International
Comparative
Legal Guides

Environmental, Social & Governance Law

2024

Fourth Edition

Contributing Editors:
David M. Silk & Carmen X. W. Lu
Wachtell, Lipton, Rosen & Katz

glg Global Legal Group

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ESG Considerations in Project, Energy, and Infrastructure Finance


Matt H. Ahrens


Allan T. Marks


Iliana Ongun


Allison E. Sloto

Milbank LLP

1 Introduction

Long before the acronym ESG (*i.e.*, Environmental, Social and Governance) entered the corporate vernacular, the underlying principles were very much present in various aspects of project development and in the policies and procedures of owners and investors. ESG considerations in project finance have always been key to understanding risk, due to the long-term nature of the investment. Now, the increased prominence of ESG presents a new dimension of investment, credit, and even reputational risk for a range of projects, from infrastructure to energy assets.

With ESG at the forefront, companies bear responsibility not only to their shareholders, but also to the public and the planet. A focus simply on the "bottom line" of short-term profitability and shareholder returns is not tenable. Since projects are long-term investments in the infrastructure, industry, or public services to a community, investors must consider the long-term stability of a project and its effects on a broad set of stakeholders, including employees and local communities. Projects depend on buy-in from the local community and adaptability in light of pressing climate risks and changing regulatory environments. ESG risks are particularly pronounced for projects related to fossil fuels and coal power, where new and anticipated regulations could constrain operations and impact viability, ultimately undermining their long-term investment rationale.

Public policies increasingly favour investments in energy and infrastructure projects that further environmental and social justice goals by mitigating the impacts of climate change, decarbonising the energy and transportation sectors, and improving both clean drinking water supplies and digital broadband connectivity in historically underserved or low-income communities.[1]

At the same time, investors and shareholders are demanding greater ESG transparency and accountability by means of ESG risk assessment, measurement, and reporting to better understand and address the impact of their investments. This is evidenced by the shakeup at Exxon in May 2021, where an activist hedge fund proposed an alternative slate of Exxon directors and, with the aid of proxy advisors, institutional investors, and fund managers focused on ESG concerns, gathered enough votes to seat two directors whom they expected to affect corporate policy to better mitigate and manage the climate change impacts facing the energy sector.[2]

Project companies increasingly leverage interest in ESG to maximise opportunities to obtain financing or to obtain favourable financing terms. ESG is a key consideration and top of mind for investors, according to a study conducted by *Harvard Business Review* of 70 senior executives at 43 global institutional investing firms, including the three largest asset managers – BlackRock, Vanguard, and State Street.[3] In fact, ESG investing has been seeing record growth: the head of BlackRock's iShares has predicted that ESG-driven investing will grow to $1 trillion by 2030, the Dow Jones has estimated that ESG investments will account for more than 15% of all investments by 2025, and PricewaterhouseCoopers has estimated that total ESG assets-under-management in the United States will more than double, from $4.5 trillion in 2021 to $10.5 trillion in 2026.[4] To meet this investor interest, there has been a proliferation of green and sustainability bonds, among other ESG financial instruments. Project companies and investors in these instruments should use tailored ESG reporting frameworks that take into consideration the risks and opportunities specific to their project.

2 ESG Considerations and Risks for Investors, Lenders, and Project Companies

Each of the three factors of ESG – environmental, social, and governance – describe considerations that go beyond traditional financial criteria and relate to sustainable growth, environmental and social impacts, and the governance arrangements of the project company. There are other terms used to express similar ideas to ESG, including the "triple bottom line" (also known as the "three P's", which are profit, people, and planet), "corporate social responsibility", and "socially responsible investment". In project finance, although the term ESG is not always used, it is highly present in various aspects of project development and in the policies and procedures of owners and sponsors. For example, since 2003, many financial institutions (including banks) have implemented a risk management framework known as the Equator Principles for determining, assessing, and managing environmental and social risk in project finance.[5] As of November 2023, more than 140 financial institutions in 39 countries have adopted the Equator Principles.[6] The purpose of the Equator Principles is to promote sustainable environmental and social performance and can lead to improved financial, environmental, and social outcomes for projects. The Equator Principles are primarily intended to provide a minimum standard for due diligence to support responsible decision-making based on the careful assessment of risk and can trigger a need to conduct certain actions to provide remedy for or offset any environmental or social issues that are identified. The Equator Principles apply across industry sectors, and have helped spur the development of responsible environmental and social management practices in the financial sector and banking industry.

