table 1: The Ten Principles of the UN Global Compact**

<b>Human Rights</b>	<p><i>Principle 1:</i> businesses should support and respect the protection of internationally proclaimed human rights; and</p> <p><i>Principle 2:</i> make sure that they are not complicit in human rights abuses.</p>
<b>Labour</b>	<p><i>Principle 3:</i> businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;</p> <p><i>Principle 4:</i> the elimination of all forms of forced and compulsory labour;</p> <p><i>Principle 5:</i> the effective abolition of child labour; and</p> <p><i>Principle 6:</i> the elimination of discrimination in respect of employment and occupation.</p>
<b>Environment</b>	<p><i>Principle 7:</i> businesses should support a precautionary approach to environmental challenges;</p> <p><i>Principle 8:</i> undertake initiatives to promote greater environmental responsibility;</p> <p><i>Principle 9:</i> encourage the development and diffusion of environmentally friendly technologies.</p>
<b>Anti-Corruption</b>	<p><i>Principle 10:</i> businesses should work against corruption in all its forms, including extortion and bribery.</p>

**Figure 1: Reproduced from IFC (2021) IFC ESG Guidebook, p 14.**

<b>Environmental</b>	
Businesses rely on natural resources and physical assets to perform their operations. Products and services may directly or indirectly impact the environment.	
<ul style="list-style-type: none"> <li>• Climate change</li> <li>• Carbon management</li> <li>• Resource depletion</li> <li>• Pollution</li> <li>• Energy consumption</li> </ul>	<ul style="list-style-type: none"> <li>• Land use</li> <li>• Loss of biodiversity</li> <li>• Water consumption</li> <li>• Waste management</li> <li>• Innovations or products or services that reduce environmental impact</li> </ul>
<b>Social</b>	
To conduct their operations, companies harness the talent and skills of their employees. Products and services, and operating activities involved in production, may benefit society or cause harm.	
<ul style="list-style-type: none"> <li>• Job creation and working conditions</li> <li>• Equal opportunity</li> <li>• Diversity</li> <li>• Training</li> <li>• Impacts on local communities</li> <li>• Health and safety</li> </ul>	<ul style="list-style-type: none"> <li>• Child and forced labor across supply chains</li> <li>• Grievance mechanisms</li> <li>• Human rights</li> <li>• Social impact of products, services, or company operations</li> <li>• Gender-based violence and harassment</li> </ul>
<b>Governance</b>	
When making decisions and allocating their natural, human and financial resources, companies should consider how they will create long-term value that will benefit all stakeholders.	
<ul style="list-style-type: none"> <li>• Purpose, values and culture</li> <li>• Board diversity, structure and oversight</li> <li>• Succession planning</li> <li>• Executive pay</li> <li>• Internal controls</li> </ul>	<ul style="list-style-type: none"> <li>• Risk governance</li> <li>• Ethics and compliance</li> <li>• Shareholder rights</li> <li>• Governance of stakeholder engagement</li> <li>• Disclosure and transparency</li> </ul>

The IFC has also released ESG Standards that comprise its existing 'Performance Standards, which define clients' responsibilities for managing their environmental and social risks and the Corporate Governance Methodology, which sets out an approach to evaluate and improve the corporate governance of clients.<sup>12</sup>

There are also important developments in ESG investing arising from within ASEAN. The stock exchanges in six of the ASEAN member states have issued guidance for listed companies on reporting of ESG factors:<sup>13</sup>

- The Indonesia Stock Exchange has issued the Application of Sustainable Finance for Financial Services Institutions, Issuers and Public Companies (2017).

- Bursa Malaysia has issued the Sustainability Reporting Guide (2020).
- The Philippine Stock Exchange has issued the Sustainability Reporting Guidelines for Publicly Listed Companies (2019).
- The Singapore Exchange has issued the Sustainability Reporting Guide (2018).
- The Stock Exchange of Thailand has issued Guidelines for the preparation of sustainability reports (2012).
- The Hanoi & Ho Chi Minh Stock Exchange, Viet Nam, has issued the Environmental and Social Disclosure Guide (2016).

**Table 2 Risk Assessment Matrix**

	Improbable/ Rare	Remote/ Unlikely	Occasional	Probable/ Likely	Almost Certain/ Frequent
Catastrophic	Dark Green		Grey		
Critical					
Moderate	Light Green		Dark Green		Grey
Minor	Light Green		Dark Green		
Negligible	Light Green			Dark Green	

In December 2020, the Monetary Authority of Singapore ('MAS') adopted Guidelines on Environmental Risk Management for banks.<sup>14</sup> In 2022, the Managing Director of the MAS, Mr Ravi Menon, was appointed the Chair of the Network for Greening the Financial System ('NGFS') which now includes over 100 central banks. The NGFS Glasgow Declaration, released at the UNFCCC COP26 in November 2021, stated that 'in light of the urgency and seriousness of climate change and environmental issues, we will expand and strengthen our collective efforts to improve the resilience of the financial system to climate-related and environmental risks, and encourage the scaling up of the financing flows needed to support the transition towards a sustainable economy.'<sup>15</sup>

Although ESG is not explicitly mentioned in the ASEAN Vision 2025, commitments in the ASEAN Socio-Cultural Community chapter support key ESG factors. The aim for the ASEAN Socio-Cultural Community is to 'be one that engages and benefits the peoples, and is inclusive, sustainable, resilient, and dynamic.' This is to be achieved by good governance (12.1), promotion and protection of human rights (12.2), environmental protection and intergenerational equity (12.3), climate change and disaster risk resilience (12.4) and promotion of innovation and global connectivity (12.5).

The ASEAN Capital Markets Forum ('ACMF') is working to foster sustainable finance for long-standing development in the region. While developing the ASEAN Sustainability Bond Standards, the ACMF published a 'Roadmap for ASEAN Sustainable Capital Markets'. As one of its top priorities, the roadmap highlights that 'ASEAN countries need to adopt consistent measures to increase the transparency and comparability of reporting in promoting sustainability.'<sup>16</sup>

The growth of ESG investing provides opportunities for the formal inclusion of ESG criteria in the linear infrastructure project lifecycle. Importantly, these criteria can be used to promote inclusivity and resilience in the funding analysis, rather than a more traditional down-stream consideration of environmental and social safeguards.

**Assessing Risks and Mitigating Impacts: The Role of Due Diligence in Supporting Resilience and Inclusivity**

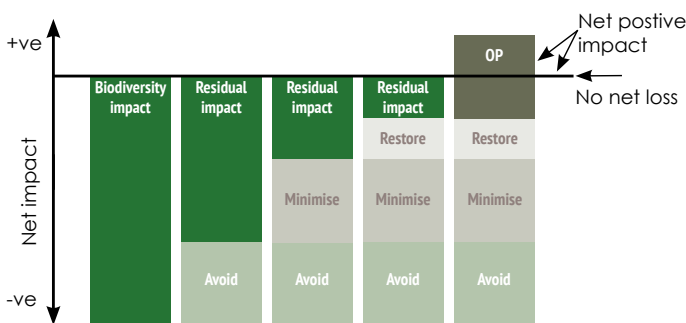
Given the potential negative impacts that ESG risk can cause to investments and projects, having appropriate strategies to identify and assess risks properly, and then make decisions to mitigate those impacts, is vital to developing appropriate responses to emerging risks. Risk is the probability of harm arising from activities or the failure to anticipate harm. Harm can directly affect the project or be experienced indirectly by other stakeholders. The most common risk assessment approach involves considering the likelihood of a particular impact transpiring against the severity of the consequence of that impact occurring. The higher the risk, the more attention should be given to limiting that potential negative impact on the environment, society, individuals and the economy. This risk assessment matrix is a common approach to risk assessment (see Table 2).

Following an assessment of risks, strategies should be developed to mitigate the potential impacts. The strategies employed to limit potential negative impacts should follow the mitigation hierarchy (see Figure 2). The mitigation hierarchy recognises that management of risks and impacts should follow the logical sequence of:

- First: avoiding impacts before they occur;
- Second: when avoidance is not possible, minimising the duration, intensity, significance and/or extent of impacts;
- Third: when impacts occur, rehabilitating or restoring the environment, site and/or communities; and
- Finally: where significant impacts remain, offsetting or compensating those impacts.<sup>17</sup>

The implementation of the mitigation hierarchy often involves iteration of these steps, with the application of the preventative steps (avoid and minimise) being significantly preferable to the remedial steps (restore/rehabilitate and offset).

**Figure 2: Mitigation Hierarchy**<sup>18</sup>



Accordingly, the mitigation hierarchy should best be understood as a tool that applies throughout the whole of the investment cycle, not just as part of the assessment of individual project proposals submitted for review and assessment. Project advisers and financial institutions considering an investment in projects should be identifying and assessing risks and considering impact mitigation from the outset of the linear infrastructure project lifecycle.

This approach is consistent with the concept of due diligence in business operations. Due diligence involves businesses:

- identifying and assessing actual and potential adverse environment impacts of activities and associated relationships on stakeholders;
- integrating environmental findings from impact assessments across internal processes;

- tracking environmental performance to verify whether adverse impacts are being effectively addressed; and
- communicating publicly, including formal reporting, on company responses to actual and potential environmental impacts.<sup>19</sup>

The OECD Guidelines for Multinational Enterprises ('OECD Guidelines') were adopted in 2011 and recommend that enterprises conduct due diligence in order to identify, prevent or mitigate and account for how actual and potential adverse impacts are addressed. These Guidelines address all thematic issues in responsible business conduct, including human rights, labour rights, information disclosure, environment, bribery, consumer interests, science and technology, competition and taxation. The OECD Guidelines include a dedicated Environment Chapter that provides recommendations for enterprises to raise their environmental performance and help maximise their contribution to environmental protection through improved internal management and better planning. The OECD developed the Due Diligence Guidance for Responsible Business Conduct 2018 to assist enterprises to implement the OECD Guidelines 'by providing plain language explanations of its due diligence recommendations and associated provisions.'<sup>20</sup>

Due diligence is an integral part of decision-making and risk management systems and is an ongoing, proactive and reactive, process-oriented activity.<sup>21</sup> ESG due diligence supports compliance with domestic environmental protection and resource management laws but goes further to consider best-practice conduct that can have positive environmental and social benefits. The extent and detail of due diligence processes should be commensurate with risks and appropriate to a specific enterprise's circumstances and context and should cover all aspects of an enterprise's operations and its business relationships.

The OECD guidance outlines the characteristics of effective approaches to due diligence by enterprises:<sup>22</sup>

- Due diligence is preventative.
- Due diligence involves multiple processes and objectives.
- Due diligence is commensurate with risk (risk-based).

- Due diligence can involve prioritisation (risk-based).
- Due diligence is dynamic.
- Due diligence does not shift responsibilities.
- Due diligence concerns internationally recognised standards of responsible business conduct.
- Due diligence is appropriate to an enterprise's circumstances.
- Due diligence can be adapted to deal with the limitations of working with business relationships.
- Due diligence is informed by engagement with stakeholders.
- Due diligence involves ongoing communication.

In addition to helping meet the environmental due diligence recommendation on making information about the environmental impacts of an enterprises activities public, reporting of broader performance against an environmental policy is in line with the OECD Guidelines dedicated disclosure chapter (covering timely and accurate information disclosure, preparation of disclosure policies and high-quality environmental reporting standards).

Inherent to due diligence is the recognition that its characteristics and effective implementation are based on internationally recognised standards and apply irrespective of the legal requirements of jurisdictions in which the enterprise operates. At the same time, compliance with those regulations cannot be avoided by reference to an enterprise's corporate processes. The OECD Guidelines are explicit that 'obeying domestic laws is the first obligation of enterprises'.<sup>23</sup> Due diligence can help enterprises observe their legal obligations while ensuring that risk assessment is undertaken to levels that meet international standards. In other words, due diligence and environmental regulations collectively provide a floor for responsible business conduct irrespective of the jurisdiction in question.

Governments are increasingly mandating due diligence as part of businesses' legal obligations, while courts rely on the concept when adjudicating environmental cases.<sup>24</sup> In particular, the relevance of due diligence is

being used when considering questions of companies' (including their directors and managers) liability for environmental harm. Accordingly, the role of due diligence in systematically applying risk assessments and the mitigation hierarchy to business activities, including the development of linear infrastructure, can be expected to continue to intensify.

## Conclusion

While some may argue that ESG investing and ESG principles need reform and amendment, it can be argued that the approaches to investing and advising must take into account risk assessment and due diligence as a matter of course. The factors that need to be taken into consideration may be expanding. In order to respond to the triple planetary crises of climate change, pollution and biodiversity loss, it would be professionally negligent not to advise clients on ESG risks and responses in 2022 and beyond.

## Notes

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- <sup>2</sup> M Baird, 'Environmental, Social and Governance Issues—The Next Frontier for Corporate Due Diligence and Risk Assessment', December 2021, p 11f.
- <sup>3</sup> The Economist, 29 September 2022, Leaders 'All Talk, No Trousers', p 12.
- <sup>4</sup> Ibid, p 12.
- <sup>5</sup> The Economist, 29 September 2022, Schumpeter, 'Blackrock and a Hard Place' p 56.
- <sup>6</sup> The Economist, n 3 above, p 13.
- <sup>7</sup> See [www.economist.com/special-report/2022-07-23](http://www.economist.com/special-report/2022-07-23).
- <sup>8</sup> See [www.germanwatch.org/en/cri](http://www.germanwatch.org/en/cri).
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- <sup>10</sup> See UNGP on Business and Human Rights 2011, available at [www.business-humanrights.org/en/big-issues/un-guiding-principles-on-business-human-rights/](http://www.business-humanrights.org/en/big-issues/un-guiding-principles-on-business-human-rights/).
- <sup>11</sup> OECD (2022) Trends in ESG Investing and Quality Infrastructure Investment in Asia-Pacific, OECD Paris, p9
- <sup>12</sup> IFC (2021), IFC ESG Guidebook, available at [www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/sustainability-at-ifc/environmental\\_social\\_and\\_governance](http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/environmental_social_and_governance) (last accessed 7 November 2022).
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- <sup>16</sup> ASEAN Capital Markets Forum (March 2019), Roadmap for ASEAN Sustainable Capital Markets, p. 13.
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- <sup>18</sup> See [www.thebiodiversityconsultancy.com/our-work/our-expertise/strategy/mitigation-hierarchy/](http://www.thebiodiversityconsultancy.com/our-work/our-expertise/strategy/mitigation-hierarchy/) (accessed 7 November 2022).

<sup>19</sup> ETS Bon (ed.) (2022), Business and Human Rights in Southeast Asia: A Practitioner's GuideKit for SMEs on Human Rights Compliance regarding the Environment and Labour, Kuala Lumpur, p 54.

<sup>20</sup> OECD (2018), Due Diligence Guidance for Responsible Business Conduct, p 3.

<sup>21</sup> OECD (2011), Guidelines for Multinational Enterprises, pp 42–43.

<sup>22</sup> OECD, n 19 above, pp 16–19.

