Text to be published in a book that will be shortly out of press – Still under embargo and shared only with the participants to the 2023 ICCC – Please do not share this text with non-participants before 31 November 2023

ESG: WHAT ROLE FOR IN-HOUSE COUNSEL?

Vanessa MARQUETTE
Stephanie DE SMEDT
Mathias HENDRICKX
Stephanie VAN LAETHEM
Florian RIGOLLE
Caro VAN DEN BROECK
Loyens & Loeff Brussels

I. INTRODUCTION

1. Increasingly, corporate lawyers anno 2023 are confronted with questions of *Environmental & Social Governance* - 'ESG' for short. Whether it concerns the reduction of emissions, the design of sustainable products and packaging, respect for human rights in the workplace, or any of the countless other sustainability objectives that companies today set themselves (voluntarily or otherwise), it is often up to the in-house lawyer to make the translation between operational reality and a company's legal obligations. These obligations may come from legislation to which the company is subject, but also from contractual commitments.

2. A major liability risk clearly lies with those companies that today, or in the near future, fall (or will fall) under the scope of legislation imposing ESG reporting. Such reporting obligations first appeared in the financial sector with the *Sustainable Finance Disclosure Regulation* (SFDR). However, ESG reporting obligations will be extended to all sectors when the CSRD will come into force, and now that a final agreement on the CSDD is also expected. Because of their high relevance to an increasing number of corporate lawyers, this contribution briefly discusses below (in Title II) the obligations arising from the CSRD and CSDDD.

3. With these obligations in mind, it is important for in-house counsel to note that the corresponding sources of liability, types of liability, the potential claimants, and the persons who can be held liable in connection with ESG reporting are numerous. A whole range of situations are conceivable that could constitute possible grounds of liability. A non-exhaustive list:

1) The most obvious source of liability is the company not issuing a report or issuing a report that does not comply with legal (content or form) requirements.

2) Some statutory provision and are included in the Companies and Associations Code ('CCC'), which can thus give rise to directors' liability; in addition, there is also a draft bill pending with a view to amending the CCC to also make carbon reporting mandatory in the annual accounts of large companies.

3) In addition, a company's purpose can also refer to certain ESG obligations, the violation of which in turn can lead to specific liability. Although still highly exceptional in Belgium, this is different for French listed companies, now that quite a few companies, spurred on by the "*Loi Pacte",* have included a "*raison d'être*" in their articles of association that includes sustainability objectives.[1] Except for social enterprises, however, a similar trend is not yet apparent in Belgium.

4) ESG reporting is also increasingly becoming part of contractual agreements (see Title III below), either as a commitment to comply with obligations arising from mandatory ESG regulations, or as a voluntary commitment. Such statements can be found, for example, in 'green loans' (*green loans*) or even in 'green' rental agreements (*green leases*). Incorrect reporting can lead to a breach of such contractual obligations. It is also becoming increasingly important to collect accurate ESG data from co-contractors. For example, in a green lease, a tenant may request to receive accurate data from the landlord to do its own reporting.

5) Climate-related commitments may initiate legitimate expectations and potential liability with third parties in case of breach. Clients or contracting parties may decide whether or not to enter into a relationship with the company in question based on available ESG reporting. This may be important if one has strict guidelines for selecting its suppliers, or because a client itself reports on its chain of suppliers. It is increasingly common for companies to base their decision to contract, as well as sometimes their own reporting, on the ESG reporting made available by their suppliers.

6) Voluntary disclosure of information can also lead to liability if that information is inaccurate, intentionally or unintentionally (so-called *greenwashing*). This can give rise to both civil and

[1] Article 1835 Civil Code (FR): " *Les statuts doivent être établis par écrit. Ils déterminent, outre les apports de chaque associé, la forme, l'objet, l'appellation, le siège social, le capital social, la durée de la société et les modalités de son fonctionnement. Les statuts peuvent préciser une raison d'être, constituée des principes dont la société se dote et pour le respect desquels elle entend affecter des moyens dans la réalisation de son activité. ".*

criminal liability. To date, there is no specific offence of greenwashing in Belgian criminal law.[2] However, in such cases the criminal law authorities can fall back on other (more broadly formulated) offences, such as:

- Forgery (art. 196 Criminal Code): if a product is marketed as more environmentally friendly than it actually is, and if the environmental benefits of the product are misrepresented in written documents, then these documents could potentially be considered forged documents.

- Falsified financial statements (section 3:44 CC): when a company's financial statements contain incorrect data regarding environmental performance, these financial statements may qualify as falsified financial statements.

- Unfair practices towards consumers (Arts VI.93 and VI.97 to VI.100 Economic Law Code): misrepresentation of the environmental benefits of a product may constitute an unfair practice towards consumers, punishable under Book XV Economic Law Code.

- Misleading communication (art 33 of the Prospectus Act and art 25 and 40 of the Act of 2 August 2002 on the supervision of the financial sector): under certain circumstances, statements by listed companies regarding the environmental performance of their activities or investments can be considered as misleading communication to the market.