Characteristics of Project Financings that Enhance ESG Risks

Project financings have particular characteristics which provide protections to creditors – such as all-assets pledges, structures, and covenants to reduce volatility in project cash flows and waterfalls prioritising debt servicing over equity distributions – that allow project companies to have higher leverage ratios than traditional companies while maintaining similar credit quality. Nevertheless, project finance lenders and investors are exposed to similar or enhanced ESG risks. Projects that involve infrastructure and construction work can have effects on the environment and require interactions with local stakeholders. Costs associated with compliance with environmental regulations and coordinating with local communities can be high throughout the life of a project and may impact projected cash flows in the operations phase of a project. To the extent that project risks are allocated to third parties, reducing commercial and technical risks, a credit analysis should identify the extent to which those third parties may be exposed to ESG risks that could affect construction schedules, costs, revenues, or supply chains.

ESG issues are important for debt and equity investors in project companies. Failure to properly address these issues can adversely impact the development and performance of projects vulnerable to ESG risks and weaken a project company's credit position and profitability. ESG factors can also create financing and refinancing challenges for projects for which the asset life is uncertain, particularly considering new environmental regulatory pressures.

For example, S&P and Moody's both cited ESG factors as key drivers in rating the debt of the operator of a coal plant in West Virginia, noting that as investors increasingly shy away from coal projects, it has become difficult to attract additional capital or arrange an extension or refinancing of existing debt facilities. In 2022, Moody's continued to highlight the operator's overall weak credit position in light of risks associated with decarbonisation and the energy transition, anticipated federal regulatory policy that could adversely impact the coal sector in general and the coal plant in particular, and increasing investor concerns relating to ESG factors, all of which had a highly negative impact on the operator's rating.[7]

Negative social and governance events also led S&P to downgrade debt issued by an owner and operator of a highway project under construction in Lima, Peru to speculative grade due to the resulting erosion in the risk profile of the project. From a social perspective, protesters destroyed a new toll plaza facility over concerns of toll charges and their impact on wealth inequality and affordability. Subsequently, the municipality of Lima suspended toll payments at the facility and decided to terminate the concession agreement early, which resulted in a loss of revenues. Pending international arbitration has resulted in an injunction whereby the facility may continue to operate until a final decision is made.[8] From a governance perspective, one of the company's sponsors had been involved in a probe for paying bribes in Latin America to win concessions. The project's relationship to this sponsor carried reputational risks, which in turn affected its ability to secure additional financing.

ESG Considerations in Project Finance

ESG considerations are relevant to all types of large, long-term infrastructure projects, from highways and bridges to energy projects (including renewable energy projects), rail lines, and water or water treatment facilities. Additionally, all three ESG factors can be interrelated and sometimes inversely related given the complicated impact that actions in one factor may have on the other factors. If a coal power plant is shut down for environmental reasons, for example, there can be cascading impacts on social issues if the shutdown results in layoffs and unemployment for local communities.

Environmental

Environmental considerations have always played a central role in project development, including those related to the siting of projects and proper disposal of materials after a project is decommissioned. The "E" can also overlap with the "S" in the areas of local community relations, environmental justice, preservation of archaeological and cultural resources, and Indigenous rights.

Project siting impacts may be temporary or permanent in nature. For example, the siting of temporary construction access roads may disturb wetlands or other sensitive habitats. Other impacts may be more permanent, such as harm to protected species. Projects and associated infrastructure (such as transmission lines for energy projects) can require a large amount of acreage, which is often agricultural or previously undeveloped land. Project development can require tree clearing, regrading of the land, and dredging/filling of wetlands. Temporary or permanent access roads or staging areas need to be placed, and ground disturbance such as excavation and filling for foundations must occur. These activities may disturb the habitat of a variety of wildlife depending on location, such as fish and other aquatic species for hydroelectric dam projects, and in some instances, projects may result in intentional or incidental animal death. Also falling under the umbrella of environmental are impacts to safe airspace travel; some types of projects can cause sight hazards or disrupt flight patterns for aircraft, especially if located in proximity to an airport, and have the potential to disrupt national air defence networks. In many jurisdictions, a project will be required to comply with a statute, such as the National Environmental Policy Act in the United States, that can trigger the need for a comprehensive review before issuance of certain permits or other governmental action. These laws can require that a project company thoroughly review the environmental impacts of the proposed project and mitigate those impacts to the extent possible. Project companies should be mindful to comply with all other environmental laws, including those that regulate sensitive resources such as wetlands and protected species.