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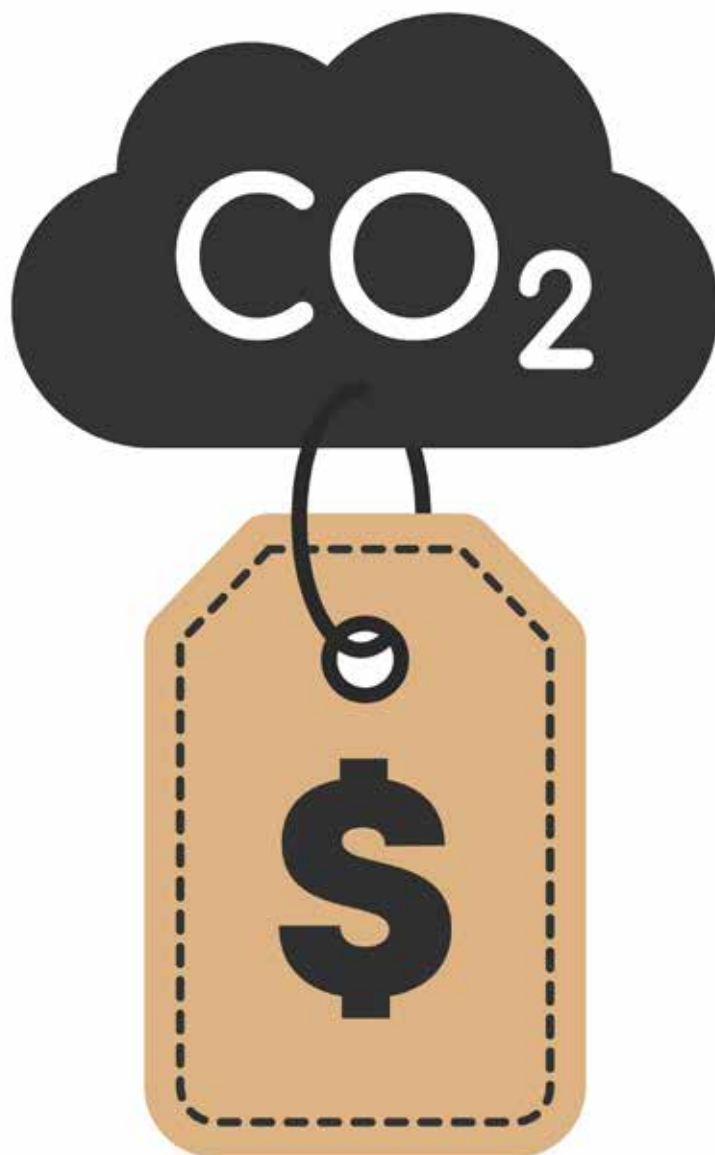
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## ESG: A Matter of Tax?

Environmental, Social and Governance ('ESG') started as a trend in response to stakeholders' demands for businesses to become responsible for the role they play in society and redefine their ways of doing business to create a more sustainable world. The trend has been embraced by multiple multinational groups across different industries and jurisdictions and is now becoming the new normal. As it is here to stay, as everything in life, it brings with it certain tax challenges that need to be addressed.





## What is ESG and What Does it Have to Do With Taxes?

ESG stands for the principles and policies to be adopted by businesses with regards to environmental, social and governance responsibilities. What started as a trend in which companies would address their stakeholders' demands for business transparency and responsibility and improve their public profile and positioning, is now here to stay.

For instance, it is becoming more usual in any lending process for banks to establish certain ESG standards as a condition for setting a certain reference interest rate and to apply penalties if the ESG standards are then not met. Also, we have recently seen some multinational groups raising funds by issuing ESG bonds, linking their remuneration to meeting specific ESG targets without losing their capacity to attract investment.

Also, consumers are reacting positively to brands that focus on sustainability in terms of responsible and local sourcing, climate change or improvement of employees' well-being, with their consumption behaviour being increasingly impacted by their perception of how these issues are being handled rather than mere prices. And, when selecting suppliers, companies are focusing on making sure that such suppliers are ESG-oriented, for example, by demanding meeting diversity standards.

Governmental and public and private institutional initiatives around the globe add to this, with policymakers signalling ESG measures as something that needs to be prioritised, to make sure that companies are transparent and accountable regarding their impact in society. Other initiatives involve setting mandatory disclosure obligations or offering incentives that inevitably redirect companies to the path of adopting and reinforcing their ESG standards.

Just like everything else that transforms or impacts how companies do business, it has an important tax angle that needs to be considered too.

ESG commitments adopted by multinational groups vary in their target and scope:

- *E-related commitments* are often aimed at achieving sustainability by reducing the multinational groups' carbon footprint—and even that of their suppliers, as a pre-requisite to accept them as business partners—

or at redefining manufacturing premises to make them less polluting and more efficient.

- *S-related commitments* are often aimed at implementing changes within multinational groups in terms of equality and diversity: for example, adopting equivalent pay standards in all jurisdictions where the multinational group is present or empowering women leadership by reaching certain quotas in decision-making bodies.
- *G-related commitments* are generally aimed at achieving more transparency and complying with society's demands in this area. In terms of tax, this involves paying a fair share of taxes, distributing those taxes fairly and in line with transfer pricing standards among the different companies spread throughout the jurisdiction in which the multinational group operates (falling under 'S') and making sure this is conveyed to stakeholders through mandatory and non-mandatory reporting.

There is no doubt that all of these commitments require a big dose of strategy setting and decision making at some level within a multinational group and will, if correctly implemented, in a shorter or longer term, bring benefits such as market positioning, operational efficiencies or access to extra funding, among others.

ESG policies are quite often adopted at headquarters and then rolled out to other companies within the multinational group that will be requested to adhere to certain standards and comply with certain key profit indicators ('KPIs'). In this context, who is to bear the costs associated with locally implementing the ESG standards decided centrally? And who is to receive any materialised benefits?

ESG policies can also impact the value chain and, therefore, the value and profit drivers within multinational groups. Does this lead to a reallocation of assets, functions and risks and a change of the companies' profile? If so, should the distribution of profits among the companies in the multinational group be altered together with the transfer pricing arrangements in place?

## Diving Deeper Into the Potential Transfer Pricing Implications of ESG

Without yet having a full consensus on the OECD's Pillar 1 and Pillar 2 projects, which may end up reshaping traditional tax principles and rules as we have known

them to date, the arm's length principle still applies to the attribution of benefits among the companies comprising a multinational group.

To avoid tax-driven profit shifting among jurisdictions through related-party arrangements, the arm's length principle requires that profit allocation within a multinational group applies the same conditions and results in the same outcome that would have resulted had the profit allocation taken place by independent companies in comparable circumstances, by adopting a separate entity approach.

Therefore, the arm's length principle is mainly anchored on the concept of value creation and the taking over of assets, functions and risks: the more value a specific company creates—which is driven by its assets, functions and risks—the more entitled it is to a greater share of the multinational group's overall profits.

ESG commitments may directly affect the distribution of assets, functions and risks—and, as a result, value creation—in a multinational group. Therefore, transfer pricing policies should be adopted to make sure that the companies still adhere to the arm's length principle and that the overall profits are allocated to each of the individual companies correctly.

The transformation stemming from ESG strategies necessarily differs depending on the industry involved, the multinational group's specific characteristics, and how far it is willing to take its ESG commitments. Consequently, the inherent tax impacts and challenges will also differ. Therefore, as no conclusions or general solutions apply to all multinational groups, ESG and its tax and transfer pricing implications must be analysed thoroughly and on a case-by-case basis.

That said, people managing the tax function within a multinational group should focus on three main challenges or concerns:

### 1. Centralisation of ESG strategy

Many multinational groups are setting up their own ESG units to take care of the issue and to decide on the strategies to be followed. They are often doing this at a global level, either by having these units placed

at headquarters only or by having the unit at the headquarters oversee all strategies and leave only their implementation to local units.

Considering this starting point, the first issue that arises is that of whether the cost of the ESG units should be passed on to all companies within the multinational group or should be borne by the headquarters entirely.

#### Example 1

*The ESG unit of a multinational group is located in Spain, where the group's headquarters are located and it is in charge of (1) decision-making in terms of defining the global ESG strategy; (2) oversight in terms of making sure the group's different international subsidiaries follow the strategy correctly; and (3) reporting in terms of the internal communication of compliance to shareholders and stakeholders and in terms of complying with external mandatory reporting obligations and disclosing efforts made to the general public through their communication departments.*

*In applying the arm's length principle, the structural costs of the ESG unit and above activities should only be passed on to the subsidiaries if a benefit test is met (that is, when the subsidiaries actually benefit from them, such as improved sales or enhanced efficiencies), so that it can be concluded that they represent a service that should be remunerated. However, the structural costs of the ESG unit should not be passed on to the subsidiaries when (a) they fall within the category of the shareholders' overseeing activities (that is, monitoring the shareholders' investment by shareholders, which involves controlling and protecting their interests); or (b) they are merely incidental (that is, brand improvement merely for belonging to the multinational group such as reference to strategic plans for listings or accessing better financing at a headquarter level only and whose benefits will not be passed on).*

*However, as ESG policies interact with consumer brand awareness, the limits between one concept and another may be blurred.*

**ESG commitments are generally related to brand awareness and consumer reaction.**

Generally, ESG strategies will benefit the whole multinational group in terms of image, purpose and positioning; therefore, the costs should be shared.

Also, when a specific ESG commitment is rolled out to subsidiaries, a second issue to be addressed relates to who should bear the cost of implementing it and who will be entitled to its benefits.

**Example 2**

The ESG unit of a multinational group is located in Spain, where the group's headquarters are located and it decides to take two measures to be implemented locally by its subsidiaries worldwide: (1) an E-oriented measure consisting of having all manufacturing plants worldwide undergo revisions of their premises and works to dismantle polluting elements and to replace them with renewable energy-based elements; and (2) an S-oriented measure consisting of increasing the representation of women in all governing bodies across the multinational group as a prerequisite to benefiting from lower interest rates in bank lending.

Costs will be incurred for implementing both measures and, from a transfer pricing perspective, their allocation to headquarters or subsidiaries should depend on which of them will benefit from the implementation and which of them will bear the corresponding risks.

Therefore, the determining factors include (a) who decides to assume the risks and effectively bears and manages them; (b) what outcomes may arise from the implementation and who will benefit from them; and (c) the timeframe in which these outcomes will arise.

In implementing the first measure, significant costs will arise from adapting the manufacturing premises. Also, at least in the short term, passing these costs on to consumers through increased sales prices will almost certainly be impossible. Consequently, a reduction in profitability will initially be triggered. As the headquarters made the decision, one may initially conclude that the manufacturing companies should not bear the costs. This may well be the case if

the manufacturing companies are limited-risk companies entitled to a routine profit based on a margin-on-costs model. However, the manufacturing companies may become more efficient as a result of the adaptation, or they may be full-risk manufacturers and distributors that undoubtedly benefit from the measure directly. If that were the case, one may conclude that the costs should be shared among or allocated to the subsidiaries only, in which case, the existing transfer pricing policies would have to be adjusted.

In implementing the second measure, if the reduction in the interest spread only benefits the headquarters, which will devote the financing to its own projects and which will bear and control the risks of not reaching the target commitments, one may conclude that the headquarters should assume the costs. Conversely, if the funds are subsequently used to fund the different subsidiaries, with the headquarters centralising the relationship with the lending banks, one could conclude that the costs should be shared among the subsidiaries, and that the headquarters may even be entitled to a cost-plus remuneration for their centralising efforts.

Again, depending on the circumstances, the solution may not be the same for all multinational groups.

As explained, ESG commitments are generally related to brand awareness and consumer reaction. Therefore, they can be an important value driver, which may affect the remuneration schemes in place within a multinational group. While centralising ESG services would usually entail a routine cost-based remuneration, a detailed asset, functional and risk analysis may demonstrate in certain specific cases that brand value is being enhanced significantly, resulting in increased royalties or increased allocation of residual profit where decisions are being made, through changing transfer pricing methodology.

In these cases, ESG costs could be seen a related to brand building and, therefore, as costs to be borne by the company owning the brand. However, once again, the business model and value chain in the multinational group will largely determine whether changes to pre-

ESG transfer pricing policies are required, and the consequences will differ depending on (1) how the multinational group is structured; (2) the distribution of assets, functions and risks; and (3) the interrelation with other activities and their corresponding assets, functions and risks.

## 2. Business restructurings and changes in the transfer pricing profiles of the companies within the multinational group

ESG commitments may also lead to changes in the setup of multinational groups, including the centralisation or decentralisation of functions or the integration of new functions within the multinational group that were previously carried out by independent third parties.

This may have two main consequences: (1) ceasing to carry out certain local activities in specific jurisdictions, leading to a business restructuring, in which the company that ceases to carry out the activities and that forgoes the profits it obtained from them in exchange for a greater benefit at a group level may be entitled to compensation (and its competent tax authorities to taxes on that compensation); or (2) integrating new functions in specific companies and altering their previous asset, functional and risk profile, thereby changing the share of the overall profits to which it is entitled.

There is no single and unique way of addressing the tax challenges posed by ESG policies and commitments.

### Example 3

*As part of the ESG strategy, a Spain-based multinational group decides that, to reduce its carbon footprint and rationalise operations in a socially responsible manner, manufacturing plants in faraway jurisdictions should be downsized to cover manufacturing needs in their jurisdiction and jurisdictions in their area of influence only, relocated manufacturing related to other markets to other jurisdictions.*

*Although the concept of business restructuring is far from being completely or unequivocally developed from a transfer pricing perspective, the OECD Transfer Pricing Guidelines refer to cross-border reorganisations of commercial or financial arrangements between related parties, including*

*the termination or substantial renegotiation of existing arrangements, irrespective of whether tangible or intangible assets are being transferred, if 'something of value' is effectively transferred. The reallocation of profit potential among the companies of a multinational group, either immediately or over several years, is undoubtedly considered 'something of value'.*

*Based on the chapter on business restructuring of the OECD Transfer Pricing Guidelines, the relocation of the manufacturing activities to another group company to comply with the ESG commitment at a group level may need to be compensated.*

*This would not be a consequence of shutting down the local manufacturing premises but rather of relocating the activity and shifting the profit potential attached to it to other jurisdictions.*

*If in an open-market situation, a profit potential transfer such as the one taking place would usually result in the beneficiary companies compensating the transferring company, in applying the arm's length principle, proper compensation should be paid.*

*This centralisation may also entail the transfer of tangible and intangible assets, which would also require arm's length compensation.*

### Example 4

*As part of the ESG strategy, and in the absence of suppliers that can meet its required ESG standards and KPIs, a Spain-based multinational group decides to integrate new functions in certain foreign manufacturing subsidiaries that were previously carried out by third-party suppliers, specifically regarding logistics.*

*As the integration of the logistics functions in the foreign manufacturing subsidiaries may result in those subsidiaries having to assume significant risks and assets, adequate remuneration in line with the arm's length principle should be paid to those foreign manufacturing subsidiaries. However, if this is not the case, or the risks and assets assumed are be limited and shared with the decision-*

*making headquarters, no remuneration or a lower remuneration may apply.*

*Also, services that are typically understood as not being value drivers and that may be characterised under the OECD Transfer Pricing Guidelines as low value-adding services—which are compensated with fixed 5% margins on costs—may, in the light of ESG gaining importance, lose their low value-adding characterisation if they become critical for meeting ESG commitments.*

In both of the above examples, applying the arm's length principle in practice becomes complex. In the case of business restructurings, it may be difficult to ascertain the realistically available options to address the issue and determine whether compensation should be paid and, if so, its calculation parameters. Also, predicting how the tax authorities will react to the change of transfer pricing profiles within the multinational group may also be difficult.

In trying to secure the multinational group's tax position and avoid future tax uncertainty (with the multinational group possibly ending up with a bad reputation, thereby ruining all ESG efforts and targets achieved), people managing the tax function within a multinational group should be willing to proactively address the issue and negotiate with the tax authorities involved. This open attitude would not only provide certainty in this complex context, but would also be, itself, an ESG indicator to measure compliance with the commitment to approaching taxes transparently and responsibly.

### Intakes

In the ESG era, taxes, which are part of the 'S' category and a big concern for stakeholders, should be given the attention they require, and this implies proactively addressing the transfer pricing challenges that adapting to the commitments certainly entails.

Evidently, as mentioned throughout the article, there is no single and unique way of addressing the tax challenges posed by ESG policies and commitments, nor can a universal and standardised approach or solution be identified. Regarding transfer pricing, it always comes down to the facts in each case and the underlying reality of the specific setups of multinational groups—and this is now aggravated by ESG itself not being a standardised issue.