7) violation of Market Abuse Regulation ('MAR'): under Article 12 MAR, the dissemination of misleading information, market manipulation, is a key concern for listed companies.

4. Given that ESG issues thus entail numerous risks for companies, it is crucial for corporate lawyers not only to closely monitor regulatory developments, but also to take a fresh look at contractual provisions to avoid pitfalls. In this contribution, we will focus in particular on some key European regulatory initiatives on sustainability (Title II) and on the enforceability of contractual sustainability obligations (Title III). This contribution is not

[2] In July 2023, the Council of Ministers approved in a second reading the bill to reform Book 2 of the Penal Code, which includes "*ecocide*". This refers to an exceptional environmental degradation that has a negative impact on a group of people, and this for both previous, current and future generations. This proposal will now be discussed in Parliament.

exhaustive. However, it does attempt to provide corporate lawyers with useful starting points in fulfilling their role within the company in terms of ESG.

II. A RAPIDLY CHANGING REGULATORY FRAMEWORK

A. THE EUROPEAN DIRECTIVE ON SUSTAINABILITY REPORTING BY COMPANIES ('CSRD')

1. Background and objective of this new legislation

5. On 5 January 2023, EU Directive 2022/2464 of 14 December 2022 amending Regulation 537/2014/EU, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, in relation to sustainability reporting by companies[3] (hereinafter 'CSRD' after the abbreviation commonly used in English) entered into force, replacing Directive 2014/95/EU of 22 October 2014 on the disclosure of non-financial and diversity information by certain large companies and groups[4] (better known as the 'NFRD').

6. The CSRD resulted in amendments to the following European legislative instruments: (i) the Accounting Directive,[5] (ii) the Audit Directive[6] and Audit Regulation,[7] and (iii) the Transparency Directive.[8] It modernises and strengthens the rules regarding the social and environmental information that companies must report.

[3] Richtl. European Parliament and Council No 2022/2464, 14 December 2022, amending Regulation (EU) No 537/2104, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, with regard to sustainability reporting by companies, *OJ L.* 16 December 2022, Exh. 322, 15.

[4] Richtl. European Parliament and Council No 2014/95, 22 October 2014 amending Directive 2013/34/EU as regards the disclosure of non-financial and diversity information by certain large companies and groups, *OJ L* 15 November 2014, ap 330, 1.

[5] Richtl. European Parliament and Council No. 2013/34, 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, *OJ L.* 29 June 2013, p. 182, 19 (hereinafter the Accounting Directive).

[6] Richtl. European Parliament and Council No. 2014/56, 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, *OJ L.* 27 May 2014, fn. 158, 196 (hereinafter the Audit Directive).

[7] Reg. European Parliament and Council No. 537/2014, 16 April 2014 on specific requirements for the statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC, *OJ L.* 27 May 2104, p. 158, 77 (hereinafter referred to as the Audit Regulation).

[8] Directive. European Parliament and Council No. 2004/109, 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, *OJ.* 31 December 2004, p. 390, 38 (hereinafter referred to as the Transparency Directive).

7. A broader group of large companies, as well as listed SMEs, are now required to publicly report on sustainability. This concerns about 50,000 companies in total, representing about 75% of the turnover of companies in the EU.

8. The new rules should ensure that investors and other stakeholders have access to the information they need to assess investment risks due to climate change and other sustainability issues. Moreover, the CSRD aims to improve the quality and comparability of sustainability information, increase transparency and accountability, and align sustainability reporting with the EU's sustainable finance agenda.[9] In particular, the CSRD requires the inclusion of a sustainability report in the board of directors' report. This sustainability report should be included in a separate section of the board report and be clearly identifiable as such.[10]

9. All companies falling under the scope of the CSRD will have to report on a broad set of ESG topics that will be set out in the new *European Sustainability Reporting Standards* ('ESRS'), a uniform set of sustainability reporting standards.[11] These also include significant actual or potential negative impacts related to the company's own operations and its value chain. As a result, the CSRD is expected to lead to the implementation of certain (internal) reporting channels and, to a certain extent, a sustainability *due* diligence *policy* that will have to be applied both internally (within the corporate group) and externally (e.g. vis-à-vis producers, suppliers, distributors, etc.).[12] It is in the roll-out and implementation of this in particular that an important role for in-house counsel will be required. Not only will the in-house lawyer make the translation between the company's legal reporting obligations and potential liability risks. He or she will also have to ensure that *due diligence* of other actors in the upward or downward value chain is contractually enabled and can be enforced. More on this under Title III.

2. Staff scope

10. The CSRD will apply to four categories of companies and will be phased in between the financial years 2024 and 2028:[13]

[9] Moreover, the sustainability reporting standards of Article 29ter CSRD refer explicitly to these objectives.
[10] Replacing Article 19a of the Accounting Directive.
[11] Addition of a Chapter 6a in the Accounting Directive.
[12] In that context, see also the discussion of the CSDDD *infra*.
[13] See Article 5 CSRD and new Article 3 Accounting Directive.