Community relations, cultural resources, and Indigenous rights are critical aspects of determining how and where a project should be sited. ESG reflects an increasing social awareness of the impacts a project may have on the surrounding community. For example, if a project is located in proximity to important cultural or Indigenous resources, sovereignty concerns should be assessed and mitigated, with Indigenous community involvement throughout the process. The Equator Principles specifically require that all projects affecting Indigenous Peoples will be subject to an informed consultation and participation process and must comply with the rights and protections for Indigenous Peoples contained in relevant national law, including laws implementing host country obligations under international law.[9] Appropriate mitigation can include performing studies and surveys of the area and preparing mitigation and preservation plans.

The concept of environmental justice more broadly strives for the fair treatment of all people when considering the siting of projects. There are legitimate concerns regarding project siting near vulnerable communities and the associated risks of pollution and disturbances resulting from noise, runoff, excavation, and other features of project operation and development. This is compounded when a community already has several similar projects within its borders. Projects are almost always subject to an approval process that requires an opportunity for public comment, which can raise these concerns and result in a better project with fewer community impacts.

Proper disposal of materials at the end of the project life cycle is an oft-overlooked project consideration. Decommissioned project components must be disposed of in ways that preserve the health and safety of the physical environment and of individuals and communities. The Equator Principles can trigger the need for a decommissioning plan, even if not required by a host country's laws.

Social

The social aspects of project finance encompass labour and human rights, supply chain considerations and the ethical procurement of materials, and diversity, equity, and inclusion ("DEI") measures.

Labour and human rights considerations include improving working conditions, addressing work stoppage risks, preventing modern slavery, and preventing the acquisition of materials from industries or jurisdictions identified as being vulnerable to labour exploitation and forced labour in violation of international standards. Child labour, slavery, and general compliance with employment and fair wage regulations are a few examples of risks that should be mitigated or avoided, including by contractual means.

Supply chain considerations arise during the procurement of materials for a project. Project companies should conduct supply chain due diligence to understand the business and employment practices of their vendors and suppliers and ensure that materials are not sourced from environmentally fragile locations or using illegal or unethical employment practices. Enhanced supply chain due diligence should be implemented when procuring materials from countries where human rights and forced labour issues are prevalent, or from suppliers that source inputs from such countries. A resource for identifying goods produced by child or forced labour is the U.S. Department of Labor's ("DOL") List of Goods Produced by Child Labor or Forced Labor.[10]

DEI measures should involve the representation and participation of a diverse workforce across all levels of a project up to leadership. DEI considerations have not traditionally been a focus in project financing, but diversity brings in different perspectives and ideas and can strengthen a project company's reputation. Diversity, coupled with equity and inclusion, has been shown to drive innovation and produce better outcomes through increased productivity and profitability. Project companies can demonstrate this commitment through onboarding and developing diverse talent internally. Project companies are also able to mandate certain diversity standards and guidelines when they hire outside vendors, such as construction companies, engineers, and attorneys.

Governance

"Governance" is a term that has an increasingly broad reach, encompassing not only traditional notions of corporate governance, but also the structures in place to manage significant areas of risk for the project company, such as transaction requirements imposed by lenders and sponsors, cybersecurity and data privacy, anti-corruption, and trade compliance.

Corporate governance relates to the composition and procedures of supervisory bodies. Additional considerations include proper separation of a project company with the sponsor or holding company. An important feature of corporate governance is regulatory compliance and the maintenance of compliance policies, procedures, and controls designed to promote compliance with relevant laws and regulations and mitigate risks associated with the jurisdiction, sector, and operations of the project.