However, as exemplified above, there are some big areas of concern that can be more commonly identified and that serve as the starting point for people managing the tax function within multinational groups to reflect on the matter and anticipate how ESG transforming their businesses also transforms their tax and transfer pricing approach.

To sum up, from a tax and transfer pricing perspective, one might identify three main approaches to ESG: (1) ESG as part of the routine services provided by the headquarters to other companies within the multinational group, with its corresponding stable but relatively low remuneration based on costs incurred; (2) ESG as part of the funding strategy, with costs allocated accordingly among the companies within the multinational group based on a risks and benefits analysis; and (3) ESG as part of the brand building strategy of the multinational group, to be aligned with the transfer pricing policies regarding brand remuneration.



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# Sustainability Due Diligence in the EU: From Soft Law to Hard Law

In 2022, the European Commission announced important proposals for sustainability due diligence, which would impose obligations on companies to take appropriate measures for their entire value chain to prevent human rights and environmental law violations. Multinational companies having business relations with the EU should consider starting risk assessments of their supply chain to comply with these upcoming rules.



## Introduction

Compliance with laws and regulations has been one of the most complex issues for large multinational companies for the following reasons: the cost of training and monitoring employees in all subsidiaries and affiliates and the number and complexity of laws and regulations to comply with. For instance, to comply with competition rules, it is essential to train salespeople in subsidiaries or local offices. In addition, multinational companies are required to comply with the competition rules of various jurisdictions, such as the US anti-trust laws, the EU competition law and other local anti-trust laws and regulations of the jurisdictions in which the companies are active.

In 2022, the European Commission ('EC') published two proposals concerning sustainability due diligence rules: a proposal for the Directive on Corporate Sustainability Due Diligence<sup>1</sup> (the 'CSDD Directive') and a proposal

for the Regulation on prohibiting products made with forced labour on the Union market<sup>2</sup> (the 'Forced Labour Ban Regulation'). Both of these proposals will require companies to conduct due diligence regarding human rights and environmental issues. If enacted, the companies operating commercial activities worldwide will have to comply with burdensome obligations. First, companies that fall into the scope of these texts would have to monitor, in addition to their subsidiaries and affiliates, their supply chains. In other words, it would be necessary for these companies to assess the risks of human rights and environmental law violations by their suppliers. Moreover, the laws and regulations that the company should comply with are diverse, they encompass all major international agreements and conventions, EU regulations and national laws protecting human rights and the environment. Therefore, multinational companies will have to take into account all these rules when assessing the risk of violations.

This article aims to describe the outline of these two proposals, which are in the ordinary legislative procedure, that is, presented to the European Parliament and Council, and will enter into effect around 2025 at the earliest. Separately, certain EU Member States, including France, have already adopted rules on sustainability due diligence. We will briefly explain French national legislation on sustainability due diligence, which has already entered into force and has been discussed in an ongoing case, to analyse the possible consequences of this proposed EU legislation in practice.

## EU Directive on Corporate Sustainability Due Diligence

### Introduction

Before publishing the CSDD Directive on 23 February 2022, the EU had already enacted three pieces of legislation that impose supply chain due diligence regarding human rights and sustainability issues. However, these pieces of legislation only concern specific industries, that is, the mineral<sup>3</sup> and wood<sup>4</sup> industries, or require only large companies located in the EU to report non-financial information, including on human rights.<sup>5</sup>

At the national level, some European countries have already introduced national legislation regarding human rights due diligence. However, these national laws focus on specific human rights violations, for example, child



labour or forced labour,<sup>6</sup> or target only large national companies. As a result, these rules have had limited implications for companies outside the EU.

The CSDD Directive, by contrast, will have a broader personal scope of application and will require more general human rights and environmental due diligence than the existing EU and national legislation. Therefore, the CSDD Directive would have broader impacts on non-EU companies either exporting products to the EU or having subsidiaries or affiliates within the EU.

### **Purpose of the Proposed Directive**

The CSDD Directive aims to foster sustainable and responsible corporate behaviour throughout global value chains.<sup>7</sup> For this purpose, the CSDD Directive provides a set of obligations for companies regarding actual and potential human rights adverse impacts and environmental adverse impacts, with respect to their own operations, the operations of their subsidiaries and the value chain operations carried out by entities with whom the company has an established business relationship (Article 1).

### **Personal Scope**

The CSDD Directive will apply to the following companies (Article 2):

- EU companies having more than 500 employees and a net worldwide turnover of more than €150 million.
- EU companies having more than 250 employees and a net worldwide turnover of more than €40 million, at least half of which is generated in specific high-risk sectors, *inter alia*:
  - the manufacture of textiles, leather and related products (including footwear) and the wholesale trade of textiles, clothing and footwear;
  - agriculture, forestry, fisheries (including aquaculture), the manufacture of food products and the wholesale trade of agricultural raw materials, live animals, wood, food and beverages; and
  - the manufacture of basic metal products, other non-metallic mineral products and fabricated metal products (except machinery and equipment).

Furthermore, the CSDD Directive will apply to companies outside the EU that meet either of the following conditions:

- have a net turnover in the EU of more than €150 million; or
- have a net turnover in the EU of more than €40 million and at least half of the net worldwide turnover is generated in the high-risk sectors listed above.

Therefore, non-EU companies that meet these thresholds will be required to comply with the due diligence requirements set by the CSDD Directive, even if they do not have a subsidiary or affiliate in the EU or their European subsidiary or affiliate is not within the scope of the CSDD Directive.

### **Due Diligence Obligations**

The CSDD Directive will require companies to conduct human rights and environmental due diligence by carrying out the following actions (Article 4):

- integrating due diligence into their policies;
- identifying actual or potential adverse impacts;
- preventing and mitigating potential adverse impacts, bringing actual adverse impacts to an end and minimising their extent;
- establishing and maintaining a complaints procedure;
- monitoring the effectiveness of their due diligence policy and measures; and
- publicly communicating on due diligence.

The human rights and environmental conventions that companies should consider when conducting due diligence are listed in the Annex of the CSDD Directive.

Due diligence obligations will extend to business relationships with the company's value chains.<sup>8</sup> That is, companies should identify, prevent and monitor actual and potential violations of human rights or environmental standards in the operations of their value chains.



There are additional obligations on large companies and EU-based companies. Companies that meet the size criteria above, whether EU companies or not, will be required to adopt a plan to ensure that their business strategy is compatible with limiting global warming to 1.5°C in line with the Paris Agreement (Article 15). In any EU-based company within the scope of the CSDD Directive, directors will be required to take into account the human rights, climate change and environmental consequences of their decisions when fulfilling their duty to act in the best interest of the company (Article 25). It is worth noting that this provision is particularly controversial as it is unclear how to assess sustainability decisions.

The above obligations will have to be satisfied at any time. However, from a practical point of view, it is preferable to assess the risk before entering into an SPA, supply agreement or any other relevant agreements with business partners, and if necessary, take appropriate measures to comply with the CSDD Directive.

**The CSDD Directive aims to foster sustainable and responsible corporate behaviour throughout global value chains.**

### Sanctions

National administrative authorities may impose fines in case of non-compliance based on the company's turnover. The EC will set up a European Network of Supervisory Authorities which will facilitate the cooperation of the supervisory authorities and the coordination and alignment of regulatory, investigative sanctioning and supervisory practices (Articles 20 and 21).

In connection with companies outside the EU, the competent authority will be that of the Member State in which the company has a branch. If the company does not have a branch in any Member State or has branches in different Member States, the competent authority will be that of the Member State in which the company generates most of its net turnover in the EU (Article 17). In addition, companies could be held liable for damages resulting from their failure to prevent potential adverse impacts or bring actual adverse impacts to an end (Article 22).

### Implications for Non-EU Companies

Companies outside the EU, especially those generating a net turnover in the EU of more than €150 million and having value chains in countries with a risk of human

rights violations, should prepare a strategy to comply with the due diligence obligations.

Furthermore, non-EU companies supplying products within the EU should also expect that European clients would ask to collaborate on their sustainability due diligence. When collaborating with competitors by sharing resources or information, it is essential to consider compliance with applicable competition law.

The proposal for the CSDD Directive has been presented to the European Parliament and the Council for approval. Once adopted, the Member States shall transpose it into national laws within two years from its entry into force. The companies that meet the size criteria of the CSDD Directive should comply with the due diligence obligations by the end of this period. Companies within the CSDD Directive's scope because of their activities in high-risk sectors, on the other hand, should do so within four years after its entry into force.

It is worth noting that the CSDD Directive is highly controversial, as an exercise of due diligence in developing and emerging countries is burdensome for European businesses. Given the sensitive nature of the rules and current controversies, the proposal is not likely to be enacted before 2023. That is, the due diligence obligations on large companies will come into force in 2025 and those on other companies in high-risk sectors in 2027 at the earliest.

## EU Regulation Prohibiting Products Made with Forced Labour

### Introduction

Following the CSDD Directive, the EC unveiled a proposal for the Forced Labour Ban Regulation on 14 September 2022. As the EC indicated, the Forced Labour Ban Regulation and the CSDD Directive are interlinked. However, it should be noted that the Proposal has a different scope of application and mechanism from the CSDD Directive. The Forced Labour Ban Regulation, which imposes new sanctions, that is, prohibition on placing products made with forced labour in the Union market, is another important signal for companies of the importance of conducting human rights due diligence in its operations and supply chains.

## Scope of Application

While the scope of the CSDD Directive is limited to large or 'high-risk' companies, the Forced Labour Ban Regulation will apply to 'economic operators', which means any natural or legal person or association of persons who is placing or making available on the Union market. Therefore, theoretically, the Forced Labour Ban Regulation will apply to any companies supplying products to the EU market, even if they are located outside the EU.

## Prohibited Products

The Forced Labour Ban Regulation prohibits economic operators from placing or making available products that are made with forced labour on the Union market (Article 3).

A 'product made with forced labour' includes any products for which forced labour has been used in whole or in part at any stage of its extraction, harvest, production or manufacture, including working or processing at any stage of its supply chain. Therefore, in parallel with the CSDD Directive, companies placing or making available products within the EU should ensure that forced labour has not been used even at the level of their supply chains.

It is worth noting that the EC specifies sectors where forced labour has frequently been reported, namely service sectors, textiles, mining and agriculture. Yet, all industry sectors are covered by the Forced Labour Ban Regulation.

## Forced Labour

Forced labour is defined in Article 2 of the International Labour Organisation's Convention Concerning Forced or Compulsory Labour, that is, 'all work or service which is extracted from any person under the menace of any penalty and for which the said person has not offered him or herself voluntarily' and includes forced child labour. It refers to situations in which persons are coerced to work through the use of violence or intimidation, or by more indirect means such as manipulated debt, retention of identity papers or threats of denunciation to immigration authorities.

Unlike the US Uyghur Forced Labor Prevention Act, which entered into force in June 2022, the Forced Labour Ban Regulation is not targeting only certain regions such as the Xinjiang Uyghur Autonomous Region.

## Investigation

The investigation process will be carried out in two phases: (1) the preliminary phase; and (2) the investigation phase.

### (1) Preliminary Phase

Unlike the EU competition law, the competent authority is a national authority designated by each Member State. Competent authorities will follow a 'risk-based approach', meaning that they should focus their enforcement efforts on the economic operators likely to violate the forced labour prohibition. In this regard, competent authorities should take into account the size and economic resources of the economic operators, the quantity of products concerned, as well as the scale of suspected forced labour. In other words, the authorities are likely to focus on large multinational companies in the sectors where there is a high risk of forced labour. With regard to the risk assessment, the EC is required to publish guidelines and make publicly available a database of forced labour risks in specific geographic areas or with specific products.

Before initiating an investigation, the competent authority should request from the company under assessment information on actions taken to identify, prevent, mitigate or bring to an end the risk of forced labour based on the applicable rules or legislation, such as the CSDD Directive; the company under assessment should respond to the authority within 15 working days. It should be noted that, if the company under assessment has conducted effective human rights due diligence based on the applicable rules, the competent authority will take this into account when they assess whether there is a well-founded suspicion of forced labour.

### (2) Investigation Phase

If the competent authority has substantiated concerns, it will be required to initiate an investigation. The competent authority will inform the company subject to the investigation within three working days from the date of the decision to initiate such investigation.

## Sanctions

If the investigation concludes that forced labour has been used, the authority will have to, without delay, adopt a decision containing:

1. a prohibition on placing or making the relevant products available on the Union market;

2. a request to withdraw the relevant products already made available from the Union market; and
3. a request to dispose of the relevant products.

Nevertheless, the Forced Labour Ban Regulation does not provide for the recall of products that have already reached end users in the Union market. Decisions taken by a competent authority in one Member State will be recognised and enforced in the other Member States.

### Customs Controls

Once the decision becomes definitive, the competent authority communicates it to the customs authorities of the Member States. Based on such decision, customs authorities should identify the concerned products and carry out controls on products entering or leaving the Union market. If necessary, customs authorities will stop products made with forced labour from entering or leaving the EU market.

### Implications for Non-EU Companies

All companies distributing their products in the EU market, whether or not they have subsidiaries or affiliates in the EU, will have to comply with the Forced Labour Ban Regulation. Moreover, the non-EU companies indirectly exporting goods to the EU, that is, producing and distributing materials or parts for the products exported to the EU, will also be subject to the Forced Labour Ban Regulation.

The proposal follows the ordinary legislative process of the EU. However, it should be noted that, given its contentious nature and geopolitical dimension, the Forced Labour Ban Regulation is also highly controversial; therefore, the European Parliament and Council will likely provide their input.

The Forced Labour Ban Regulation is expected to be adopted and enter into force in 2024 at the earliest. Then, the new Regulation will apply 24 months from its entry into force, that is, in 2026. It should be noted that, unlike EU directives, EU regulations shall apply within the Member States without being incorporated into the national law.

### French Duty of Care Law

These proposals for the new EU rules on sustainability due diligence are still unclear from a practical point of view and many companies are confused about how to comply with such obligations and what are the potential

impacts on the company in the case of a breach. In order to better understand the practical implications of sustainability due diligence, it would be helpful to study some examples in European countries where such duty has already been imposed on large companies.

In France, there will be a hearing involving the French energy and petroleum company TotalEnergies before the Paris judicial court on 7 December 2022, upon a claim filed by NGOs on the basis of breaches of its duty of care. This case marks the first use of this concept created by the law of 27 March 2017 on the duty of care of parent companies and companies giving orders (the 'Duty of Care Law').<sup>9</sup>

The Duty of Care Law inserted an article L. 225-102-4 of the Commercial Code which establishes a regime for any French limited company (*société anonyme*) that employs, at the close of two consecutive financial years:

- at least 5,000 employees within the company and its direct and indirect subsidiaries whose registered office is in France; or
- at least 10,000 employees within the company and in its direct or indirect subsidiaries whose registered office is in France or abroad.

The companies that meet this criterion must establish and effectively implement a due diligence plan. The provision specifies that subsidiaries are deemed to fulfil this duty if the parent company establishes and implements a due diligence plan.

Due diligence plans should include reasonable due diligence measures to identify the risks to be prevented, the serious violations of human rights and fundamental freedoms, the health and safety of people, and the environment resulting from the actions of the company (or companies it controls). The plan should in principle be developed in association with the company's stakeholders. The Duty of Care Law provides at least five measures in the vigilance plan:

1. a risk map to identify, analyse and prioritise risks;
2. procedures for regular assessment of the situation of subsidiaries, subcontractors or suppliers with whom an established commercial relationship is maintained, in the light of risk mapping;

3. appropriate actions to mitigate risks or prevent serious harm;
4. a mechanism for alerting and collecting reports on the existence or occurrence of risks, established in consultation with the representative trade unions in the company; and
5. a system for monitoring the measures implemented and evaluating their effectiveness.

