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ESG related clauses in SPAs and post-M&A disputes

Despite the inclusion of ESG factors in compliance, reporting and due diligence, ESG components in transaction documents have been largely neglected. Our blog post provides insight into the importance of ESG within the contractual documents of a deal, in particular the sale and purchase agreement (SPA). An SPA that takes ESG opportunities and risks into account can protect sellers and buyers against time-consuming and costly disputes.

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ESG related clauses in SPAs and post-M&A disputes

It is impossible to imagine the future of M&A transactions without assessing ESG opportunities and risks. However, the increasing number of ESG disputes shows that the associated risks are still being underestimated.

While ESG factors in due diligence are becoming part of the standard repertoire, sellers and buyers still face considerable challenges when integrating sustainability aspects into their transaction documents, including the sale and purchase agreement (SPA). These issues include the measurability of ESG aspects, increased regulatory requirements, complex areas such as ESG compliance in supply chains, assessment of causation and remedial measures, and the unclear wording, interpretation, and application of ESG clauses.

Despite these difficulties, efforts to incorporate ESG factors into the SPA are worthwhile, both from a legal and financial perspective. The concrete measurability of ESG items is driven by the intensified efforts for internationally comparable sustainability reporting. At the same time, there is scope for a more or less favorable accounting treatment of certain ESG items based on corporate use such as CO^2 certificates, considered an intercompany liability or cash-like item. ESG items can play an important role in the calculation and negotiation of purchase price and are regularly part of cost- and time-intensive post-M&A disputes. Moreover, sellers can shield themselves from future ESG-related indemnification payments, while buyers can actively protect themselves against potential ESG-risks.

To support the Green Transition and meet the challenges of the actors involved, some pilot initiatives have drafted ESG-specific SPA clauses. The Chancery Lane Project (TCLP) is a global association of 3,600 lawyers and business leaders, as well as 375 organizations from 113 countries, that aim to drive global decarbonization with the help of climate contracting. Their website offers free access and usage rights to more than 100 topic- and industry-specific, peer-reviewed climate clauses and more than 70 climate-related glossary terms, drafted and assessed by industry and legal experts.

The second initiative is the Working Group Model Contract Clauses 2.0 (MCCs 2.0) launched by the American Bar Association's Business Law Section. With a focus on US state law and the United Nations Convention on Contracts for the International Sale of Goods, this group has set itself the task of translating the UN Guiding Principles on Business and Human Rights (UNGPs) and the OECD Due Diligence Guidance for Business (OECD Guidance) into contractual obligations so that business actors can include them in supply contracts for the manufacture and sale of goods. The standard clauses of both projects offer industry-specific guidance and a basis for drafting transaction-specific clauses.

Environmental clauses that refer to compliance with existing environmental protection laws are already standard in SPAs. Typical examples of more current ESG-specific contractual clauses include climate change/net-zero targets, human rights and/or anti-discrimination obligations, and renewable energy commitments. ESG-specific clauses can be included in different parts of the SPA to meet the interests of both seller and buyer. This includes ESG legal aspects in representations, warranties, and indemnities. Beyond the assurance of there being no evidence of climate-related litigation, a popular example of representations and warranties in the US context is the "Weinstein clause", which arose from the #MeToo movement, and compels companies to disclose allegations of sexual harassment. ESG-related contractual agreements furthermore offer buyers the opportunity to protect themselves against cases of greenwashing that were not identified during due diligence.

Analysis of ESG-related liabilities and reputational risks is the basis for their inclusion in the contract documents. Under indemnity agreements, buyers can protect themselves against sustainability risk identified during due diligence but unclear at the time of signing in terms of outcome or associated costs, for instance a pending investigation into specific environmental pollution and the costs associated with their remediation. For effective dispute prevention, the wording of such agreements should be as specific as possible. Current post-M&A disputes reveal the added value that consideration of ESG aspects in transactions would bring. Disputed items we regularly deal with include provisions for environmental protection obligations, CapEx investment obligations required by extended ESG regulation, and use-based accounting of CO^2 certificates. SPAs that consider ESG risks and opportunities function as a valuable tool for dispute prevention, helping sellers and buyers avoid the time and costs spent on later ESG disputes.

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