Transaction requirements can include information disclosures and reporting requirements. Investors may build these requirements into project financing documentation to improve transparency and strengthen the integrity of a project. Such requirements may include documentation that will allow financial institution investors to verify the identity of project company borrowers and their beneficial owners, pursuant to their obligations under anti-money laundering laws. Transaction governance can also include internal processes to manage the proceeds of green or sustainability financing and track the allocation of funds.

Cybersecurity and data privacy issues, if not addressed, can pose significant operational and financial risks, and can halt an entire project. Project companies should review their corporate security and business continuity plans and invest in strengthening their data and cyber protection and resiliency systems. They can look to guidance issued by the White House,[11] the U.S. Federal Trade Commission,[12] and the U.S. Securities and Exchange Commission ("SEC")[13] to understand what is considered reasonable cybersecurity practice. Final rules issued by the SEC on July 26, 2023 include requirements for the reporting of material cybersecurity incidents cybersecurity and maintenance of procedures to minimise user-related risks, prevent unauthorised information and systems access, and address cybersecurity incident response and recovery.[14]

Ethics and anti-corruption strategies should promote accountability, transparency, and integrity, both internally and externally with customers, suppliers, and third-party agents. Project companies, particularly project companies with meaningful non-U.S. dealings and interactions with foreign governments, including through suppliers or distributors, should be mindful of their obligations under the U.S. Foreign Corrupt Practices Act and other anti-corruption laws, and should develop policies and procedures to promote ethical behaviour and prevent bribes and other corrupt payments.

Trade compliance considerations related to sanctions and import/export controls may restrict a project's ability to engage certain customers, suppliers, distributors, or other counterparties, or to import certain raw or finished materials. For example, the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") has imposed blocking sanctions on a number of Chinese individuals and entities in connection with forced labour and human rights abuses in the Xinjiang province of China.[15] Also, Congress passed the Uyghur Forced Labor Prevention Act in December 2021 creating a rebuttable presumption that goods manufactured, wholly or in part, in the Xinjiang province are produced through forced labour and therefore barred their release by U.S. Customs and Border Protection from U.S. ports of entry.[16] In March 2023, the U.S. Department of Homeland Security, the agency responsible under the Uyghur Forced Labor Prevention Act for creating a sanctions list for companies known to traffic in forced labour, stated that one of its highest priorities is continuing to add entities to the sanctions list.[17] Solar project companies, which often rely on silica from Xianjing province as a raw material in the production of solar panels, should be aware of these restrictions and implement appropriate diligence and screening procedures. Additionally, in response to Russia's invasion of Ukraine, the United States has imposed a number of sanctions measures targeting certain Russian individuals and entities and dealings involving certain sectors. The United States has also prohibited U.S. persons from engaging in any new investment activity in Russia, directly or indirectly. Investors will have to be mindful of these restrictions in relation to projects in Russia or involving Russian counterparties.[18]

3 Financial Instruments for ESG Investment in Projects

There are a number of financial instruments available to project companies engaged in ESG activities. These include green, social, and sustainability bonds, whose proceeds are linked to

ESG activities, as well as sustainability-linked bonds, whose financial terms are linked to ESG metrics.

Green Bonds, Social Bonds, and Sustainability Bonds

Green, social, and sustainability bond financing are activity-based bonds that link the proceeds of the financing or refinancing provided to project companies to ESG activities, such that project companies must use the proceeds in a manner that meets criteria as "green" or "social" activity, or a mix of the two for sustainability bonds.

The eligibility of projects to qualify for this type of financing can be based on a multitude of frameworks, including the International Capital Market Association's ("ICMA") Green Bond Principles,[19] Social Bond Principles,[20] and Sustainability Bond Guidelines.[21] The four core components for alignment with these principles are related to the following: (i) use of proceeds; (ii) process for project evaluation and selection; (iii) management of proceeds; and (iv) reporting.

Use of Proceeds and Project Selection

Green bonds are instruments where the proceeds are used solely to finance projects with environmental benefits. They can include projects in renewable energy, energy efficiency, land and water management, biodiversity conservation, clean transportation, pollution prevention and control, and climate change adaptation. The proceeds for social bonds meanwhile finance projects that address a social issue, by mitigating social harms or attempting to achieve positive social outcomes. Such projects can seek to improve a community's access to, or the affordability of, essential services, housing, infrastructure, employment, and food, and may be aimed at socioeconomic advancement and empowerment. Sustainability bonds are bond instruments whose proceeds are used to finance a particular goal (such as decarbonisation) or a combination of "green" and "social" projects.