The company's management report must make public the company's compliance plan and its effective implementation. It is also specified that when a company that has been given formal notice to comply with the obligations set out therein fails to do so within a period of three months from the date of the formal notice, the competent court may, at the request of any person with interest in the matter, enjoin it, if necessary, under penalty, to comply with them.

In the TotalEnergies case, the NGOs have argued that the TotalEnergies' plan does not identify the risks in a precise manner, which makes it impossible to put in place effective vigilance measures. It is expected that the French courts will provide further clarification regarding the extent to which companies should specify the actions to be taken in the due diligence plan in this case.

## Conclusion

In the EU, the rules on sustainability due diligence, which impose burdensome obligations on companies operating a business in many countries, would no longer be a 'soft' law but legally binding provisions that can be enforced by competent authorities or parties with interest around 2025 at the earliest. Moreover, the TotalEnergies case illustrates that the failure of the sustainable due diligence obligations would result in court proceedings, which could have severe consequences on the company's operation within the EU as well as its reputation.

Despite the ambiguity of the proposed texts, it would be advisable that companies directly or indirectly subject to these new rules start assessing the risks of violations of human rights or environmental law within the supply chain.

## Notes

<sup>1</sup> European Commission, Proposal for a Directive on corporate sustainability due diligence and amending Directive (EU) 2019/1937, Brussels, 23.2.2022 COM (2022) 71 final.

<sup>2</sup> European Commission, Proposal for a Regulation of the European Parliament and of the Council on prohibiting products made with forced labour on the Union market, Brussels, 14 September 2022, COM(2022) 453 final.

<sup>3</sup> So-called the Conflict Minerals Regulation, Regulation (EU) 2017/821 of the European Parliament and of the Council of 17 May 2017, laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas.

<sup>4</sup> Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010, laying down the obligations of operators who place timber and timber products on the market.

<sup>5</sup> Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014, amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

<sup>6</sup> UK Modern Slavery Act 2015.

<sup>7</sup> European Commission, press release 'Just and sustainable economy: Commission lays down rules for companies to respect human rights and environment in global value chains', 23 February 2022, available at [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_22\\_1145](https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1145).

<sup>8</sup> 'Value chain' is defined as activities related to the production of goods or the provision of services by a company, including the development of the product or the service and the use and disposal of the product as well as the related activities of upstream and downstream established business relationships of the company (Article 3(g)).

<sup>9</sup> TotalEnergies' trial for non-compliance with due diligence in Uganda and Tanzania postponed (rfi.fr).



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# A Rising Topic and Explorative Practices— ESG in China

Although environmental, social and governance ('ESG') in China is still in the initial stage of standard formation and consensus building, with the rapid development of the ESG concept in China, it is no longer the 'icing on the cake' or an optional item for some enterprises and investment institutions, but a regular and mandatory item for enterprises' operation or investment evaluation. With expertise and experience in each of these areas, lawyers can assist companies and investment institutions in their ESG journey to address ESG risks and embrace ESG opportunities.





## Overview of the ESG Trend and Development in China

The incorporation of the 'ESG' concept into investment decision making or business operation management has become a global craze and the breadth of the issues covered and the complexity of the ecological system have determined that ESG practice is not only an exclusive issue that needs to be paid attention to by special enterprises such as heavy polluters and listed enterprises, but it is also a topic that all types of enterprises need to think about. In China today, how to carry out ESG practice has become an important issue for more and more enterprises.

ESG has become an important investment concept and corporate action guide worldwide. Specifically, at the investment level, ESG is an investment philosophy that focuses on the environmental, social and governance aspects of an enterprise's performance rather than only on its traditional financial performance; at the corporate level, ESG refers to the practice of incorporating environmental, social and governance factors into management operations.

There are no unified standards on what issues are included in ESG in China, and there are differences in the ESG matters required to be disclosed by regulatory authorities, ESG disclosure standards issued by international organisations, reference indicators used by ESG rating agencies and the issues that investors focus on when conducting ESG due diligence on target enterprises. Nevertheless, there are still major commonalities in the ESG issues of concern to various entities:

- E (Environment): focuses on environmental factors related to sustainable development, including climate change, natural resource use, pollution and consumption, etc.
- S (Society): focuses on the range of stakeholders involved in corporate activities, including employees, consumers, supply chain and community relations.
- G (Governance): focuses on the internal mechanisms established by the enterprise to achieve internal and external benefit needs and usually includes an examination of the enterprise's governance structure and the enterprise's business ethics.

Up to now, the ESG concept is an 'imported product' and a set of unified disclosure standards and evaluation system on ESG has not been formed at the level of legal regulation in China. The legal regulations on ESG are mainly divided into two parts: first, they are scattered in the underlying legal regulations that all parties must comply with, such as the Environmental Protection Law, Protection of Rights and Interests of Consumers Law, Employment Contract Law, Anti-Unfair Competition Law and Enterprise Law; second, they are scattered in the regulations of the Securities Regulatory Commission ('SRC') and the Stock Exchange on the disclosure of relevant non-financial reporting information of listed enterprises. Overall, there is a wide range of ESG-related regulations and a general ESG framework has been built. While specific standards and consensus are still being established and cultivated, the regulatory measures for ESG are still mainly voluntary and not unified, resulting in an uneven quality of ESG disclosures by enterprises.

The ESG concept started late in China compared to the international community. However, in recent years, with the participation of multiple entities, it has developed rapidly in China and will continue to 'travel in the fast lane'.

In 2022, ESG continued its previous vigorous development. With the announcement of the establishment of the Social Responsibility Bureau by the State-owned Assets Supervision and Administration Commission of the State Council in March 2022, a signal was released to promote enterprises to practice the ESG concept, which requires more state-owned listed companies to disclose ESG reports. In this context, how to carry out ESG practices will become a key concern for central enterprises and SOEs in the near future.

On 15 May 2022, the Guidelines on Investor Relations Management of Listed Enterprises issued by the SRC came into effect and ESG was explicitly included in the communication between listed enterprises and investors. In June 2022, the China Banking and Insurance Regulatory Commission issued the Guidelines for Green Finance in Banking and Insurance Sectors, which for the first time comprehensively proposed ESG requirements for financial institutions. In the context of ESG in China's

green capital market, capital market participants play two roles: on the one hand, they are the subjects who need to fulfil their ESG responsibilities; on the other hand, they are responsible for urging stakeholders to strengthen their ESG management by means of fund allocation and other means, thus achieving the effect of using green finance to promote the practice of ESG concepts in all sectors of society and achieve national economic transformation and sustainable development. Therefore, both listed companies and financial institutions are the key service targets of ESG.

On 1 June 2022, the China Enterprise Reform and Development Research Society issued China's first corporate ESG disclosure standard, the Corporate ESG Disclosure Guidelines.

The guideline is led by the China Enterprise Reform and Development Research Association, Capital University of Economics and Business and joined by dozens of standard development units, including the National Energy Investment Group, China Mobile, etc. It is expected that industry standards may lead to the development of ESG in China. This

is the first group standard for corporate ESG disclosure in China, which is localised in terms of ESG material issues and provides a framework guidance for Chinese enterprises to identify ESG material issues in the context of China's national conditions.

The guidance consists of a system of primary, secondary, tertiary and quaternary indicators. The primary indicators are the three dimensions of environment, society and governance; the secondary indicators (10) and tertiary indicators (35) are based on ESG theory, Chinese laws and standards, and the quaternary indicators (118) are specific measurement and assessment methods for the tertiary indicators. When Chinese enterprises identify major ESG issues, they should draw on the experience of the international standards while also incorporating elements with Chinese local contexts and goals, such as carbon peaking and carbon neutrality, promotion of rural revitalisation and common prosperity.

In this process, we have observed that more and more enterprises, especially listed enterprises, are more proactive in making ESG disclosures, from non-existent to excellent. Many enterprises are rapidly moving from

**While a company may cover a wide range of ESG issues, not all of them are worthy of inclusion in an ESG report.**

concern to action at the board level; climate change compliance is on the agenda, and many enterprises are thinking and acting on their 'dual carbon' policies. Environmental responsibility is no longer a story, but data. More industries have released their own ESG frameworks, combining different stakeholders with rating analysis to build better disclosure solutions.

In the historical process of ESG, E began to develop and mature in the 1960s along with major environmental events and various environmental issues have invariably stirred up huge public opinion controversies, contributing nearly half of the key issues and topics in the ESG evaluation system in recent years. Along with the struggle for control of companies and the prevalence of corruption and bribery in company management since ancient times, G has also been occupying a considerable amount of space in ESG reports of listed companies, highlighting the company's achievements in governance with detailed texts and icons.

In this way, S appears to be relatively unappreciated. However, as the epidemic brings uncertainty to the global economy, the way people work and live has undergone transformative changes and long-standing social issues such as workplace insecurity and employment have become more prominent and the focus on social issues in ESG has been greatly promoted. The way enterprises approach their social responsibility in social issues, how they promote labour compliance and how they handle relationships with stakeholders has become an important factor for investors to measure corporate value.

Selecting the key ESG issues can help enterprises clarify the focus of ESG practice and it is also a prerequisite for information disclosure and compliance management. At present, the scope and logic of the topics in the disclosure or evaluation criteria in the ESG reports that have been issued in China and abroad are different and the selection of topics in the ESG report disclosure of Chinese enterprises also lack uniform standards. In practice, most of the ESG reports/social responsibility reports/sustainability reports (hereinafter collectively referred to as 'ESG reports') disclosed by enterprises do not specify their issue selection methods, but there are some practical cases with reference value, for example, some enterprises have disclosed their key issue selection methods in their annual sustainability reports, through a three-stage analysis model of 'Issue

Identification—Issue Assessment—Report Screening', conducting stakeholder questionnaire research, statistical analysis and assessment of substantive issues for the report.

As mentioned above, ESG covers a wide range of issues, from climate change, energy management, pollution prevention in the environmental context, to employee health and safety, product quality and safety, data security and privacy, and supply chain management in the social context, to corporate governance structure, the balance of shareholders' interests, board independence and diversity, and various risk controls (such as anti-corruption and anti-bribery) are all part of its business.

While a company may cover a wide range of ESG issues, not all of them are worthy of inclusion in an ESG report. Generally speaking, the following issues are those that enterprises need to consider in their ESG practice: (1) how to select the issues in the ESG report; (2) how to reflect the sustainable development capability of listed enterprises in the issues; (3) how to respond to the concerns of investors and other stakeholders in the issues; (4) how to connect the issues with the statutory compliance requirements and mandatory information disclosure requirements; (5) how to reflect the positive response to the major national policies; and (6) how to connect with the existing ESG evaluation system.

## Chinese Legal Rules for ESG Issues

### Introduction

We have combed through the existing effective Chinese ESG-related policies, laws and regulations, standards and practice studies, as well as the disclosure or evaluation contents in domestic and international ESG standards, and summarised the common critical environmental, social and governance topics in ESG reports of listed enterprises.

### Environment

#### 1. An Increasing Concern

The environmental dimension, as one of the three major ESG dimensions, is an important element of ESG reports. In recent years, investors' concern about environmental issues such as climate change has increased and they believe that 'climate change has become the top issue on the ESG agenda in recent years', which is true here in China compared with the social and governmental dimensions.



## 2. Resource and Energy Management

Resource and energy conservation is a basic national policy in China and it is also inseparable from the reduction of carbon emissions. In practice, the resource and energy management information disclosed by listed enterprises in ESG reports mainly includes energy structure, energy consumption, energy conservation, water consumption and water conservation management, etc.

### *Energy Structure, Energy Consumption and Energy Conservation*

As early as 1997, China enacted the Energy Conservation Law, which sets forth energy conservation requirements for different industries and subjects. The Outline of the 14th Five-Year Plan for National Economic and Social Development and Long-Range Objectives for 2035 (hereinafter referred to as the '14th Five-Year Plan') also proposes to 'focus on new energy and other strategic emerging industries', 'promote the energy revolution' and 'promote the clean, low-carbon, safe and efficient use of energy'.

In practice, the information related to energy management disclosed by listed enterprises in ESG reports includes energy consumption, energy utilisation efficiency, the proportion of various types of energy (including renewable energy) used, energy saving targets, energy saving systems, energy saving measures, completion of energy saving targets and energy saving benefit analysis, etc.

### *Water Consumption and Water Conservation Management*

It is a legal requirement of the Water Law and a requirement of the 14th Five-Year Plan to implement water conservation initiatives. In practice, listed enterprises disclose information related to water management in their ESG reports, including the total amount and type of water consumption (fresh water/recycled water, etc.), unit water consumption and water saving, water saving targets, water saving systems and measures, and the effectiveness of water saving, etc.

## 3. Carbon Peaking and Carbon Neutrality

On 22 September 2020, Chinese President Xi Jinping proposed China's carbon peak and carbon neutrality targets in his important speech at the 75th General Debate of the United Nations General Assembly, and proposed to 'improve the carbon emission reporting and

information disclosure system for enterprises and financial institutions', which makes it a priority for listed enterprises to regularly publish information on their carbon emissions.

The SRC has made 'measures taken to reduce carbon emissions and their effects during the reporting period' a voluntary disclosure requirement for enterprises and requested that enterprises on the Science and Technology Innovation Board that disclose their ESG reports should focus on disclosing the measures they have taken to help achieve the 'carbon peak, carbon neutral' goal and promote sustainable development.

In practice, the information on carbon emissions disclosed by listed enterprises in ESG reports includes direct and indirect greenhouse gas emissions, emission reduction targets, emission reduction systems and measures, and the effectiveness of emission reduction. In addition, information on risks and opportunities related to climate change disclosed by listed enterprises includes disclosure of natural or regulatory risks or opportunities related to climate change, related impacts of the risks or opportunities, methods of managing the risks or opportunities, and costs of related actions.

## 4. Ecological and Environmental Protection

Ecological environmental protection is the basic national policy of China. To do a good job in ecological environmental protection, enterprises need to comply with the law in environmental management and ecological protection in all pollutant emission aspects throughout the life cycle of each project.

In practice, the information related to ecological environmental protection disclosed by listed enterprises in ESG reports includes ecological and environmental risk assessment and protection measures taken throughout the life cycle of the project, various types of pollution emissions, emission reduction targets, emission reduction measures or technologies, emission reduction effectiveness, wildlife, habitat and biodiversity protection, ecological and environmental management and restoration, etc.

## Society

### 1. Complex Issues

The social issues in ESG practice are very extensive, complicated and even politically sensitive sometimes. They involve various stakeholders in the process of enterprise operation, and once they are not

handled properly, significant negative public opinion of the enterprise may occur and even affect the development of enterprise operation activities in addition to regulatory risks. Paying attention to social issues is of great significance to the long-term development of enterprises and the creation of long-term corporate value in the new era.

## 2. Protection of Employees' Rights and Interests

The protection of employees' rights is the theme and a statutory requirement of the Labor Law, the Employment Contract Law and other laws and regulations in this field. Employee protection and protection of employees' rights and interests are also important elements of the disclosure requirements of the Shenzhen Stock Exchange for social responsibility reports of listed enterprises. Domestic and international ESG standards also include employee rights and interests protection as a disclosure or evaluation content in the social dimension.

Enterprises' practices in employee rights protection could include employment and anti-discrimination, occupational health and safety, employee compensation and benefits, etc.

### *Equal Employment and Anti-discrimination*

The Employment Promotion Law stipulates that enterprises shall provide equal employment opportunities and fair employment conditions to workers and shall not engage in employment discrimination, as an important disclosure or evaluation content of the 'Employee Rights Protection' section in the social dimension. In practice, the information related to equal employment and anti-discrimination disclosed by listed enterprises typically includes the establishment of a recruitment system to regulate recruitment requirements and processes, gender, age and regional distribution of employees, etc.