- Category 1 refers to "large companies" or parent companies of a "large group" (EU or non-EU) that have securities listed on a regulated market in the EU, or are otherwise a "public interest entity"[14] and have more than 500 employees on average. This category will have to start reporting from 2025 in accordance with the CSRD in respect of the 2024 financial year. It should be noted that this first category covers companies that are already required to report in accordance with the NFRD today.

- Category 2 covers EU "large companies" and EU parent companies of "large groups" that do not fall under category 1. This category will have to start reporting in line with the CSRD in relation to the 2025 financial year from 2026.

- Category 3 refers to "small and medium-sized enterprises" (not: "micro enterprises") with securities listed on a regulated market in the EU. This category will have to start reporting from 2027 in accordance with the CSRD in respect of the 2026 financial year.

- Category 4 refers to non-EU parent companies of "large groups" not falling under categories 1 or 3, where the group has net sales of more than €150 million in the EU and has an EU subsidiary or a significant (i.e. net sales of more than €40 million) branch in the EU. This category of companies will have to report in accordance with the CSRD in respect of the 2028 financial year from 2029.

11. To determine whether a company is "large", "medium", "small" or "micro", the following criteria apply under Article 3 of the amended Accounting Directive:

Criteria	Micro	Small	Medium	Large
Total assets	≤ €350 thousand	≤ €6 million	≤ €20 million	> €20 million
Net sales	≤ €700 thousand	≤ € 12 million	≤ €40 million	> €40 million
Average number of employees	< 10	< 50	< 250	≥ 250

[14] A "public interest entity" is defined in Article 2(1) of the Accounting Directive as encompassing listed EU companies, as well as certain other specific types of companies, such as credit institutions and insurance companies, and entities designated as such by EU member states.

12. If the enterprise is a parent company required to prepare consolidated financial statements, the criteria set out above should be assessed on the basis of such consolidated financial statements. Consolidation of an investee in the financial statements of the parent company is in principle required if the parent company controls the investee, subject to certain exemptions.[15]

3. Substantive reporting requirements

13. Like the *Sustainable Finance Disclosure Regulation*[16] ('SFDR'), the CSRD also includes the concept of "dual materiality" or the "dual materiality perspective". This means that companies must consider both (i) the risks and opportunities for the company within the scope of reporting, and (ii) the risks and opportunities for the people and environment affected by them. Companies should thus report not only information necessary to understand the company's development, performance and position, but also information necessary to understand the impact of the company's activities on environmental and social issues, respect for human rights, anti-corruption and bribery. Companies should consider each materiality perspective in isolation and disclose information that is relevant from both perspectives, as well as information that is relevant from only one of the perspectives. [17]

14. Companies will further need to conduct both retrospective and forward-looking analyses. This means sharing quantitative information (such as historical measured impact to date) and qualitative information (such as objectives, strategy and risk assessment related to ESG factors).[18]

15. Particular attention should also be paid to the requirement in the CSRD to disclose so-called "scope 3 emissions".[19] These are the indirect carbon emissions produced by all other companies connected to the company throughout the value chain. This is a trend that is striking throughout the EU's suite of ESG legislation (see also Title II.B on CSDDD), with the supply or value chain being indirectly pulled under the scope of the legislation. This dramatically increases the impact of such ESG regulations and will make it crucial for in-house counsel to

---

[15] New Article 3 Accounting Directive.
[16] Reg. European Parliament and Council No 2019/2088, 27 November 2019 on sustainability disclosure in the financial services sector, *OJ L* 9 December 2019, p. 317, 1 (hereinafter SFDR).
[17] New articles 19a *in conjunction with* 29a Accounting Directive.
[18] Recital 33 CSRD.
[19] Recital 47 CSRD.

integrate robust information, reporting, and monitoring obligations into the contractual arrangements within this value chain (see also Title III).

4. Reporting standards

16. The ESRS will develop a set of reporting standards covering all sustainability issues from a dual materiality perspective. Companies subject to the CSRD will thus have to report according to the ESRS. These draft standards are being developed by EFRAG, the *European Financial Reporting Advisory Group*, an independent body that brings together various stakeholders. [20]

17. The aim of the ESRS under the CSRD is that they are proportionate and do not impose an unnecessary administrative burden on companies that are required to use them. As such, where appropriate, the standards will take into account existing sustainability reporting and accounting standards and frameworks.[21] While in the past, reporting standards and frameworks were developed on an individual basis, or legislation on country-by-country reporting was adopted, the aim of the ESRS as such is to create a more harmonised and integrated reporting standard to ensure that disclosed information is of equal quality, usability and comparability.[22]