Proceeds Management and Reporting

Project companies issuing these types of bonds should implement an internal process to manage the proceeds and for reporting on uses of proceeds. Issuers should report on the use of bond proceeds by describing the projects and their impact, at least on an annual basis. It is recommended that issuers use both qualitative and quantitative performance indicators. For projects where the actual impact cannot be calculated until projects are completed and operational, which may not be at bond issuance, issuers can report on the estimated impact of their projects. This is common for social projects like the construction of affordable housing or healthcare facilities. Green bonds are generally certified at issuance by an independent third party. Of late, credit ratings agencies are introducing ratings methodologies for debt that is intended to be sustainable or to meet green or social goals of the issuer.

For green bonds, the Harmonised Framework for Impact Reporting,[22] developed by multilateral development banks and international financial institutions, lays out principles and recommendations for impact reporting. Harmonised frameworks have been released for energy efficiency and renewable energy projects, sustainable water and wastewater management projects, sustainable waste management and resource-efficiency projects, clean transportation projects, green building projects, biodiversity projects, and climate change adaptation projects. The frameworks offer sector-specific recommendations for reporting, including core principles, metrics, and indicators for reporting. For example, the suggested core indicators for renewable projects include: (i) annual greenhouse gas emissions reduced or avoided; (ii) annual renewable energy generation; and (iii) capacity of renewable energy plants constructed or rehabilitated. The frameworks do not dictate a single commonly used standard for the calculation of indicators, and issuers may follow their own methodologies. Issuers are encouraged to use this guidance to develop their own reporting that is adapted to their own circumstances and their own approaches to the management of proceeds.

For social bonds, a working group created within the ICMA has been established to develop a harmonised framework. The outcome of the working group is a document that sets out principles for reporting.[23] In addition to reporting on the use of bond proceeds and on the expected impacts, issuers are encouraged to identify the target populations for which the project is expected to result in positive socioeconomic outcomes, and why the selected target population is considered underserved or vulnerable. For projects addressing broad social issues that impact the general population, like health issues and water supply, issuers are still encouraged to identify any particular segments of the population that are expected to especially benefit from the project.

In addition, multilateral organisations have established internal standards for their financing of "green" projects. For example, green bond financing by the International Finance Corporation ("IFC"), a member of the World Bank Group, may include investments in the following types of projects: (i) investments that result in a reduced use of energy per unit of product or service generated; (ii) investments that enable the productive use of energy from renewable resources such as wind, hydro, solar, and geothermal production; (iii) investments to improve industrial processes, services, and products that enhance the conversion efficiency of manufacturing inputs, like energy, water, and raw materials, to saleable outputs; (iv) investments in manufacturing of components used in energy efficiency, renewable energy, or cleaner production; and (v) investments in sustainable forestry.[24]

In addition to meeting green bond eligibility criteria, any project financed through green bond proceeds must also meet IFC's investment process, which includes rigorous due diligence, including disclosure and consultation requirements and integrity due diligence using IFC's Environmental and Social Performance Standards[25] and Environmental, Health and Safety Guidelines.[26] Projects must also comply with IFC's Anti-Corruption Guidelines, with potential penalties for entities engaging in fraud and corruption being sanctions and debarment from financing from IFC and other international financial institutions and multilateral development banks.[27]

Sustainability-Linked Bonds

Sustainability-linked bonds are performance-based bond instruments, for which proceeds can flow to general corporate activities, unlike with green, social, and sustainability bonds. Instead, the interest rate, payment, or other financing terms are linked to ESG factors and may be adjusted if certain sustainability performance targets are met. Sustainability performance targets are tracked by key performance indicators, which should be measurable and reportable, such as emissions reductions.

The Sustainability-Linked Bond Principles,[28] also developed by the ICMA, can be used to determine eligibility for sustainability-linked bonds. These principles have five core components related to: (i) selection of key performance indicators; (ii) calibration of sustainability performance targets; (iii) bond characteristics; (iv) reporting; and (v) verification.