### *Occupational Health and Safety Production*

The protection of occupational health and safety is a legal requirement under the Labor Law, the Law on Prevention and Control of Occupational Diseases and the Law on Work Safety. Domestic and foreign ESG standards also include occupational health and safety production as the disclosure or evaluation content in the social dimension.

In practice, the information related to occupational health and safety production disclosed by listed enterprises includes occupational health management,

certification of occupational health and safety management system, number of new occupational diseases, safety production management system, safety promotion and employee training, hidden danger investigation and remediation, emergency management system, safety production investment, safety production accident and work injury response, etc.

### *Employee Compensation and Benefits*

Compensation and benefits are also disclosed or evaluated in the 'employee rights and interests protection' section of the social dimension of ESG standards in and out of China, which includes employee responsibility, employee care, occupational health and safety, etc.

In practice, the employee responsibility section in the report of listed enterprises discloses the enterprise's efforts in employment system, employee training and development, compensation system and employee protection, including the development of a comprehensive compensation management system, the provision of staff canteen, staff dormitory, shuttle bus, special medical fund, staff school, maternity room and other aspects of housing, transportation, children's education, medical care and other services for employees, etc.

## 3. Protection of Consumer Rights and Interests

The Protection of Rights and Interests of Consumers states that: 'Protection of legitimate consumer rights and interests is the common responsibility of the society'. Domestic and international ESG standards also include consumer protection as an important disclosure or evaluation content in the social dimension.

In practice, the disclosure of information related to consumer protection by listed companies may include information on consumer protection systems, mechanisms and service systems, consumer protection activities, consumer protection measures taken, customer satisfaction surveys, customer complaint handling, etc.

## 4. Social Responsibility with Chinese Characteristics

In addition to domestic and international ESG standards which normally include public welfare and charity as disclosure or evaluation content in the social dimension, there are many social responsibility issues which are emphasised in China. For example, the Promotion of



It is worth noting that human rights are comparatively sensitive and ambiguous issues in China.

Rural Revitalization Law encourages enterprises to participate in the wave of rural construction.

In practice, listed companies disclose information related to rural revitalisation undertakings, which may include regional economic development, scientific research or technological innovation, precise poverty alleviation, special group relief, disaster relief and epidemic prevention, etc. Some companies disclosed in their ESG reports their work in helping rural revitalisation, focusing on children's healthy growth, regional economic revitalisation, post-disaster education revitalisation, beautiful villages projects, and sick children's aid programs, as well as actions in several major areas such as ecological and environmental protection, support for science and technology innovation, and community development, to devote themselves to social welfare and give back to society.

It is worth noting that human rights are comparatively sensitive and ambiguous issues in China. Therefore, there are rare practices in this regard. However, as the Constitution Law of China explicitly provides that human rights shall be comprehensively protected, it is believed that more enterprises will consider this topic as the ESG develops.

## Governance

### 1. Corporate Governance

According to the laws and regulations such as the Enterprise Law, the Securities Law, Guidelines on Governance of Listed Companies, and the industry regulations and guidelines of stock exchanges, the general meeting of shareholders, the board of directors, the supervisory board, the management, and the professional committees of listed enterprises should perform their duties conscientiously in accordance with the provisions of the articles and the positioning of their duties to achieve coordinated operation and effective checks, which ensures a clear ESG governance structure, smooth information communication and perfect working mechanism.

### 2. Shareholder Governance

The Enterprise Law and Guidelines on Governance of Listed Companies stipulate that enterprises should protect the legal rights of shareholders and ensure that they are treated fairly, as well as respect the basic rights and interests of stakeholders. Listed enterprises shall disclose in the annual report the status of shareholders and changes in shares, shareholders' meeting, controlling shareholders, protection of the rights and interests of small and medium shareholders, etc.

In practice, listed enterprises could disclose in the ESG report the relevant content at the institutional level and the practical level with respect to shareholder governance, including: the institutional level shall include the rules of procedure of shareholders' meetings, the policy on profit distribution to shareholders and the regulations related to investor protection, etc.; the practical level shall include the number of shareholders' meetings held, the voting method, the content of topics, the information channels for communication with small and medium shareholders, the content and frequency of communication, etc.

### 3. Organisational Structure

According to the Enterprise Law, the Securities Law, Guidelines on Governance of Listed Companies and other laws and regulations, as well as the regulatory

documents of stock exchanges, listed enterprises should, in accordance with the aforementioned regulations, clarify the responsibilities and authority, terms of appointment, rules of procedure and working procedures of the board of directors, the supervisory board and the management, so as to ensure the separation of decision making, execution and supervision.

In practice, most listed enterprises have disclosed in their ESG reports their efforts in building ESG governance mechanisms with reasonable structure, strict procedures and scientific decision making, including the establishment of ESG governance structure and the division of ESG management functions at various levels and departments within the enterprise.

#### **4. Governance of Directors and Supervisors**

According to the Guidelines on Governance of Listed Companies, clear provisions are made for the composition and duties of the board of directors and the supervisory board, the selection and appointment of directors, supervisors and senior management, performance evaluation and incentive and restraint mechanisms, the system of independent directors and the protection of stakeholders' interests. Since the board of directors is an important part of the corporate governance mechanism and the efficiency of its governance directly affects the performance of the enterprises and the interests of all shareholders, there are special provisions in laws and regulations and stock exchange guidelines for directors and boards of directors of listed enterprises.

In practice, listed enterprises can disclose the relevant contents at the institutional level and practical level in the ESG report for the governance of directors and supervisors: the institutional level can include the status and responsibilities of the board of directors, supervisory board and senior management, the system of independent directors, the value code and code of conduct guidelines for directors, supervisors and senior management, and the remuneration management methods, etc.; the practical level may include the number of meetings of the board of directors and supervisory committee, the structure of the board of directors to maintain diversity and professional background, the training and evaluation of the performance of directors, supervisors and senior management, etc.

#### **5. Establishment of the Organisation of the Chinese Communist Party**

The Enterprise Law and the Guidelines on Governance of Listed Companies provide for the establishment of the organisation of the Communist Party of China ('Party') and the development of the Party activities in listed enterprises. The listed enterprises should provide necessary conditions for the activities of Party organisations. State-controlled listed enterprises, in accordance with the Enterprise Law and relevant regulations, should also incorporate the requirements related to the establishment of the organisation of the Party into their articles of association, taking into account the enterprise's shareholding structure, business management and other practicalities. The Guidelines for Articles of Association of Listed Companies have added provisions on the establishment of party organisations of listed enterprises.

Therefore, although we have not yet seen ESG-related domestic and international standards include the Party building work as a disclosure requirement, we understand that listed enterprises, as important builders and participants of the Party-led socialist cause with Chinese characteristics, should carry out the Party activities according to the aforementioned statutory requirements, and it is likely that establishment of the organisation of the Party will become an important localised indicator in the future ESG disclosure-related standards or guidelines in China. Therefore, listed enterprises could include establishment of the organisation of the Party as the disclosure content of ESG report to highlight the organisation and standardisation of corporate governance.

From the operation of the establishment of the organisation of the Party of listed enterprises in practice, listed enterprises generally stipulate in the articles of association the main duties of the Party committee and the pre-procedures of the Party committee's deliberations and decisions, make it clear that the board of directors should listen to the views of the Party committee in making decisions on major matters, set up an enterprise disciplinary committee to supervise disciplinary violations, strengthen the construction of the enterprise's party members and carry out the construction of the party style and clean government, etc.

## Outlook of ESG-related Legal Services in China

International consulting firms are currently at the forefront of ESG services, and these professional organisations provide a wide range of related consulting services, but mainly around ESG reports, which seem to be more focused on industry research, audit and accounting, statistical analysis, data management, impact on asset valuation and other perspectives. The construction of a professional compliance management system for ESG and the establishment of ESG management process rules are still in the embryonic stage. The selection of topics for ESG reports requires a systematic review of current laws, regulations and policy requirements, as well as a comprehensive consideration of the actual situation of corporate management and stakeholder concerns and reference to the ESG report evaluation criteria guidelines, which are indispensable for a comprehensive, accurate and appropriate selection of topics. While the top large law firms have recently begun to leverage their broad areas of expertise and robust personnel to capture the expanding ESG services market, specialised firms have the unique advantage of providing in-depth services in certain niche indicators.

In particular, lawyers, as professionals, are closely related to ESG from the soil of growth and their own genes. Lawyers usually take corporate business as the cornerstone and establish long-term cooperation with enterprises. Due to the specificity and importance of legal affairs, lawyers are often deeply involved in all levels of strategic decision making in corporate development, including but not limited to:

1. Paying attention to ESG at the strategic level, assisting enterprises to formulate and improve system documents, improve ESG organisation and promote the construction of an internal ESG system.
2. Assisting enterprises to establish and improve the ESG management process through compliance consulting, due diligence, project review, contract review, compliance training, etc., and integrating ESG strategy into investment decision, product development, sales operation and other aspects.
3. Tracking ESG regulatory developments and domestic and international disclosure standards, identifying and responding to ESG compliance risks,

assisting enterprises in ESG disclosure, publishing ESG reports, realising multilateral dialogue and interaction with stakeholders, assuming more social responsibility, and leading the standard setting of the whole industry.

ESG in China is still mainly in the primary stage of standard formation and consensus building and the current ESG services are mainly to meet the requirements of ESG reports. However, from the perspective of the fundamental concept of ESG and the long-term development of enterprises, the roots of meeting ESG report requirements and promoting ESG practice lies in the accurate understanding of relevant laws, while the practice and adjustment of enterprises to meet ESG assessment and reporting requirements need to incorporate legal and compliance perspectives into corporate management, which are very important values and roles for lawyers to join the ESG service field.



**Dr Jiang Junlu**  
Managing Partner, Beijing Puran Law Firm, Beijing

Dr Jiang Junlu is among the earliest Ph.D. holders in labour law in China and specialises in labour law. He has previously led a research team in drafting the PRC Employment Contract Law upon the Legal Affairs Office of the PRC State Council's request. Dr Jiang now is the Managing Partner at Puran Law Firm.



**Dr Luo Kaitian**  
Founding Partner, Beijing Puran Law Firm, Beijing

Dr Luo Kaitian specialises in labour and employment law, corporate compliance and general business and commercial matters. He has rich experience in handling labour issues in M&A, bankruptcy, layoffs and international employment. Dr Luo initiated the establishment of the Beijing Puran Law Firm as a Founding Partner in January 2022.

# Environmental, Social and Governance Standards in India

Governance norms in India have been gradually strengthened in the past decade, first through the introduction of a new Companies Act 2013, and then through the regular introduction of standards and regulations by the Ministry of Corporate Affairs. Environmental, Social and Governance ('ESG') standards and compliance are at the forefront of these norms. This article summarises the development and progression of ESG in India, although much remains to be done.



## Introduction

ESG or Environment, Social and Governance have become buzzwords in modern economic parlance, and the value or worth of a company is almost always now impacted by its commitment to ESG. Stakeholders' focus on ESG is reflected in the investing pattern of investors. Countries are adopting ESG into their legislation. Investors are requiring companies to disclose ESG compliance in their annual reports. Stock Indices are developed for ESG assessment and reporting.

Globally, promotion of ESG is encouraged through:

1. The Paris Agreement: a legally binding international treaty on climate change, the focus of which is environmental protection and sustainable development by assisting developing and developed countries in meeting their mitigation targets.
2. The UN Sustainable Development Goals: adopted by member states of the United Nations in 2015 and likely to be used in ESG assessment frameworks.



3. The Green, Social and Sustainability bonds: used to finance projects that have environmental benefits.

## Development of ESG in India

### Introduction

In India, development of ESG started in the year 2009 when the Ministry of Corporate Affairs of the Government of India published the Corporate Social Responsibility Voluntary Guidelines, recommending that all businesses should formulate a Corporate Social Responsibility ('CSR') policy. Thereafter, ESG in India has developed through various regulations like Corporate Social Responsibility under the Companies Act 2013, Business Responsibility and Sustainability Reporting, Stock Exchange Reporting, etc.

Over the past decade, the Government of India has formulated many regulations and offered great incentives for the promotion of environmental, social and governance standards. On one hand, there are a multitude of incentives and subsidies in the form of business opportunities encouraging companies to embrace environmentally friendly businesses and practices. On the other, the government has

enforced stricter regulations and norms to achieve its sustainability objectives.

### Corporate Social Responsibility

The Companies Act 2013 requires companies with the following threshold of turnover or profitability to establish a CSR Committee, develop CSR policies, spend 2 per cent of profits on these policies and report on these activities to the shareholders in its annual report:

- net worth of at least INR5 billion;
- turnover of at least INR10 billion; or
- net profit of at least INR50 million.

Companies are encouraged to focus their CSR activities on eradicating poverty, hunger and malnutrition; improving education; promoting gender equality and female empowerment, as well as environmental sustainability. Since the outbreak of the COVID-19 pandemic, CSR funds are permitted to be used for alleviating pandemic-related hardship as well.

Prior to 2019, CSR spending was voluntary. After the 2019 amendment to the 2013 Act, it has been made a mandatory obligation for companies. As per the new amendment, a company must transfer the unspent CSR amount to a government-specified fund. Non-compliance to this requirement attracts penalties for the company and defaulting officers.

New CSR rules enacted in 2021 have laid down the reporting mechanism for companies. Companies to whom CSR is applicable must prepare an annual report on CSR in the prescribed format and attach it to its board report. Companies exceeding the specific threshold of CSR obligations must undertake an impact assessment by an independent agency. CSR activities must be displayed on the company's website.

### National Voluntary Guidelines

In 2009, India's Ministry of Corporate Affairs published the Corporate Social Responsibility Voluntary Guidelines (the 'CSR Guidelines'), recommending that all businesses formulate a CSR policy. Since then, sustainability disclosures have formed an integral part of the best practices of any company that wants to develop and demonstrate its green or community-oriented credentials.

In 2011, the CSR Guidelines were superseded by the expanded and more detailed National Voluntary Guidelines ('NVGs') on Social, Environmental and Economic Responsibilities of Business, containing comprehensive principles to be adopted by companies as part of their CSR activities. This introduced a structured reporting format for business, requiring certain specified disclosures and demonstrating the steps taken by companies to implement the ESG principles.

The NVGs define nine principles of responsible business conduct to be adopted by companies as part of their practices and mandates for preparing a business responsibility report by providing stakeholder information about the initiatives, impacts and future course of action across ethics, transparency and accountability, product life-cycle sustainability, employees' well-being, stakeholder engagement, human rights, environment, public advocacy, inclusive growth and customer value.

In 2019, the NVGs were revised and the Ministry formulated the National Guidelines on Responsible Business Conduct ('NGRBC'). The NGRBC have been designed to assist businesses in fulfilling their regulatory compliance requirements. The NGRBC are made applicable to all businesses, irrespective of their ownership, size, sector, structure or location. These new guidelines contain precise pillars of business responsibility (called principles) and are accompanied by a set of requirements and actions that are essential to the operationalisation of the principles, referred to as the 'core elements'. The principles highlighted in the NGRBC are:

- businesses should conduct and govern themselves with integrity in a manner that is ethical, transparent and accountable;
- businesses should provide goods and services in a manner that is sustainable and safe;
- businesses should respect and promote the well-being of all employees, including those in their value chains;
- businesses should respect the interests of and be responsive to all their stakeholders;



**New CSR rules enacted in 2021 have laid down the reporting mechanism for companies.**

- businesses should respect and promote human rights;
- businesses should respect and make efforts to protect and restore the environment;
- businesses, when engaging in influencing public and regulatory policy, should do so in a manner that is responsible and transparent;
- businesses should promote inclusive growth and equitable development; and
- businesses should engage with and provide value to their consumers in a responsible manner.