18. In November 2022, EFRAG published the first set of draft ESRS, which includes 12 standards, divided into cross-sectoral standards (general ESG reporting provisions such as on *due diligence*, strategy and business model, and value chain) and sector-agnostic standards (divided between the three letters of ESG: "E" or environmental (five standards: E1 - Climate change, E2 - Pollution, E3 - Water and marine resources, E4 - Biodiversity and ecosystems, E5 - Resource use and circular economy), "S" or social (four standards: S1 - Own employees, S2 - Employees in the value chain, S3 - Affected communities, S4 - Consumers and end users) and "G" or governance (one standard: G1 - Corporate behaviour)). There will also be sector-specific requirements. Initially, these will cover mining, quarrying and coal mining, oil and gas, road transport, animal husbandry, agriculture and fisheries.[23]

19. On 9 June 2023, the Commission launched a public consultation for a draft delegated act containing the first set of ESRS under the CSRD. The ESRS set out in the European Commission's draft build on the draft ESRS proposals prepared by EFRAG, and provide for

[20] New Article 29ter Accounting Directive.
[21] *Ibid.*
[22] Recital 51 CSRD.
[23] These can be found on EFRAG's website at https://www.efrag.org/lab6 (webpage consulted August 2023).

significant revisions to those draft proposals, including additional phased implementation, making certain disclosures voluntary, and subjecting all disclosure requirements (except for a set of general disclosures) to materiality assessments.

5. Auditing and control

20. The CSRD introduces the requirement for sustainability reporting to be certified by an accredited independent auditor or certification body. This independent party must ensure that sustainability information meets the certification standards adopted by the EU. Non-European companies' reporting must also be certified, either by a European auditor or an auditor based in a third country.[24]

21. Member states are also given the option to open the market for sustainability assurance services to "independent providers" of such services, *i.e.* companies other than the usual auditors of financial information.[25]

B. PROPOSAL FOR A EUROPEAN SUSTAINABILITY DUE DILIGENCE DIRECTIVE

1. Background and objective of this new legislation

22. On 23 February 2022, the European Commission published its proposal for a directive "on corporate sustainability due diligence"[26] (hereafter 'CSDD', after the abbreviation commonly used in English). This proposal aims to require certain companies to implement specific processes in their value chain in line with ESG-related purposes. The CSDD thus fits into the broader framework of EU ESG-related legislative initiatives and provides a substantive backbone for the resulting reporting requirements, in particular the CSRD mentioned in Title II.A of this contribution. Meanwhile, the Council and the European Parliament have taken position, on 1 December 2022,[27] and 1 June 2023 respectively,[28] on this CSDD proposal.

---

[24] New Article 34 Accounting Directive.
[25] *Ibid.*
[26] Proposal for a Directive of the European Parliament and of the Council on due diligence in corporate sustainability and amending Directive (EU) 2019/1937, 23 February 2022, COM(2022) 71 final, C9-0050/2022 - 2022/0051 (COD).
[27] Council general approach on the Proposal for a Directive of the European Parliament and of the Council on due diligence in corporate sustainability and amending Directive (EU) 2019/1937, 15024/1/22 REV 1.
[28] Amendments adopted by the European Parliament on 1 June 2023 on the Proposal for a Directive of the European Parliament and of the Council on due diligence in corporate sustainability and amending Directive (EU) 2019/1937, P9_TA(2023)0209 (hereafter the Amendments).

23. Note that references in this contribution to certain articles of the CSDDD are to the text as proposed by the European Commission in 2022.

2. Staff scope

24. The staff scope of the CSDD is already a first bone of contention. The European Commission puts forward two groups of (very) large EU companies, namely (i) companies with an average of more than 500 employees and a global net turnover of more than €150 million in the last financial year for which annual accounts have been prepared, and (ii) companies operating in certain so-called "high-risk sectors" and which had an average of more than 250 employees on top of a global net turnover of more than €40 million in the last financial year for which annual accounts have been prepared, provided that at least 50% of the net turnover was achieved in one or more high-risk sectors. Such sectors would include wholesale and retail of textiles, clothing and footwear, agriculture, forestry, fishing and mineral extraction.[29]

25. In its current form, the CSDD will also apply to non-EU companies if they meet any of the net turnover criteria listed above for EU companies.[30] Thus, for non-EU companies, the CSDD does not look at the number of employees, but only at the net turnover realised in the EU.

26. Based on the above criteria, it is estimated that around 17 000 companies operating in the EU would fall directly within the personal scope of the CSDD.