Accordingly, project companies issuing sustainability-linked bonds should implement internal processes and procedures to ensure proper monitoring, disclosure, and verification of key performance indicators. Projects should report on key performance indicators regularly, and in any case for any date or period that may be relevant for assessing the status of sustainability performance targets that are established as trigger events leading to a potential adjustment of the bond's financial or structural characteristics.

4 Frameworks for Accurately Assessing Whether a Project Meets ESG Standards

As noted above, there is significant investor appetite for understanding and measuring the ESG benefits and risks of a project. There are a plethora of frameworks that project companies can use or take inspiration from to identify relevant and material indicators for reporting on ESG metrics. They include international agreements, such as the Paris Agreement, which was formed by 197 countries with the goal of reducing the increase in global average temperatures to 1.5 degrees Celsius,[29] and standards adopted by countries, such as the UN Sustainable Development Goals ("SDGs"), which establish 17 political goals related to peace, climate action, affordable and clean energy, clean water and sanitation, infrastructure, ending poverty, and reducing inequality, among others. The SDGs are defined by 169 targets that are tracked by 232 indicators.[30]

The UN Principles for Responsible Investing ("PRI") is an initiative of the United Nations with large institutional investors that lays out six principles for responsible investments relating to the incorporation of ESG issues into investment analyses, decision-making processes, ownership policies and practices, and disclosures from the entities in which they invest.[31] PRI, in collaboration with the UN Global Compact and UN Environment Programme, has also issued practical guidance on the integration of ESG into investment analyses and decisions. The UN Guiding Principles on Business and Human Rights, voluntary principles adopted by the UN Human Rights Council, set forth the responsibility of companies to respect human rights and provide a remedy when adverse impacts occur.[32]

Project companies can also look to guidance or tools such as those developed by the Global Reporting Initiative ("GRI"),[33] Sustainability Accounting Standards Board ("SASB"),[34] and Task Force on Climate-Related Financial Disclosures ("TCFD").[35] Both GRI and SASB have published sets of universal standards that provide guidance on disclosures across companies, as well as sector-specific standards that account for the sustainability context of a particular sector. SASB has developed a set of 77 sector-specific sustainability accounting standards, which identify financially material sustainability topics and their associated metrics for a typical company in that sector. In August 2022, Value Reporting Foundation, which houses SASB, completed its consolidation with the Climate Disclosure Standards Board to form the International Sustainability Standards Board ("ISSB").[36] ISSB aims to combine existing disclosure frameworks and develop an integrated, comprehensive baseline that would make it easier for companies to distil and report information to investors,[37] and has undertaken the development of a comprehensive global baseline for sustainability disclosures (with the ISSB assuming the TCFD's monitoring responsibilities as early as July 2024).[38] On June 26, 2023, the ISSB issued its inaugural global sustainability disclosure standards (IFRS 1 and IFRS 2).[39] Project companies can also rely on benchmarks and data houses such as S&P Dow Jones Indices that supply datasets providing industry-specific and financially material ESG opportunities and risks.[40]

Each project company should consider the most appropriate framework that is tailored to its activities. Ultimately, though, the metrics that a project company adopts will inevitably reflect what its investors are demanding.

5 Mechanisms to Manage and Mitigate ESG Risks

There are a multitude of positive effects on the "triple bottom line" when project companies, sponsors, lenders, and investors take ESG seriously during project development and funding. There can also be risks associated with the failure to properly apply ESG metrics to a project. Investors and lenders may choose to decline to fund projects that do not place emphasis on ESG. There can be impacts to credit quality – positive or negative – caused by reviewing a project against ESG standards. For example, in the energy industry, a renewable energy project may receive a more favourable credit rating, while projects producing or using fossil fuels may receive a worse rating due to uncertainty around future regulatory policy or environmental impacts. Project location may also receive heightened scrutiny, and construction in areas vulnerable to extreme weather events may require higher liquidity reserves and insurance policies. For projects that are less resilient or have higher ESG risks, insurance may become more expensive or less available.

The lack of a unified conceptualisation and parameters for ESG and the variability of ESG factors by sector and by location has led to challenges with ESG reporting. Since projects can involve a wide variety of sectors, harmonisation of metrics and comparability and reliability of reporting is an issue. In the current formal regulatory vacuum, it can be difficult to choose which ESG framework to apply and understand how to properly assess ESG metrics. Other contributing factors are the voluntary nature of the frameworks, difficulties of monitoring and measurement, and the absence of mandatory external auditing and verification.