### **Business Responsibility and Sustainability Reporting**

In August 2012, the Securities and Exchange Board of India ('SEBI') issued the business responsibility report ('BRR') norms, making it mandatory for the 100 largest listed companies to publish an annual business responsibility report, capturing the company's non-financial performances through economic, environmental and social factors. In 2015, this requirement was expanded to the 500 largest companies and in December 2019, to the 1,000 largest listed companies.

In May 2021, SEBI introduced a new reporting format, the Business Responsibility and Sustainability Report



('BRSR'), which is effective from the 2022–2023 financial year. The BRSR, in addition to the existing factors, focuses on sustainability-related factors.

The BRSR requires companies to disclose their compliance with the nine principles of business responsibility, which include ESG factors. For Indian companies to attract future investment, they must disclose their performance on ESG factors along with financial factors, which makes publishing the BRSR essential.

The BRSR requires companies to detail the initiatives taken from an ESG perspective, in a prescribed standard template format which helps companies to publish their BRSR in a structured manner. It also helps the government in conducting a comparative analysis across multiple entities.

Companies that follow an internationally accepted reporting framework to publish their sustainability reports are not required to prepare a separate report. They have only to furnish the same to their stakeholders along with the details of the international framework under which their BRSR has been prepared along with a mapping of how the principles contained in these guidelines apply to disclosures made in their sustainability reports.

### Stock Exchange Disclosure and ESG Indices

In 2018, the Bombay Stock Exchange published a guidance document on ESG disclosures, which serves as a comprehensive set of voluntary ESG reporting recommendations, guided by global sustainability reporting frameworks. This provides 33 specific issues and metrics on which companies should focus.

The National Stock Exchange ('NSE') of India has launched two ESG indices, NIFTY100 Enhanced ESG Index and NIFTY100 ESG Index, to appeal to those parts of the investment community looking to align their investment with ESG goals. The ESG indices cover a company's:

- impact on the environment, such as its carbon intensity, recycling and waste management processes and development of renewable energy;
- social factors such as policies and the impact of a company's activity on working conditions, human rights, health and safety norms and financial inclusion; and

- governance factors measuring the effectiveness of processes and policies pertaining to corporate governance, business ethics, fraud, anti-corruption measures and public policy.

A company is rated based on three main areas: preparedness, disclosure and performance. Preparedness indicators measure the effectiveness of a company's policies, programmes and structures; disclosure indicators measure the effectiveness of a company's standards and reporting process; and performance indicators capture the company's controversies and incidents and its response to them.

### Conclusion

ESG reporting and investment in India is gradually increasing. For now, ESG reporting is only limited to the top listed companies. But it is only a matter of time before it is made applicable to all companies, irrespective of their size and legal structure. It is recommended that all companies take a proactive approach to include ESG in their business conduct and reporting. Companies with a good ESG track record are increasingly being considered good long-term investments by investors.



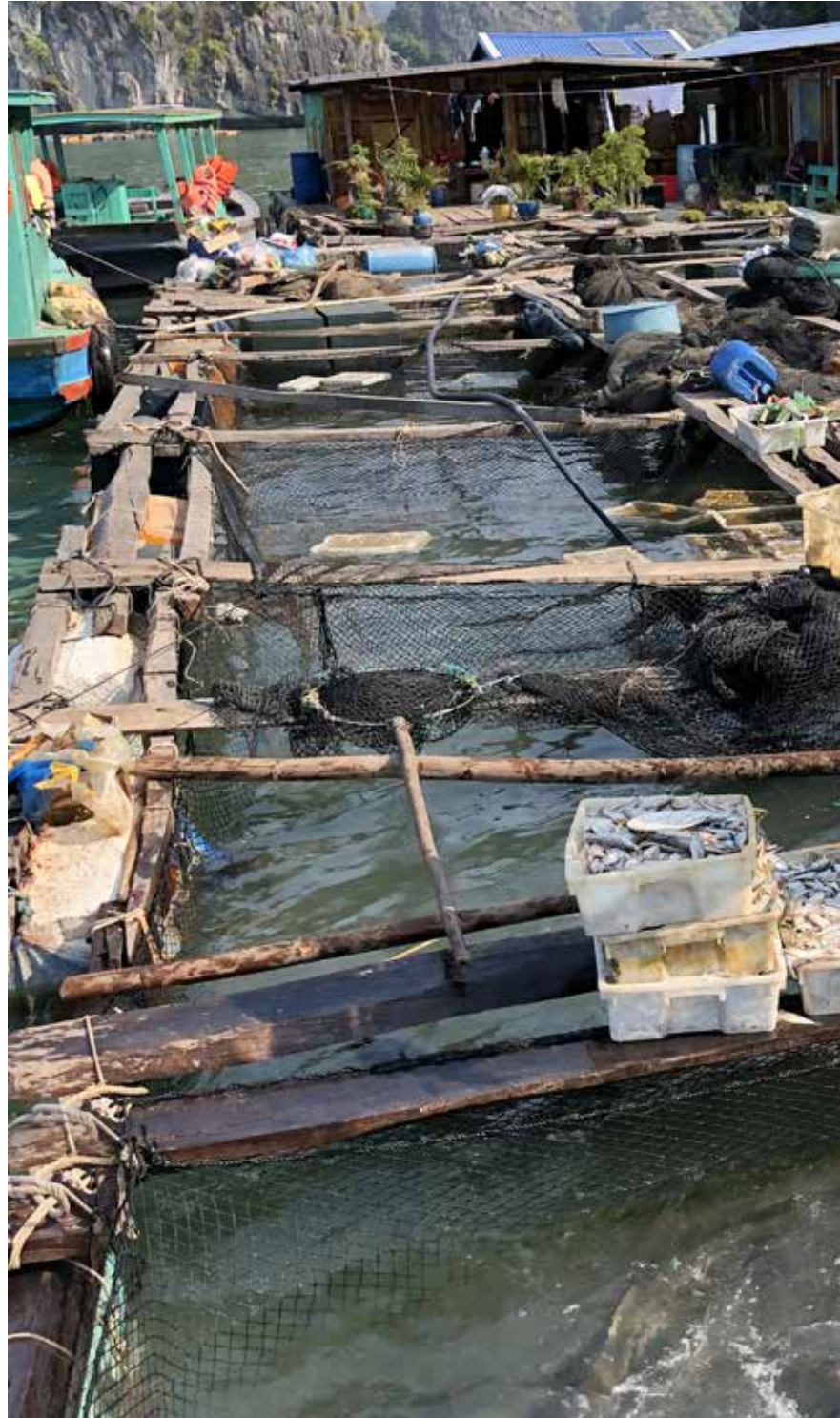
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Shabbir S Wakhariya is a multi-jurisdiction, internationally qualified lawyer, admitted to practice in India, New York, Washington DC and as a Solicitor of England and Wales. Mr Wakhariya primarily advises international companies doing business in India on set up, compliance, governance and regulatory issues and guides boards of directors on best practices and risk assessment for various business initiatives. Mr. Wakhariya also acts as outside General Counsel to several international companies. He heads a full-service law firm which he founded in 1998 and leads a team of lawyers in offices located in Mumbai and Pune, and through independent affiliates located in New Delhi, New York, Washington DC, Luxembourg, Paris, Munich and Taipei.

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# ESG Law And Practice in Vietnam

ESG has become as an integral part of oriented development and operation of an enterprise. Increased scrutiny from investors, changes in expectations of consumers and customers, and changes in public policy mean companies are facing new pressures to evaluate, publish and improve ESG-related issues.



## Introduction

The phrase Environmental, Social and Governance ('ESG' or 'ESG criteria') first appeared in 2003 in a United Nations report called 'Who Cares Wins' and is applied by investors and managers in the management



and development of their own business. Over a period of operation, enterprises as well as countries realise that this is a necessary criterion for the sustainable development of an enterprise and one that investors consider themselves when choosing businesses in which they invest. In Vietnam, the ESG criteria has been known since 2017, although it is still vague, but through the process of trading with transnational enterprises as well as investment funds, enterprises in Vietnam acknowledge that the ESG criteria is no longer a standard for sustainable development, but it is also considered a prerequisite for the subsistence of each enterprise, especially after the severe impacts of the Covid pandemic.

## Understanding ESG

ESG is an acronym that includes E-Environmental (environment), S-Social (society) and G-Governance (corporate governance); this is a set of standards to measure factors related to sustainable development and the impact of enterprises on the community.

When it comes to 'environment', it can be understood that enterprises need to comprehensively consider issues of energy, waste treatment, nature conservation, greenhouse effect, building eco-friendly supply chains and others to ensure the sustainability of the environment. In other words, the enterprises not only focus on financial benefits but also need to ensure they are 'green' for the environment, not only for the present but sustainably for the future.

For the 'society' criterion, this requires criteria for enterprises to maintain harmony between business profits and consumers, harmony in relationships with partners, suppliers and customers, government and especially with the community. Accordingly, in relation to the community, besides earned benefits, enterprises should also join with the government in social security issues.

The remaining criterion in the ESG standard is 'governance', which is to maintain sustainability and enterprises should harmoniously balance the relationships between them and their members and shareholders against conflicts of interest. Fairness and transparency should be ensured between enterprises and shareholders and between members and shareholders to maintain internal stability and avoid disputes and conflicts that affect the business

stability. Especially for listed companies on the stock exchange, this factor plays a key role in their securities transactions.

The above criteria contribute to forming a common standard called ESG, which is considered the basis for assessing the sustainability of enterprises. Currently, investors are concerned in relation to the traditional business model because of the potential risks in the dissatisfaction of environmental-social-governance standards. If not fully meeting these criteria, enterprises will face the risk of instability from internal conflicts or violations of the law and of more concern, boycotts from customers.

In recent years, with the effects of climate change or conflicts arising from members of large-scale corporations, investors have been more hesitant to invest, thereby viewing ESG as an indispensable standard and using ESG as a measure of enterprises. They have issued a set of criteria to evaluate the satisfaction of an enterprise's ESG, from which they can consider whether to invest in the enterprise.

## ESG Under Vietnamese regulations

### Introduction

Catching up with the global investment trend, the Government of Vietnam has developed action plans for each period, specifically to implement the National action plan on green growth for the period 2014–2020, the Governor of the State Bank issued Directive No 03/CT-NHNN dated 24 March 2015, related to the green credit promotion and management of environmental and social risks within the scope of credit granting activities. In 2018, the green banking development project in Vietnam was approved. The approval of this project also contributes to increasing the awareness of the enterprises operating in the fields of finance and banking that are responsible for environmental issues. However, this just scratches the surface, because these projects and plans only generally recognise the responsibility of enterprises to the environment, but not responsibilities to society and governance.

As at the time of writing this article, the Vietnamese Government has not issued a specific document in which ESG is concretised as a set of standards to

evaluate the operations of enterprises like the ISO standards that we have applied. The State Securities Commission was one of the earliest Vietnamese state management units involved in the development of criteria for sustainable corporate development, but they are currently only recognised principles for determining whether an enterprise meets the Environmental and Social criteria; there are no specific regulations that fully recognise the ESG criteria.

Thus, when an enterprise develops a set of ESG standards, the enterprise must check the legal provisions of each criterion, and based on that, form a separate ESG standard corresponding to the enterprise. In the same way, investors or funds will develop their own sets of ESG standards based on which to evaluate the invested enterprise to determine its eligibility to receive investment capital.

Although the general provisions for ESG standards have not been regulated by the Government of Vietnam, when separating each environmental-social-governance criteria, it can be seen that these regulations are scattered in specialised legal documents. Please refer to the following provisions of each criterion in the legal documents.

### Environment

The Law on Environmental Protection 2020 is a legal document that directly regulates the issues regarding the Environment in the ESG standard. Although this document does not have any provision on how to determine whether an enterprise meets the 'environmental' criterion, it sets out the ways that enterprises should behave to protect the environment. Accordingly, there are several actions that enterprises must not take towards the ultimate goal of environmental protection, specifically, as in Article 6 of the Law on Environmental Protection, there are prohibited acts in environmental protection as follows:

1. Failure to transport, bury, discharge and burn solid and hazardous waste in accordance with technical process and regulations of law on environmental protection.

**The Law on Environmental Protection 2020 is a legal document that directly regulates the issues regarding the Environment in the ESG standard.**

2. Discharging wastewater and exhaust gases that have yet to be treated according to technical regulations on environment into the environment.
3. Dispersing and releasing into the environment hazardous substances and harmful viruses capable of infecting humans and animals, untested microorganisms, dead bodies of animals dying of epidemics and other agents harmful to human health, creatures and nature.
4. Generating noise and vibration in excess of the permissible level stipulated in technical regulations on environment; discharging smokes, dusts and noxious gases into the air.
5. Executing investment projects or discharging waste in case of failure to satisfy all conditions prescribed by the Law on Environmental Protection.
6. Importing, temporarily importing, re-exporting and transiting waste from foreign countries in any shape or form.
7. Illegally importing used vehicles, machinery and equipment for the purposes of dismantling or recycling.
8. Failure to operate works or take measures to prevent and respond to environmental emergencies in accordance with regulations of law on environmental protection and other regulations of law.
9. Concealing acts of polluting the environment, obstructing and falsifying information concerning environmental protection activities, thereby resulting in adverse effects on the environment.
10. Manufacturing and trading products harmful to humans, creatures and nature; manufacturing and using raw materials and building materials containing toxic factors in excess of the permissible level prescribed in technical regulations on environment.
11. Manufacturing, importing, temporarily importing, re-exporting and selling ozone-depleting substances prescribed in the international treaty on substances that deplete the ozone layer to which the Socialist Republic of Vietnam is a signatory.
12. Sabotaging or infringing upon natural heritage sites.
13. Sabotaging or infringing upon structures, equipment and facilities serving environmental protection activities.
14. Abusing positions or powers to commit violations against regulations of law on environmental protection.

In addition to the provisions of the above-mentioned prohibited acts, there are specific requirements and responsibilities of enterprises based on their fields of operation, business sectors, scale, production projects, environmental objects to be protected (such as water, soil, air, etc.). Some notable points are referred to below:

- Enterprises should actively develop assessments of the project's potential impacts on the environment, which is clearly demonstrated by their responsibility to prepare environmental impact assessment reports when implementing investment projects. This is a proactive measure to detect potentially harmful factors to the environment and propose solutions to prevent, treat waste and remedy environmental problems.
- Enterprises should apply for an environmental permit. Accordingly, for a number of fields with potential risks to the environment, enterprises must carry out licensing procedures before operating.
- Enterprises shall provide their information and information of organisations and individuals related to environmental factors, implement preventive measures as well as measures to respond to environmental incidents, etc.

However, the above regulation is only for guidance for compliance with the law and the fact that enterprises fully comply with the provisions of the law on the environment does not mean that the enterprises meet the 'environment' criterion in ESG. Because the enterprise's environmental responsibility is not only within the scope of complying with regulations on the use of resources, but the enterprise should also proactively have solutions to minimise the impact on the environment. Every enterprise should have innovative and creative solutions to minimise the impact of climate change on its business activities, as well as consider the option of using renewable energy.

## Society

Similar to the 'environment' criterion, even if each criterion is separated, there is currently no document in Vietnam's law that regulates and instructs enterprises on what to do to be considered as meeting the 'society' criterion, as well as there being no official definition according to the understanding of the Government of 'what is the "society" criterion?'. Currently, enterprises are self-assessing and building the 'society' criterion on the basis of both achieving profits and creating benefits and value for employees, customers and communities. The success of an enterprise lies not only in business operation results but also in a commitment and fulfilment of responsibility to society and the community. Only values that bring meaning to people and the community are sustainable values because, after all, the interests of enterprises more or less depend on the benefits of society.