27. The Council's view deviates only slightly from this, only as regards the temporality of the conditions (i.e. the conditions mentioned above would have to be fulfilled for two consecutive financial years).[31] In contrast, the European Parliament provides for a much broader scope in its proposed Amendments, notably by using the net turnover threshold of EUR 40 million and a minimum quantity of 250 employees as a general threshold for EU companies (without differentiating according to whether the company operates in a "high-risk sector").[32] Moreover, the Amendments add an additional category of companies, namely the parent company of a group with at least 500 employees and a net turnover of €150 million, of which

[29] Article 2(1) CSDD.
[30] Article 2(2) CSDD.
[31] Council approach, p. 4, fn. 12.
[32] Amendments, p. 68 ff, Amendments 89-93.

at least €40 million is generated in the EU.[33] The Parliament also extends these extensions to non-EU companies.[34]

3. Care requirements

28. Companies covered by the scope of the CSDDD will be required to exercise "due diligence" on human rights and the environment by implementing the following actions, in line with previous OECD guidelines on responsible corporate behaviour:

(i) integrate appropriate due diligence (or *due diligence*) into their policies (Article 5);
(ii) identifying actual or potential adverse effects (Article 6);
(iii) prevent and mitigate potential adverse effects and terminate actual adverse effects and minimise their magnitude (Articles 7 and 8);
(iv) establishing and maintaining a complaints procedure (Article 9);
(v) monitor the effectiveness of their due diligence policies and measures (Article 10); and
(vi) communicate publicly about due diligence requirements (Article 11).

29. With regard to these obligations, differences between the EU institutions are relatively limited. Both the Council and the European Parliament consider that a *risk-based* approach should be used to identify (and, according to the Amendments, assess) the (potential) negative impacts.[35] The Amendments further extend the complaints mechanism of Article 9 by providing general reporting channels and allowing certain organisations to represent injured parties.[36] In addition, they also aim to require companies to verify the effectiveness of their policies themselves.[37]

30. *Due diligence obligations* cover not only the company itself, but also its subsidiaries and their operations, as well as activities carried out by established business relationships throughout the value chain. [38]

[33] *Ibid.,* amendment 90.
[34] *Ibid.,* Amendments 94-95.
[35] Council's approach, p. 6, marginal 17 and Amendments, p. 91 et seq, amendments 149-55.
[36] Amendments, p. 118ff, Amendments 207-12.
[37] Amendments, pp. 124-25, Amendments 222-23.
[38] Article 1 CSDDD.

31. To properly understand the scope of *due diligence obligations*, Article 3 of the CSDDD defines a number of key terms:

- **negative impacts** are defined with respect to the violation of prohibitions and rights contained in international environmental or human rights treaties listed in annex to the CSDDD;

- **an established business relationship** is defined as a direct or indirect business relationship that is sustainable, or expected to be sustainable, given its intensity or duration and that is not a negligible or merely incidental part of the value chain. However, this definition is still subject to debate. The Council prefers a reference to the concept of "business partner" as a starting point, which implies a narrower definition, covering only legal entities with which the company has a commercial agreement in connection with its products, services or activities, or which carry out activities in this connection.[39] In contrast, the European Parliament refers to "business associates" in general, i.e. any entity, including (sub)contractors, in the value chain with which the company maintains a relationship, directly or indirectly, either by virtue of being linked by a commercial agreement or by virtue of such entity performing work in connection with the company or with its products, services or activities[40] ;

- **value chain** is defined as the activities related to the production of goods or the provision of services by a company, including the development of the product or 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 (with specific derogations for regulated financial companies).[41] The Amendments broaden this definition as follows: (i) henceforth, reference would also be made to the entities involved in the listed activities, and (ii) the matters to which the activities relate are defined more broadly, clarifying that, among other things, transporting, storing, supplying raw materials or components of products and distributing them are covered by the notion of value chain.[42] As under the previous point, the Council also opts for a different point of reference here. The term "chain of activities" replaces "value chain"

[39] Approach of the Council, p. 6, fn. 17.
[40] Amendments, p. 76, amendment 110.
[41] However, the specific regulation of companies in the financial sector is beyond the scope of this contribution.
[42] Amendments, p. 77 ff, Amendments 114-6.

to emphasise the activities of upstream business partners and downstream business partners respectively, each time clarifying the relevant activities, analogous to the aforementioned Amendments, but with a more pronounced focus on the supply chain rather than the entire value chain.[43]

32. Note further in particular that, in addition to the general *due* diligence *obligations*, (i) EU companies with, on average, more than 500 employees and global net sales of more than €150 million in the last financial year for which financial statements have been prepared, as well as (ii) non-EU companies with net sales of more than €150 million in the financial year preceding the last financial year, should prepare a plan ensuring that their business model is compatible with limiting global warming to 1.5° C in line with the Paris Climate Agreement. Moreover, when climate change is identified as a significant risk to, or impact of, a company's operations, it must also include emission reduction targets in its plan.[44]

III. IMPLEMENTING ESG OBLIGATIONS IN COMMERCIAL AGREEMENTS

A. WHAT ARE 'ESG CLAUSES'?

1. Origin of 'ESG clauses'

33. ESG clauses are contractual instruments used by companies to encourage or require their contractors (suppliers, distributors, commercial partners, etc.) to improve their environmental and/or social governance and to implement more sustainable, climate-friendly and ethical measures. ESG clauses are designed to encourage and enforce such initiatives and measures throughout each step in the value chain of a given product or service.