Further, ESG is not a static concept. ESG considerations and evolving ESG standards are fundamentally a reflection of the present zeitgeist, and the current events that inform policy objectives, the interests of consumers and investors, and technological developments. The field of ESG is just as complicated and nuanced as the world that informs it. As these features evolve and change, so do the factors that make up ESG and the methods of assessing their interconnectedness.

These challenges have made ESG reporting susceptible to "greenwashing", where some companies overreport sustainability, cherry-pick metrics, or otherwise engage in an inaccurate portrayal of ESG practices to look better to investors or to qualify for funding. In a noteworthy example, in April 2022, the SEC charged Vale, a Brazilian mining company and one of the world's largest iron ore producers, with making false and misleading claims about the safety of its dams prior to the January 2019 collapse of its Brumadinho dam, which killed 270 people and caused immeasurable environmental and social harm.[41] The SEC alleged that Vale intentionally misled investors through its ESG disclosures in which it made assurances that the company adhered to the "strictest international practices" in evaluating dam safety and that one hundred percent of its dams were certified to be in stable condition. On March 28, 2023, the SEC reached a $55.9 million settlement with Vale to resolve the allegations.[42] Proposed new ESG disclosure requirements under securities laws and the establishment of more objective, consistent standards for claimed environmental attributes or other ESG metrics may help address this complex issue.

Another concerning trend involves companies that engage in "brownwashing", which has taken on different meanings. It could mean investors that are betting against ESG and acquiring fossil fuel assets at discounted prices relative to projected cash flows. The term has also been used to describe companies that sell fossil fuel assets to private equity funds or other buyers so that their balance sheets appear greener to consumers or investors. "Brownwashing" may also refer to companies underreporting their ESG credentials, which may be intentional or may be due to a lack of understanding of ESG issues or inadequate management of ESG monitoring.

While approaches to ESG reporting remain in flux, investor demand for "consistent, comparable, and decision-useful" disclosures related to ESG risks remains strong, as has been highlighted by SEC Chair Gary Gensler.[43] Taking heed of these demands, on March 21, 2022 the SEC released its proposed rules on climate risk disclosures, which amend and build upon existing climate change disclosure rules and guidance and seek to enhance and standardise disclosures on climate-related risks that are like to have a material impact on a public company's business and financing performance.[44] In crafting the Proposed Rules, the SEC took guidance from existing third-party frameworks, standards, and metrics, principally the TCFD and standards for accounting and reporting on greenhouse gas emissions established by the Greenhouse Gas Protocol. The SEC has missed its self-imposed deadline to finalise the rule by October 2022 due to the large volume of comments received and a technical glitch in its online comment system that required reopening of the comment period for the rule; the rule is now expected to be finalised sometime in late 2023 or early 2024.[45] The DOL, on November 22, 2022, published a final rule allowing plan fiduciaries to consider climate change and other ESG factors in their selection of retirement investments.[46] The EU has published its own climate reporting rules, with the Corporate Sustainability Reporting Directive ("CSRD") entered into force on January 5, 2023, which requires companies to report according to European Sustainability Reporting Standards ("ESRS").[47] In the United Kingdom, the U.K. Financial Conduct Authority published a Consultation Paper (CP22/20) in October 2022 with proposed rules aimed at addressing greenwashing that would standardize and qualify specific sustainable investment labels, with an intent to publish a final rule by the fourth quarter of 2023.[48] Demand for ESG reporting standards is even expanding into the public sector, with the International Public Sector Accounting Standards Board ("IPSASB") announcing on June 14, 2023 that it would develop the first climate-related disclosure standard for governments.[49]

Yet, over the past few years, another trend has been emerging in the United States: a counter-reaction to companies' increasing normalisation of ESG reporting. Vocal critics have framed ESG efforts as a type of stakeholder capitalism that injects politics into the decision-making processes of corporations and shifts the focus away from maximisation of shareholder profits and raising questions about the future of the SEC's Proposed Rules.[50]

With these considerations in mind, project companies should take steps to leverage opportunities and mitigate risks by understanding the ESG considerations of a project from the very beginning of the development and procurement process. Site selection and initial design and engineering should reflect ESG goals and risks, for example, by intentionally choosing to site a project in a location that would not adversely affect vulnerable communities or environmentally sensitive areas and that would be more resilient to extreme weather events. Investors and lenders that embrace ESG goals should create a contractual framework to hold project companies accountable and encourage incorporation of ESG into project development. Increased transparency, verification, and reporting will be important to maintain a robust market for green, social, and sustainability bonds and other financial instruments, and to bolster the integrity of market standards for project financings in the future.