## Governance

What is the 'governance' criterion and how is it determined? This issue has not been specifically regulated by any legal documents of Vietnam; it is similar to the 'society' criterion. The 'governance' criterion is scattered in specialised documents such as enterprise law, labour law, etc. Especially in the scope of internal governance of enterprises, members/shareholders, the Law on Enterprise 2020 has stipulated provisions that enterprises should comply with in order to create stability and harmony in the relationship between enterprises and members and between shareholders themselves to avoid conflicts of interest.

## ESG Application Trend in Vietnam

The term 'ESG' appeared in Vietnam before 2000; however, the majority of enterprises or experts in various industries were not interested in ESG nor understood the genuine nature of the term. When it first appeared in Vietnam, ESG was mainly applied by enterprises operating in the field of finance, but only in the state of exploration, or only applying part of the standard. Since 2017, an enterprise operating in the field of finance, namely the Ho Chi Minh City Stock Exchange, had launched the Vietnam Sustainability Index ('VNSI'), but this Index only attracted a certain number of enterprises, even at the time in 2017, the issue of a 'sustainable development index' or ESG standards was still quite strange to Vietnamese enterprises.

Actually, before the period of 2021–2022, the ESG concept was better understood and applied widely and evenly by enterprises in several fields, not only in financial businesses as previously. ESG has in fact been carried out by many enterprises and applied thoroughly in business activities.

Typically, there are several pioneering enterprises in the application and maintenance of ESG implementation in Vietnam, including the Vinamilk Company and Masan Group. As for investors, with the desire to find sustainably developed enterprises to eliminate risks from enterprises receiving investment capital, investment organisations have built their own sets of ESG criteria based on which they search for enterprises that they believe will give them substantial profits. Tundra Frontier, a fund specialising in investing in new markets, has also chosen to invest in ESG enterprises. To facilitate the selection of enterprises that meet ESG standards, this fund has also developed and applied eight ESG criteria to evaluate enterprises.



However, Vietnamese enterprises have not yet received high appreciation from investment organisations when it comes to ESG standards since, coming from a developing country, Vietnamese enterprises are mainly focusing on creating immediate profits and not concentrating on sustainability factors. A representative of the Dragon Capital organisation commented as follows: 'Vietnam is a developing country, most enterprises are still focusing on growth without focusing on investing properly in resources to integrate environmental, social and corporate governance (ESG) factors into production and business activities', while the Mobius Partners fund has said that businesses in Vietnam still need to make more efforts in improving transparency and governance capacity.

From 2020 until now, the COVID-19 pandemic has caused substantial damage to many enterprises, but this is also a factor that accelerates the application of ESG; investors have changed the criteria for selecting

enterprises to invest capital, whereby ESG has gradually replaced traditional financial indicators.

According to Morningstar's assessment and statistics, in 2020, ESG funds have attracted record cash flow, twice as much as the previous year. Net cash money from investors pouring into sustainability funds totalled US\$51 billion, rising to a record high for the fifth consecutive year. Organisations with investment activities in Vietnam have also made comments from which Vietnamese enterprises have made positive changes in understanding and practising ESG. Typically, Mr. Bournet Gregory, Corporate Finance Director of PwC Vietnam and Malaysia, said: 'Banks, financial institutions or private investment funds are shifting their investment strategies in the present and future through the lens of ESG'. He also said that commitments aimed at ESG factors are changing the way enterprises are valued and their attractiveness in the eyes of investors. Mr Vicente Nguyen, Fund Manager at AFC Vietnam Fund, commented: 'The flow of capital into ESG investment funds is an inevitable trend, when a series of world powers including the US, Japan, Korea, EU, etc. Australia is focused on promoting ESG criteria to improve environmental quality, reduce emissions and balance society'.

All of this shows that investors and enterprises in the Vietnamese market are very interested in ESG criteria and Vietnamese enterprises are aware that the investment trend is directed to enterprises applying ESG. That is a reason why they need to change.

Reality shows that some enterprises in Vietnam when applying ESG criteria have achieved certain results, which is making other enterprises believe that choosing to develop under ESG criteria is a good call. A typical example can be seen of Vinamilk through its development period. Vinamilk had applied ESG in its operations before 2012, and in 2012, the company's annual sustainability report was published in its annual report, presenting ESG standards transparently. This company has also been continuously evaluated in the top 20 VNSI green stocks, with a total ESG rating of 90 per cent. Moving towards ESG standards, Vinamilk has implemented a self-contained production process organically, whereby it has invested in farms according to the European Organic and Global G.A.P. standards, managing up to hundreds of hectares of farms meeting the European organic soil standards.



**Every enterprise should be equipped with ESG knowledge from the management board to its employees executing ESG.**

This is the enterprise's method of using resources towards the protection of land resources, which is the most important foundation of agricultural activities.



**Vinamilk has invested in farms according to the European Organic standards standards, including being organically self-contained and using environmentally friendly energy. In particular, solar energy systems cover 13/13 farms and 10/13 factories.**

*Image: VGP/Phường Dung*

The 'governance' criterion of ESG is also effectively applied by Vinamilk. Currently, the company applies a three-line model of defence according to Vinamilk's risk management and internal control practices to ensure objectivity and independence when evaluating management processes. What Vinamilk has achieved when practising ESG effectively is sustainability and stability in both revenue and personnel when faced with the fluctuations in the market due to the impact of the COVID-19 pandemic. Accordingly, in 2021, Vinamilk set a target total revenue of VND62,160 billion. However, only in the second quarter, Vinamilk announced a record high revenue of VND15,729 billion, exceeding the set threshold and increasing by 1.4 per cent over the same period last year. Accumulated in the first six months of 2021, the business has completed 47 per cent of the year plan. These will be the numbers through which Vietnamese businesses realise that ESG is no longer an option but should be mandatory for sustainable survival.

ESG is considered an inevitable trend and a prerequisite that investors and fund organisations can rely on to evaluate whether to invest in those enterprises, especially in the field of finance, manufacturing and the stock market. In addition to enterprises that focus on researching and applying ESG, such as Vinamilk, Pan Group and their ESG

practices, which are highly appreciated by investment organisations, there are still many enterprises applying ESG but who do not meet the criteria targeted by investors, or some enterprises apply ESG only for coping purposes.

Vietnamese law does not have any specific definition of ESG, official guidelines on ESG, as well as regulations defining the criteria to evaluate if an enterprise meets ESG standards, sanctions for enterprises when they do not meet the applied ESG standards and as to which competent authority monitors the practice of these enterprise. In other words, this is a situation where the needs of businesses are required but the legal corridor is not yet available. This leads to the fact that enterprises are vague on understanding ESG standards and applying it, most enterprises build their own set of ESG standards for their own business operation, referring to the set of standards that investment funds use to identify businesses that are eligible to receive capital and the opinions of experts in this field.

The act of 'greenwashing' is taking place in many fields, whereby greenwashing is understood as an enterprise announcing the application of ESG but their action is contrary to what is announced in the 'environment' criterion. Currently, in line with the world trend of environmental protection as well as targeting the user's psychology, many 'green products' and 'green applications' have been issued, but none of them are really aiming to protect the environment. When there is no legal document, supervision by the jurisdiction, the self-declaration of an enterprise to achieve ESG, especially the 'environment' criterion (products and processes to minimise harm to the environment, energy saving, etc.), will lead to inaccurate assessments of investors of the enterprises and entail financial risks later when the 'sustainable development' has collapsed.

The transparency of the ESG announcements that enterprises are making public every year is a dilemma for investors when figuring out the practice and results of enterprises applying ESG in Vietnam. Some enterprises, when realising the attraction of ESG to investors, in order to enhance their position when calling for capital, have reported and published ESG indicators, but the accuracy is not guaranteed. Even if the ESG report is not accurate and transparent, it is still a difficult obstacle for investors to verify if their judgment is correct.



## What is the Solution for ESG Enterprises?

The priority for a solution for the above-mentioned issues is undoubtedly that Vietnam should develop a legal corridor to specifically regulate ESG, this will be a clear and official basis for enterprises when deciding to apply ESG standards as well the foundation for investment funds to evaluate whether ESG enterprises are eligible for these organisations to invest. In addition, an instruction method to report ESG practices has not been developed and concretised in accordance with the law. Therefore, the development of this method is necessary because enterprises that have applied ESG also need to publish the sustainability indicators that the enterprises have achieved annually, especially for enterprises having securities transactions because this will ensure the transparency and the interests of investors. The European Union has recently issued the Sustainable Finance Disclosure Regulation to serve as the basis for the formulation of the ESG report.

While waiting for the Government to build a legal corridor, every enterprise should be equipped with ESG knowledge from the management board to its employees executing ESG. The enterprises should gradually build ESG for themselves, based on the successes of enterprises that have been highly appreciated by international organisations in ESG application and the sets of standards that investment organisations are using to choose enterprises to receive contributed capital.

Implementing ESG is a long process that requires enterprises not only to consider the plan of using their personnel, along with being consistent with what enterprises choose, but also to keep in mind that finance is a key factor in implementing ESG in practice. Therefore, enterprises should develop and prepare a sufficient budget, with a specific plan to ensure the smooth application and practice of ESG during a continuous period as planned.

In addition, enterprises should also strengthen the consensus and support from their members, shareholders and the community for their ESG activities because not all members and shareholders can understand ESG and the significant financial costs incurred in the implementation process.

## Conclusion

ESG is a global trend and is also being enthusiastically received by Vietnamese enterprises, because ESG enterprises are receiving significant attention and

investment capital from investors who are looking for sustainability in businesses. Grasping this mentality, Vietnamese enterprises have made crucial changes in their business operations, which may not meet all the criteria set by ESG. This is a remarkable effort of enterprises to keep up with the development of other enterprises in other countries.

On the Government's side, the recent actions show that the Government is planning to help enterprises map out the sustainable development indicators as well as make proposals for legislators to research and promulgate corresponding regulatory documents. Recently, a seminar 'Accelerating mindset and system transformation to optimize sustainable corporate governance' organised by the Vietnamese Chamber of Commerce and Industry, the Vietnam Business Council for Sustainable Development ('VCCI-VBCSD') was held on 22 September 2022. This is the first event in a series of seminars within the framework of the Vietnam Corporate Sustainability Forum ('VCSF') 2022 and attracted more than 300 delegates from ministries, sectors, business associations, and international organisations and enterprises to attend in person and online.

The recent actions of the Government are generating the interest of investors in pouring capital into the Vietnamese market and helping Vietnamese enterprises better understand that sustainable development enables enterprises to rebuild their future and the country as well as jointly solve global problems.



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# Data Protection and Cyber Security Increasingly Integral to Good ESG

A good Environmental, Social and Governance ('ESG') friendly conscience may not be new for organisations, though it is an evolving concept for many. Today, inculcating individual privacy, data protection and cybersecurity in an organisation's ESG framework has become immensely crucial. This is due to an increased frequency of data breaches and cyber security attacks over the last couple of years, fuelled by remote working models.



## ESG and its Significance

A good ESG framework and implementation could positively influence an organisation's social, business and financial performance. Good ESG may be a driving factor to long-term success, including fostering relationships with customers and employees,<sup>1</sup> though it does not end at legal compliance or corporate reporting. ESG consists of investments in sustainability, ethics, values and policies with an aim to foster growth and relationships with internal and external stakeholders.

## Data and Cyber Security Considerations in ESG

Many BigTech, IT/ITES and technology-focused conglomerates have expanded their product offerings and presence over the last decade, through R&D, innovation and investment. For instance, Siemens began harnessing Artificial Intelligence ('AI') and Internet of Things ('IoT') technologies back in 2014.<sup>2</sup> In recent years, especially during the COVID-19 pandemic, many healthcare, retail, services, manufacturing, automobile and real estate businesses have gone online.<sup>3</sup> This has resulted in an increased dependence on personal and non-personal data collection, processing, storage and sharing, as well as corresponding information and technology security risks.

Today, inculcating individual privacy, data protection and cybersecurity in an organisation's ESG framework has become immensely crucial. This has been largely due to an increased frequency of data breaches, compromises and cyber security attacks over the last couple of years. Furthermore, work-from-home ('WFH') and hybrid working models leave technology service providers and organisations more dependent on the cloud for delivery of services, with nearly half of all data breaches occurred on the cloud, and each data breach costing nearly US\$5 million on average.<sup>4</sup>

## Environmental Factors

The repercussions of technologically fuelled activities on the environment appear more impactful than one can imagine. Even basic technological functions, such as an internet search or an email, results in release of a few grams of greenhouse gases, which seems like a small cost, but upon continuous and heavier use, the scale of impact on the environment becomes a huge cause for concern.<sup>5</sup> One way to reduce the effects of the technological burden on the environment is to streamline efficiency, in terms of power that various devices and

applications require, as well as data collection, storage and collection activities.

Over the last two decades, the development of technological tools including IoT sensors, cloud computing services, big data analytics and the introduction of new smart devices and software applications has resulted in an exponential increase in the volume of data generated.<sup>6</sup> To store and transmit all of the data powering the internet, data centres consume enough electricity to account for one per cent of global energy demand—which is more than the total consumption of many countries. Even before the pandemic, the Internet's carbon footprint had been increasing and accounted for about 3.7 per cent of global greenhouse gas emissions.<sup>7</sup>

Another problem attached to poor data centre configuration is the production and inappropriate disposal of e-waste. Since 2014, the global generation of e-waste has grown by 9.2 million metric tonnes, which is around 21 per cent<sup>8</sup> and poses a severe problem owing to the presence of substances such as lead, mercury, cadmium and beryllium in this waste.<sup>9</sup> Even though nearly 80 countries have e-waste policies and provisions—like the E-Waste (Management) Rules 2016 in India, The Waste Electrical and Electronic Equipment Regulations 2013 in the UK and the Small Home Appliances Recycling Law (2013) in Japan, many of which impose liability and penalties upon indulgence in improper handling and management of e-waste<sup>10</sup>—many organisations fail to comply leading to negative implications like contamination of air, water and soil.

There has been a controversial debate on whether penalties for violations are adequate and actually deter businesses from inappropriately discarding their e-waste. Target was fined US\$7.4 million for inappropriately disposing of electronic waste in 2019 and violating California's Electronic Waste Recycling Act 2003.<sup>11</sup> Irrespective of monetary penalties involved, such publicity may not do businesses any favours and could have repercussions in terms of stakeholder trust and brand value. Lately, by investing in renewable energy, optimising data storage mechanisms and implementing sounder waste disposal frameworks, organisations like Google, Microsoft and Amazon appear to lead by example and have made considerable steps toward reducing their environmental effect.<sup>12</sup> Some of the initiatives by these entities include cutting the carbon

footprint in data centre design and construction as encouraged by UN's Net Zero project,<sup>13</sup> as well as powering their operations with renewable energy.

### Social Concerns

Technology and society have become intricately interwoven, and while the financial costs of a data breach or a cyber attack are high and obvious, the social impact of the same is no less damaging. It might be less apparent but can have long-term consequences for consumers, personnel and the organisation as a whole, including the effects on its competitive position, goodwill and brand image. In the past, companies like JP Morgan Chase, Adobe and Vodafone observed a sharp fall in their share prices for months after data breaches.<sup>14</sup> The bottom line is investors, stakeholders and, most importantly, consumers favour companies that invest in strong and transparent cyber security mechanisms.<sup>15</sup> After all, data breaches have huge potential to cause imminent risk to individuals to whom the data pertains.

Consumers may, at large, provide their data to organisations if they have confidence in the brand or truly require the service offering. This data, which often includes personal information, sometimes even sensitive personal information, location and other demographic details, is extremely beneficial to businesses. In 2021, by introducing software updates, Apple used privacy protection as a competitive edge in the market<sup>16</sup> and the same was widely appreciated among the consumer base. Organisations seem to be shifting their approach to that of a two-pronged approach: intention of compliance and establishing a trustworthy image. Such an approach can also aid in the development of new products and services, as well as in the personalisation of advertising and marketing.<sup>17</sup>

From a security perspective, limiting the purpose of processing personal information to only purposes actually needed for providing the individual a particular product or service, adequate de-identification and anonymisation where appropriate to safeguard personally identifiable data, minimal data retention periods and sufficient security checks, as well as impact data protection and cyber risk assessments and audits,

may go a long way in a business's ESG initiatives and customer confidence.