34. Introducing ESG clauses in contracts or policy documents also results in companies being better able to guard themselves against legal, financial and reputational risks that may arise from their suppliers' failure to comply with sustainability and ethical standards. Indeed, even companies with the noblest intentions may unknowingly and consequently unwittingly cooperate with companies that participate in forced labour or corruption, which can significantly damage their reputation. To avoid such situations, it is important to also build in a robust system of monitoring.

[43] Council approach, pp. 6-7, marginal 18-9.
[44] Article 15 CSDD.

35. In addition, including ESG clauses in contracts throughout the value chain can bring several commercial benefits, such as improving customer relations, and reputational benefits for companies that are seen as environmentally and socially conscious as a result.

36. Yet ESG clauses and their associated consequences and outcomes can vary considerably. As a result, these clauses introduce a degree of uncertainty in practice for many companies. It is therefore important that ESG clauses are drafted in such a way that it is clear to parties (i) what the desired outcome is, and (ii) how this will be verified and enforced.

2. Legal basis

37. Although ESG is not new, it has gained significant importance in recent years. After all, we live in a time where concerns about climate change have increased significantly, as well as the demand for socially conscious business. It is now essential for companies to market themselves as actors that are not only focused on generating revenue, but also recognise the broader impacts their business activities have on society, and actively seek positive change. Studies show that investors increasingly consider ESG factors when making investment decisions and that 63% of consumers prefer to opt for, switch to or avoid a brand based on views on social issues. How companies deal with climate change also has a clear impact on consumer buying behaviour.[45]

38. With the growing importance of corporate ESG performance, ESG is high on everyone's agenda today. While building ESG clauses into contracts is mainly a matter of voluntary initiative, legislative initiatives on the disclosure and reporting of environmental and social risks also require some (contractual) influence on the value chain. In this context, for example, the Organisation for Economic Cooperation and Development (OECD) and the United Nations (UN) have recommended that companies influence their suppliers through contractual agreements to maintain and improve sustainability and responsible corporate behaviour. See also the European initiatives discussed under Title II, and the various initiatives to combat *greenwashing*. For example, a proposed EU directive will require companies to communicate in a more transparent way about the "green" aspects of their products or services, and strong and more efficient control mechanisms will be built in.

[45] See article available online at 2022 Edelman Trust Barometer Special Report The New Cascade of Influence FINAL.pdf (webpage consulted August 2023).

39. When building ESG standards into contractual relationships, it is important to consider what legal safeguards already exist, and what additional safeguards should be contractually embedded. For instance, companies may opt to contractually expand the scope of existing legislation or to further develop or specify existing obligations.

3. Different types of 'ESG clauses'

40. ESG clauses can come in different shapes and sizes and extend to different areas, including:

(i) **Environmental measures**: These obligations can cover various aspects, such as banning certain raw materials or packaging materials, imposing certain delivery requirements to minimise the carbon footprint, for example, etc.

(ii) **Social justice measures**: ESG clauses can also focus on safeguarding human rights and combating child labour. For example, companies can require their suppliers to provide a healthy working environment for their employees.

(iii) **Ethical measures**: ESG clauses can also encourage companies' ethical behaviour. For example, they can prohibit suppliers from participating or cooperating with other companies involved in corruption, drug or arms trafficking, or similar activities.

41. ESG clauses can thus cover a wide range of domains, offering the flexibility to adapt to specific situations so that they can accurately address the exact needs and risks faced by the parties. Take, for example, the scenario where a supplier's factories are located in a country where working conditions or workers' rights or environmental issues are less strongly regulated. In such a case, it is important to build in proper contractual safeguards to still ensure that the supplier pays due attention and care to this. However, for these clauses to lead to the desired result, it is important to dwell on some legal considerations.

4. Important considerations for in-house counsel

Knowledge of ESG clauses

42. When contracting parties are requested to respect (internal or external) codes of conduct, policies or guidelines, it is important that they are actually acquainted with them or at least given the opportunity to become acquainted with them. Such documents should thus be communicated in an appropriate manner so that the contracting party has the opportunity to learn about the content and scope of these obligations, as well as the consequences in case of

incorrect compliance. It is also important that such notification (or possibility of notification) takes place before the formation of the contract. Indeed, documents that are only communicated afterwards will not be considered part of the contract unless the contracting party expressly agrees. Ideally, such obligations or documents would thus be included directly in the contract or general terms and conditions. This can be done, for example, by including the relevant clauses therein, or by adding relevant documents as annexes.

43. However, merely stating the existence of ESG obligations (e.g. in general terms and conditions) is not in itself sufficient. As stated above, it is important that the contracting party is at least given the opportunity to actually take note of the scope of these obligations. If this is not the case, it will simply be able to argue that it was not aware of them and consequently could not agree to their application. Effective communication of ESG documentation is all the more important when it comes to internal policies or lesser-known guidelines, which cannot reasonably be expected to be known by an external contracting party.