Acknowledgments

The authors would like to thank Neil Whoriskey, a partner in the Global Corporate Group at Milbank LLP, and Thomas D. Goslin, special counsel in the Environmental Practice Area of the Global Corporate Group at Milbank LLP, for their valuable contributions to this chapter. Neil's practice focuses primarily on mergers, acquisitions, and corporate governance matters and he has authored numerous articles on these topics. He also has experience in advising on ESG matters, with respect to Governance. Tom's practice focuses on a range of environmental and energy concerns in mergers and acquisitions, private equity investments, financing transactions, infrastructure projects and corporate restructurings.

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Matt H. Ahrens is a New York-based partner in charge of the firm's Environmental Practice Area. Mr. Ahrens advises on a wide range of environmental matters, particularly on identifying and resolving environmental issues and liability in complex global and domestic transactions, including financing, project development, M&A, real estate development, securities offerings and corporate restructuring. His practice has an emphasis on environmental and social matters related to construction of new and repowered wind and solar projects throughout the United States and Latin America. He has worked on hundreds of transactions involving a wide range of industries, especially with respect to renewable energy, power, oil and gas upstream, midstream, downstream and service, mining, hospitality and infrastructure. His experience includes ESG, remediation, air permits, climate change, wastewater, endangered species, environmental bankruptcy matters and environmental due diligence.

Milbank LLP
55 Hudson Yards
New York, NY 10001
USA

Tel: +1 212 530 5882
Email: mahrens@milbank.com
URL: www.milbank.com

Allan T. Marks, one of the world's leading project finance lawyers, works on transactions in renewable power, water, biofuels, transportation, ports, airports, and digital infrastructure. His clients include developers, sponsors, banks, institutional investors, private equity and infrastructure funds working on project development and finance, joint ventures and acquisitions, capital markets transactions, sustainability-linked/green bonds, and restructurings. He represents the developers of 3.3 GW of U.S. offshore wind projects and has worked on pioneering wind and solar projects throughout the United States and Latin America. Mr. Marks hosts the Law, Policy & Markets podcast and is a regular contributor to Forbes and an editorial board member of Law360 for Project Finance. He speaks and publishes often on ESG, sustainability, renewable energy, public-private partnerships, and economic policy. Mr. Marks is an Adjunct Lecturer at the University of California, Berkeley School of Law and Haas School of Business and a member of the Pacific Council on International Policy.

Milbank LLP
2029 Century Park East, 33rd Floor
Los Angeles, CA 90067
USA

Tel: +1 424 386 4376
Email: atmarks@milbank.com
URL: www.milbank.com

Iliana Ongun advises both public and private companies in a wide range of industries in connection with mergers and acquisitions, including cross-border and domestic acquisitions and divestitures, joint ventures, private equity transactions and spin-offs. Ms. Ongun also advises companies and sponsors with respect to shareholder activism, takeover defense strategies and other corporate governance matters.

Milbank LLP
55 Hudson Yards
New York, NY 10001
USA

Tel: +1 212 530 5571
Email: iongun@milbank.com
URL: www.milbank.com

Allison E. Sloto is a New York-based associate and a member of the Environmental Practice Area. Ms. Sloto focuses her practice on a range of environmental matters, particularly on identifying and resolving environmental issues and liability in transactions, including financing, project development, M&A, real estate development, securities offerings, and corporate restructuring. She regularly provides environmental advice and due diligence support for large-scale renewable energy projects. Her educational background allows her to provide a multidisciplinary perspective when counselling clients on ESG, especially climate change and sustainability concerns.

Milbank LLP
55 Hudson Yards
New York, NY 10001
USA

Tel: +1 212 530 5954
Email: asloto@milbank.com
URL: www.milbank.com

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