From an ethical standpoint, having an abundance of personal data can be used to deploy systems like AI and machine learning (ML) tools, which can be used for a humungous array of functions. Though, as demonstrated by Amazon's now discontinued machine-learning recruitment software which allegedly developed a bias against hiring women, it is crucial for organisations to ensure that the use of personal data and more importantly automated decision-making based on data does not amount to discrimination, bias or misuse.<sup>18</sup> Cooperation between diverse departments, such as product engineering, HR and legal, are important to ensure legally compliant and ethical functioning of AI/ML internally or externally deployed; and that individuals how the process works and how it may affect them.

**Investors, stakeholders and, most importantly, consumers favour companies that invest in strong and transparent cyber security mechanisms.**

### Governance-Led Compliance

The 'governance' aspect in ESG may pertain more toward compliance with privacy, data protection and cyber security laws and regulation. Failure to comply with the regulatory norms may result in statutory penalties being awarded and sometimes imprisonment of directors or key officers of the company. However, is not only at the time of non-compliance and enforcement that organisations' directors and key executives come into the equation; instead, such members are required at the early stages of policy formation, budget proposals and greenlighting various ESG initiatives. Compliance may be taken care of at various levels and verticals, but governance begins from the top brass. It is essential for the board and key executives and officers of the company to be involved in the formulation and finalisation of the organisation's privacy, data protection and security policies, practices and technologies as well as disaster recovery, business continuity and risk assessment strategies.

Applicable privacy, data protection and cyber security legislation may dictate the overall framework of compliance on the subject. For instance, in India, privacy was recently declared as a fundamental right of an individual<sup>19</sup> enshrined under the Constitution of India,

which has led to the Government preparing a new and extensive data protection bill that may be enacted into law in 2023. The current regime, The Information Technology Act 2000 and the Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules 2011 make up a rather basic framework of compliance which include publishing a privacy policy, obtaining explicit consent, grievance officer appointments and reasonable security practices for certain categories of sensitive personal information. However, compliance with the current regime across the board is a mixed bag.

There are also industry-specific regulations to protect identified items of data in certain sectors, such as debit/credit card data storage restrictions in the banking and fintech space, as well as infosec and data localisation requirements for telecom data, payments data, insurance policy information, etc. Other privacy-focussed laws across jurisdictions include the General Data Protection Regulation ('GDPR') 2016 in the European Union, The California Consumer Privacy Act 2018 in California, The General Data Protection Law ('LGPD') 2020 in Brazil and the Protection of Personal Information Act ('POPIA') 2013 in South Africa. New sets of data legislation or recent amendments to existing laws such as Singapore's Personal Data Protection (Amendment) Act 2020 enhance compliance requirements on consent, breach reporting as well as liabilities. Even though a corporate privacy and data governance structure cannot be one-size-fits-all,<sup>20</sup> the legislative frameworks often provide a detailed checklist for the entities to follow. General and sector-specific data and cyber security laws may prescribe detailed requirements including for privacy notices; manner of obtaining consent; data storage, purpose and collection limitations; grounds for processing data; special provision on children's data; user rights such as the right to be forgotten and data portability; security standards (such as IS/ISO/IEC 27001 and various other privacy certifications from industry bodies); transparency and record-keeping; breach reporting; localisation and cross-border transfer compliances and restrictions; data protection offices; data protection authorities; codes of practice and penalties.

One such legal requirement that stands out from an ESG perspective is that of 'privacy by design', present in the GDPR. Privacy by design essentially requires technical and organisational measures to be taken at the time of

planning a processing system, aimed to protect data safety. The type, scope, circumstances and purpose of data processing should be considered at the early development phase. Methods such as encryption, anonymisation and user authentication may be used as well as ISO standards. India's proposed Personal Data Protection Bill 2019 contemplated that 'privacy by design' policies of an organisation should include managerial, organisational, business practices and technical systems designed to anticipate, identify and avoid harm to the individual to whom the personal data pertains; as well as technologies deployed, innovation achieved and overall transparency of the processing exercise. This accentuates the need for board and key executive level involvement in an organisation's privacy initiatives. Other sectoral laws especially those governing banks and financial institutions for instance, require board-approved cyber security and information security policies to be in place.

## Conclusion

Privacy, data protection and cyber security are integral components of ESG without which organisations stand to lose out to those that use these as tools to differentiate themselves in the market. Microsoft frequently emphasises how a company's ESG score benefits from their investment in IT security and can demonstrate an additional return on investment and win support from a range of stakeholders.<sup>21</sup>

Tech stalwarts like LinkedIn, Yahoo! and Facebook<sup>22</sup> have been subject to the largest data breaches over the last three to four years,<sup>23</sup> as well as a host of small to mid-size businesses with lesser resources to combat increasingly sophisticated cyber attacks. With an estimate that by 2025 there may be more than 180 zettabytes (180 billion terabytes) of data breached or compromised worldwide,<sup>24</sup> the spotlight falls on businesses of all sizes to include and implement adequate privacy, data protection and security budgets, policies, practices, and technologies as part of their ESG initiatives. Ignoring to do so may cause businesses to face penalties under applicable legislation in case of violations, reputational risks, loss of stakeholders' trust and competitive disadvantages.<sup>25</sup>

*Views are personal. Special thanks to Ms. Rhythm Vijayvargiya for her research and contribution to this article.*

**Notes**

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<sup>3</sup> 25 Industries & Tech Shaping the Post-Covid World, available at [www.cbinsights.com/research/report/industries-tech-shaping-world-post-covid/](http://www.cbinsights.com/research/report/industries-tech-shaping-world-post-covid/) (Last accessed 20 October 2022).

<sup>4</sup> IBM: Cost of a Data Breach 2022, available at [www.ibm.com/reports/data-breach](http://www.ibm.com/reports/data-breach) (Last accessed 20 October 2022).

<sup>5</sup> S Griffiths, 2020. 'Why Your Internet Habits are not as Clean as You Think', BBC, available at [www.bbc.com/future/article/20200305-why-your-internet-habits-are-not-as-clean-as-you-think#:~:text=Those%20scraps%20of%20energy%2C%20and,emissions%2C%20according%20to%20some%20estimates](http://www.bbc.com/future/article/20200305-why-your-internet-habits-are-not-as-clean-as-you-think#:~:text=Those%20scraps%20of%20energy%2C%20and,emissions%2C%20according%20to%20some%20estimates) (Last accessed 19 October 2022).

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<sup>8</sup> A Adepetun, 2022. 'Global eWaste Generation Rises by 9.2m MTs in Eight Years', *The Guardian*, available at <https://guardian.ng/technology/global-ewaste-generation-rises-by-9-2m-mts-in-eight-years/> (Last accessed 20 October 2022).

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<sup>10</sup> Rule 21, E-Waste (Management) Rules 2016.

<sup>11</sup> 'Target Gets \$7.4 Million Fine for Throwing E-waste in the Trash', available at <https://securis.com/news/7-4-million-fine-for-illegally-throwing-e-waste-in-the-trash/> (Last accessed 20 October 2022).

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# IPBA New Members September to November 2022

We are pleased to introduce our new IPBA members who joined our association from September to December 2022. Please welcome them to our organisation and kindly introduce yourself at the next IPBA conference.

<b>Australia</b> , Matthew Amoils, ASG Immigration	<b>China</b> , Dongkun Li Beijing Jingsh Law Firm Shenzhen Office
<b>Australia</b> , Timothy Randall, Ashurst	<b>China</b> , Dongsheng Li Beijing Jingsh Law Firm Shenzhen Office
<b>Bangladesh</b> , Saiyeed Jakaria Baksh Imran Baksh Maritime Law and Associates	<b>China</b> , Li Li Beijing Jingsh Law Firm Shenzhen Office
<b>Cambodia</b> , Chhay Heng R&T Sok & Heng law office	<b>China</b> , Xiaer Li Beijing Jingsh Law Firm Shenzhen Office
<b>Cambodia</b> , Sophonnora Tiv R&T Sok & Heng law office	<b>China</b> , Xinjian Li Beijing Jingsh Law Firm Shenzhen Office
<b>Canada</b> , Dierk Ullrich Fasken Martineau DuMoulin	<b>China</b> , Yilong Mo Reiz Law Firm
<b>China</b> , Zhenwen Chang Beijing Jingsh Law Firm Shenzhen Office	<b>China</b> , Yanan Mu Beijing Jingsh Law Firm Shenzhen Office
<b>China</b> , Juanchun Chen Beijing Jingsh Law Firm Shenzhen Office	<b>China</b> , Vincent Xuekai Qian Beijing Dentons Law Offices, LLP
<b>China</b> , Jiaqing Deng Beijing Jingsh Law Firm Shenzhen Office	<b>China</b> , Zaiyog Rai Reiz Law Firm
<b>China</b> , Xing Du Beijing Jingsh Law Firm Shenzhen Office	<b>China</b> , Xiaomin Shi Beijing Jingsh Law Firm Shenzhen Office
<b>China</b> , Siqi Fan Beijing Jingsh Law Firm Shenzhen Office	<b>China</b> , Biyu Michelle Wang JunZeJun Law Offices
<b>China</b> , Junfang Guo Beijing Jingsh Law Firm Shenzhen Office	<b>China</b> , Dandan Wang Beijing Jingsh Law Firm Shenzhen Office
<b>China</b> , Guoliang Han Beijing Jingsh Law Firm Shenzhen Office	<b>China</b> , Yanfei Wang Beijing Jingsh Law Firm Shenzhen Office
<b>China</b> , Weiqin He Beijing Jingsh Law Firm Shenzhen Office	<b>China</b> , Zonglin Wang Beijing Jingsh Law Firm Shenzhen Office
<b>China</b> , Yutian He Beijing Jingsh Law Firm Shenzhen Office	<b>China</b> , YanYan Weng Beijing Jingsh Law Firm Shenzhen Office
<b>China</b> , Xiaodong Hu Beijing Jingsh Law Firm Shenzhen Office	<b>China</b> , Tiecheng Wu Beijing Jingsh Law Firm Shenzhen Office
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<b>China</b> , Zhongchang Jiang Beijing Jingsh Law Firm Shenzhen Office	<b>China</b> , Lin Xiao Beijing Jingsh Law Firm Shenzhen Office

<b>China</b> , Jiam Xie <i>Beijing Jingsh Law Firm Shenzhen Office</i>	<b>Indonesia</b> , Arfidea Dwi Saraswati <i>AKSET LAW</i>
<b>China</b> , Jiuying Yang <i>Beijing Jingsh Law Firm Shenzhen Office</i>	<b>Indonesia</b> , Ardhiyasa Suratman <i>A&amp;CO Law Office</i>
<b>China</b> , Ni Zeng <i>Beijing Jingsh Law Firm Shenzhen Office</i>	<b>Japan</b> , Carlotta Bruessel <i>Nishimura Asahi</i>
<b>China</b> , Shuo Zhang <i>Reiz Law Firm</i>	<b>Japan</b> , Ichiro Fujimoto <i>Creativity &amp; Insight Legal Professional Corporation</i>
<b>China</b> , Zhou Zhang <i>Liaoning Zea Zone Law Firm</i>	<b>Japan</b> , Rintaro Hirano <i>Nagashima Ohno &amp; Tsunematsui</i>
<b>French Polynesia</b> , Vanessa Corunfeld <i>CORUNFELD Avocat</i>	<b>Japan</b> , Minami Hosoi <i>Kitahama Partners</i>
<b>Germany</b> , Roland Falder <i>Emplawyers PartmbB</i>	<b>Japan</b> , Hiroyuki Iwamural <i>Ashurst</i>
<b>Germany</b> , Yixiao Li <i>Gleiss Lutz</i>	<b>Japan</b> , Nana Okada <i>TMI Associates</i>
<b>Germany</b> , Sebastian Skradde <i>Emplawyers PartmbB</i>	<b>Japan</b> , Takahiro Sakamoto <i>Aska Law Offices</i>
<b>Germany</b> , Torsten Spiegel <i>Gleiss Lutz</i>	<b>Japan</b> , Toshiyuki Sawai <i>Oh-Ebashi LPC and Partners</i>
<b>Greece</b> , Alkisti-Irene Malamis <i>Malamis &amp; Associates</i>	<b>Japan</b> , Akihiro Tokura <i>Nagashima Ohno &amp; Tsunematsu</i>
<b>Hong Kong</b> , Joseph Chung <i>Deacons</i>	<b>Japan</b> , Ikegawa Yoshino <i>Kitahama Partners</i>
<b>India</b> , Vanita Bhargava <i>Khaitan &amp; Co</i>	<b>Korea</b> , Dong Wook Kang <i>Bae, Kim &amp; Lee LLC</i>
<b>India</b> , Barunesh Chandra <i>August Legal</i>	<b>Korea</b> , Eric Eunyong Yang <i>Bae, Kim &amp; Lee LLC</i>
<b>India</b> , Kinshuk Chatterjee <i>Amicus Advocates &amp; Solicitors</i>	<b>Korea</b> , Joonki Yi <i>Bae, Kim &amp; Lee LLC</i>
<b>India</b> , Siddhi Ghatlia <i>Almt Legal</i>	<b>Kuwait</b> , Shaha Al Nuwaif <i>Al Sadara</i>
<b>India</b> , Pavi Jain <i>Khaitan &amp; Co</i>	<b>Kuwait</b> , Mona Alarbash <i>Alarbash International Center</i>
<b>India</b> , Ankit Khushu <i>Kachwaha &amp; Partners</i>	<b>Kuwait</b> , Shoug Alkandari <i>Loay Jasim AlKharafi Law Firm</i>
<b>India</b> , Saurav Kumar <i>Induslaw</i>	<b>Kuwait</b> , Omar Alsaeed <i>AlMarkaz Law</i>
<b>India</b> , Aditi Sharma <i>Phoenix Legal</i>	<b>Kuwait</b> , Aliaa Behbehani <i>Aliaa Behbehani lawfirm</i>
<b>India</b> , Akshay Singhi <i>S.K.Singhi &amp; Partners</i>	<b>Kuwait</b> , Zainab Mustafa <i>Al- Maswuwlia legal group</i>
<b>Indonesia</b> , Abraham Devrian <i>ACO Law Office</i>	<b>Kyrgyzstan</b> , Qiufang Wang <i>The Bishkek International Court of Arbitration for Mining and Commerce</i>



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<b>Singapore</b> , Wei Li Fong Forward Legal	

## Members' Notes

### Stephan Wilske, Germany



Stephan Wilske was a speaker at the Taipei International Arbitration Conference 2022 on 5 October 2022, where he and his colleague Annemie Heubach presented the following topic: 'The Global Goals of ESG (Environmental, Social and Governance)—Are Arbitral Institutions Doing Their Part?'. A paper with the same title will be published in Vol 16/1 (May 2023) of the *Contemporary Asia Arbitration Journal*.

### Mark Shklov, United States



I, Mark Shklov, regularly host a talk show called *Law Across the Sea*. Many of my shows feature IPBA Members. Recent IPBA guests have included Juan Carlos Hernandez in Mexico, Jose Manuel Abastos in Peru and Ravi Nath in India. These shows and others featuring IPBA members can be found on my Playlist at <https://thinktechhawaii.com/tag/mark-shklov/>.

Hosting *Law Across the Sea* has allowed me to connect with many IPBA Members in meaningful and insightful discussions. The IPBA has provided me with wonderful opportunities to meet, make and maintain friendships across the sea with great lawyers in many countries all over the world.

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