44. In this context, account should also be taken of Article VI.91/4, 4° of the Economic Law Code. Indeed, this article states that any clause that irrefutably presupposes a party's cognisance or acceptance of a provision of which that party had no actual opportunity to take cognisance prior to the conclusion of the contract should be considered unlawful and, consequently, null and void. In other words, references in the contract or general terms and conditions suggesting that certain documents or guidelines apply and indicating that the other party agrees to them will, in principle, be declared null and void, unless it can be effectively demonstrated that these guidelines or documents were actually made available or available to the other party.

45. The above also applies to unilateral amendments to ESG-related codes of conduct, policies or guidelines. Often, general terms and conditions or contractual clauses stipulate that amendments to such documents will automatically apply as soon as they are published on the company's website, for example. Such a practice can be agreed upon. However, when the changes made result in a significant aggravation of the contracting party's obligations, it is nevertheless advisable to actually notify it of the proposed changes, possibly stating that if no objections are raised within a reasonable period of time, the change will be considered accepted.

The scope of the ESG commitment

46. It is important to define the desired ESG measures in a clear and measurable way, in such a way that it is clear to both contracting parties what the risks are, what measures should be taken, what is specifically expected, and how these expectations or measures should be met.

47. The more detailed an ESG clause is formulated, the less likely disputes are about its scope and interpretation. If an ESG clause is drafted very broadly and states, for example, that a supplier must "act in an environmentally conscious manner" or "conduct activities in an ethically responsible manner", the likelihood of interpretation disputes is high. This is because the meaning of the terms used can vary greatly depending on the person reading it. Adding more specific objectives or clearly defining the required measures helps minimise this risk. Moreover, it then becomes easier to determine when and to what extent the supplier has breached this commitment. This is certainly the case when the documents containing ESG clauses were drafted unilaterally by the company. Indeed, in that case, they will in principle be interpreted to the disadvantage of the drafter when the intention of the parties cannot be deduced from their wording.

48. Second, it is important to decide whether the ESG obligation will constitute an effort obligation or a result obligation within the meaning of Article 5.72 of the New Civil Code. For example, is it sufficient that the contracting party makes all reasonable efforts to meet the stated expectations, or must it achieve a specific measurable result?

49. The answer to this question plays an essential role in deciding whether the ESG obligation has been fulfilled (or breached). A best-efforts obligation (or means obligation) is an obligation that obliges its obligor to exercise all care proper to a prudent and reasonable person to achieve a particular result. In other words, a party bound by a best efforts obligation (only) undertakes to use all reasonable efforts that could be expected of a normally prudent contracting party of the same specialisation in similar circumstances. An obligation of result, on the other hand, is one that obliges its debtor to achieve a certain result. If the result is not achieved, the debtor's fault is presumed unless force majeure is proven. The distinction between the two thus lies mainly on the burden of proof. Indeed, under a best-efforts obligation, a supplier who fails to meet the expected results will not always commit a contractual breach. It will be up to the company to prove the supplier's fault. Therefore, for such clauses, it is useful to include specifiable (measurable) indicators to assess the supplier's efforts (e.g. by defining

which efforts will count as a minimum). The clause itself should include all relevant indicators to assess the supplier's behaviour.

"Essential" nature of the ESG commitment

50. Certain contractual obligations play a more important role in the commercial relationship between parties than others. For example, in a sales contract, delivery of the merchandise and payment of the price qualify as essential obligations. These are obligations that are essential to the continued existence of the contract and without which the contract loses its object or purpose.

51. Qualifying an obligation as an essential obligation by the parties entails a number of benefits and protections. In principle, they are considered sufficiently serious to justify termination of the contract (see below). In addition, the contracting party will not be able to exonerate liability relating to such essential obligations. Thus, article VI.91/5, 6° WER stipulates that clauses releasing a company from its liability for failure to perform the essential obligations that are the subject of the contract are presumed to be unlawful.

Enforcement of ESG clauses

52. Attaching a specific sanction to the breach of an ESG clause will not only act as an *incentive* and thus encourage the contracting party to actually comply with it, but it will also bind the company to a solution in case a contracting party fails or refuses to give the appropriate follow-up.

53. Traditionally, parties opt for (i) damages or (ii) a right of suspension or termination (or a combination of both). The choice of an appropriate sanction usually depends on the importance of the ESG obligation in question. For example, companies will often include a termination clause for participation in human trafficking, corruption or other similarly serious situations, while less serious breaches, such as failure to fully comply with specific product supply regulations, will often be addressed through the award of liquidated damages or the imposition of a remedial undertaking.

54. In the event of non-compliance with a contractual obligation, a party may additionally recover the damage suffered by it from its counterparty. In principle, unless the contract provides otherwise, the debtor is obliged to make full reparation for the damages suffered by

the creditor.[46] Specific to ESG clauses, it can be difficult to assess and quantify the damages suffered as a result of the breach. After all, it will often be reputational damage. To mitigate this risk, parties can insert a liquidated damages clause in the agreement. Indeed, in that case, parties agree in advance that in case of an attributable breach of an ESG obligation, there will automatically be an obligation to pay a fixed amount. However, when determining this amount, it is important to note that a damage clause may only serve to cover the (potential) foreseeable damage in the event of a breach of the ESG obligation. Under no circumstances may a liquidated damages clause be 'punitive' in nature, nor be manifestly disproportionate in relation to the potential harm that may be suffered by the company. Damage clauses that are disproportionate are presumed to be unlawful and may be annulled in accordance with Article VI.91/5, 8° WER.

55. Besides a damage clause, parties can also opt to demand reparation in kind in case of a breach of an ESG commitment, i.e. to undo or remedy as much as possible the breach committed. Alternatively, a more ESG-focused solution can be chosen where the contracting party is obliged, for example, to make a donation to a recognised human rights or climate organisation in the event of a breach.

56. At the other end of the spectrum, a rescission clause grants a contracting party the right to terminate the contract unilaterally (and out of court) in the event of a contractual default. However, for a rescission clause to be valid, it is required that the non-performance relied upon by the creditor is sufficiently serious to justify rescission.[47] Thus, to emphasise the importance of ESG obligations in the contract, parties may choose to explicitly state in the contract which obligations they consider essential and which, in case of non-compliance, will jeopardise the continuation of the contract. In the absence of this, the seriousness of the breach and its impact on the contractual relationship will have to be assessed by a court and on the basis of all relevant circumstances.

57. Finally, plea of non-performance is included as of right in any recoupment contract.[48] As with other sanctions, the plea of non-performance must be invoked in good faith in accordance with the principle of proportionality. However, to provide greater legal certainty, parties may opt to stipulate a right of suspension in case of breach of a material or essential

[46] Article 5.237 new Civil Code.
[47] Article 5.39 new Civil Code.
[48] Article 5.239 new DCC.

obligation. In such a case, it is advisable for parties to explicitly state in the agreement which ESG obligations the parties consider to be essential and which, in case of non-compliance, are sufficiently serious to justify suspension. A right of suspension will grant the company the right to suspend its commitments until the contracting party remedies the breach committed.

5. ESG documentation & audits

58. The enforceability of ESG clauses depends heavily on a company's ability to verify or monitor compliance with the obligations it imposes on its suppliers. Agreements therefore often include an obligation to actively report progress on ESG obligations, issue regular certificates, implement internal or external audits, etc.

59. Moreover, ESG clauses are usually enforced through audit rights. Conducting ESG *due diligence* within the context of value chains may require involvement of experts in engineering, social, environmental and other relevant areas. Several audit and consulting firms already offer customised services to conduct ESG *due diligence*. These audits not only focus on a company's direct suppliers, but also extend to their intermediaries and subcontractors.

60. From the perspective of in-house counsel, it should be stressed that reporting and audit clauses are best adapted to the specific needs of the parties and this by including specific or more practical conditions. For example, it can be agreed that audits can only be conducted during working hours (or specific hours), that they should follow a certain frequency (monthly or annually), how confidential information should be handled, how the costs of the audit will be shared, and other specific modalities.

Concluding observations

By Celine Beys, legal, ESG & ethics counsel.

This contribution illustrated how ESG considerations can have a significant impact on the day-to-day practice of in-house counsel, particularly when following legal obligations and translating them into contractual obligations throughout the value chain.

The ever-expanding legislative framework in the ESG domain is increasingly imposing obligations throughout the company, and this means that the eyes within all departments of the company are on the in-house lawyer. Thus, we see that in large companies, a separate position has already been created under the name "ethics & compliance" to focus very specifically on

the legal aspects of ESG. In many cases, this is someone with a background as a corporate lawyer who chooses to specialise. Given the scope and relatively recent nature of much of the legislation, this is an exciting challenge.

But in addition, and above all, the field of ESG also provides an excellent opportunity for the in-house lawyer, to take a prominent role in what can be an exciting and unifying project for the entire company. Because, amidst all the legislation, let us not forget that ESG goes far beyond legislation alone. That the raison d'être for the legislative framework translates a growing desire within society, for a way of doing business where ethics, a more equitable socio-economic balance and proper attention to the environment, are central. In other words, the in-house lawyer, in his or her day-to-day practice, touches, more than ever before, on the core of the values for which the company stands and in doing so becomes an important ambassador in terms of integrity.

The implication of the in-house lawyer will be crucial, with the help of a good knowledge of existing business processes, an excellent internal network, solid expertise and a connecting and strong communication, to enable a successful ESG policy for the company. Thus, the corporate lawyer can ensure that both the legislation and the values promoted by the company do not remain a dead letter. But also - and above all - he or she is a true pivotal figure for efficient risk management for the company, for an inspiring and recruiting corporate image that will attract more customers and motivated employees, and *last but not least*, from the work within the ESG domain, the in-house lawyer makes a contribution that cannot be underestimated in the pursuit of a more harmonious world.