ESG for Deal Professionals:
Selected Developments & Trends

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Weil, Gotshal & Manges LLP

Agenda

- Developments and trends in ESG/impact investing
- Fund regulation updates
  - EU Sustainable Finance Disclosure Regulation
  - UK Sustainability Disclosure Requirements
- Hot topics in energy transactions
- ESG due diligence including supply chain
- ESG considerations in integration
  - Disclosure
  - Anti-ESG

Presenters

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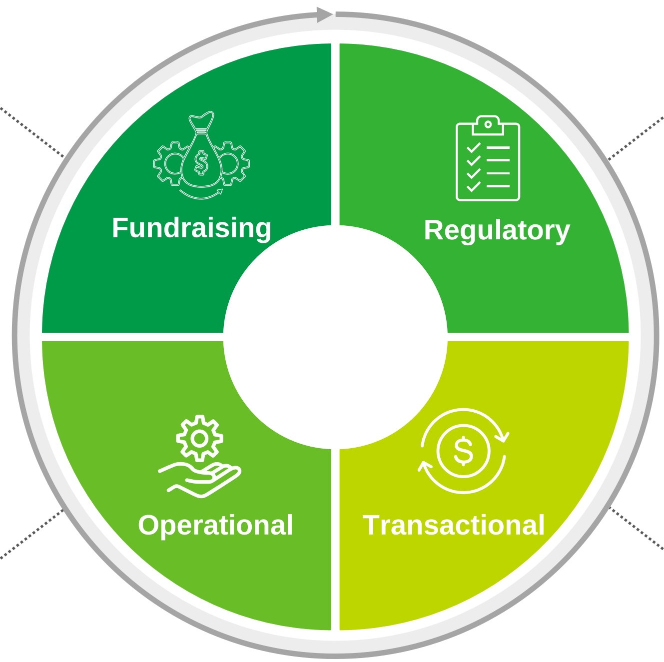
Regulatory Transactions

Select ESG Considerations for Deals - Overview



- ESG/impact focussed fundraising
- Development and communication of ESG strategy / approach to the market
- LP considerations including identifying known ESG or impact focussed investors - pre-planning for ESG requests and negotiating into fund documentation (LPAs and / or side letters)

- Evaluation of relevant regulatory standards e.g., SFDR or UK SDRs
- SFDR and investor side letter compliance linked to financings and investment processes, including due diligence checklists and preparation for ICs

- Dovetailing of fund level reporting and management reporting
- Ensuring portfolio company level reporting aligns with fund LPA and /or side letter obligations
- ESG considerations in integration, including disclosure and anti-ESG
- Training and education including for marketing teams, including development and trend tracking
- Consistency of data reporting, internal processes, procurement team and resources

- Nature of target asset e.g., energy transition or otherwise linked to ESG thesis of fund
- Challenge of ESG linked metrics and need to ensure transparency in calculation methodologies
- ESG due diligence
- Risk mitigation strategies (fund and portfolio level)
- Appropriate portfolio company governance for consistency with ESG fund thesis
- Sustainability linked or green financing

Developments and Trends in ESG / Impact Investing

Impact-Oriented Investments

	TRADITIONAL INVESTING	RESPONSIBLE INVESTING	SUSTAINABLE INVESTING	IMPACT INVESTING	PHILANTHROPY
EXPECTED RETURNS	Market returns				
				Limited to no financial returns	
GOALS		Manage financially material ESG risks (i.e. risks to portfolio value)			
		Manage ESG risks of investments to the planet and people			
			Allocate capital and pursue investments in line with ESG themes		
				Focus on investing in measureable high-impact solutions and services	
ESG INTEGRATION	Limited to no ESG integration	ESG risk mitigation	ESG considerations integral to investment approval process	Investing to address ESG challenges while generating financial returns	Providing capital to address ESG challenges, with no expectations of direct financial returns

SFDR Basics

- The EU Sustainable Finance Disclosure Regulation ("**SFDR**") was introduced by the European Commission as part of the European Green Deal, and became effective in March 2021
- SFDR requires categorisation of in-scope funds on the basis of various criteria as one of the following:

ARTICLE 6 FUNDS ("MAINSTREAM FUNDS")

This is the minimum categorisation under SFDR and requires all in-scope funds to provide certain ESG-related pre-contractual PPM disclosures and related website disclosures

ARTICLE 8 FUNDS ("ESG-FOCUSED FUNDS")

These funds promote environmental or social characteristics and invest only in companies which follow good governance practices. They also can commit to making some "sustainable investments" as defined in the SFDR

ARTICLE 9 FUNDS ("IMPACT FUNDS")

These funds have as their objective a positive impact on the environment and society and invest exclusively in "sustainable investments" as defined in the SFDR. All investee companies must follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance

- Under SFDR, fund managers are required to implement ESG policies and make certain detailed disclosures as to how ESG factors, including environmental and social characteristics, are being integrated into investment decisions, due diligence and internal processes. Disclosures should only relate to investment selection criteria that are binding when selecting investments

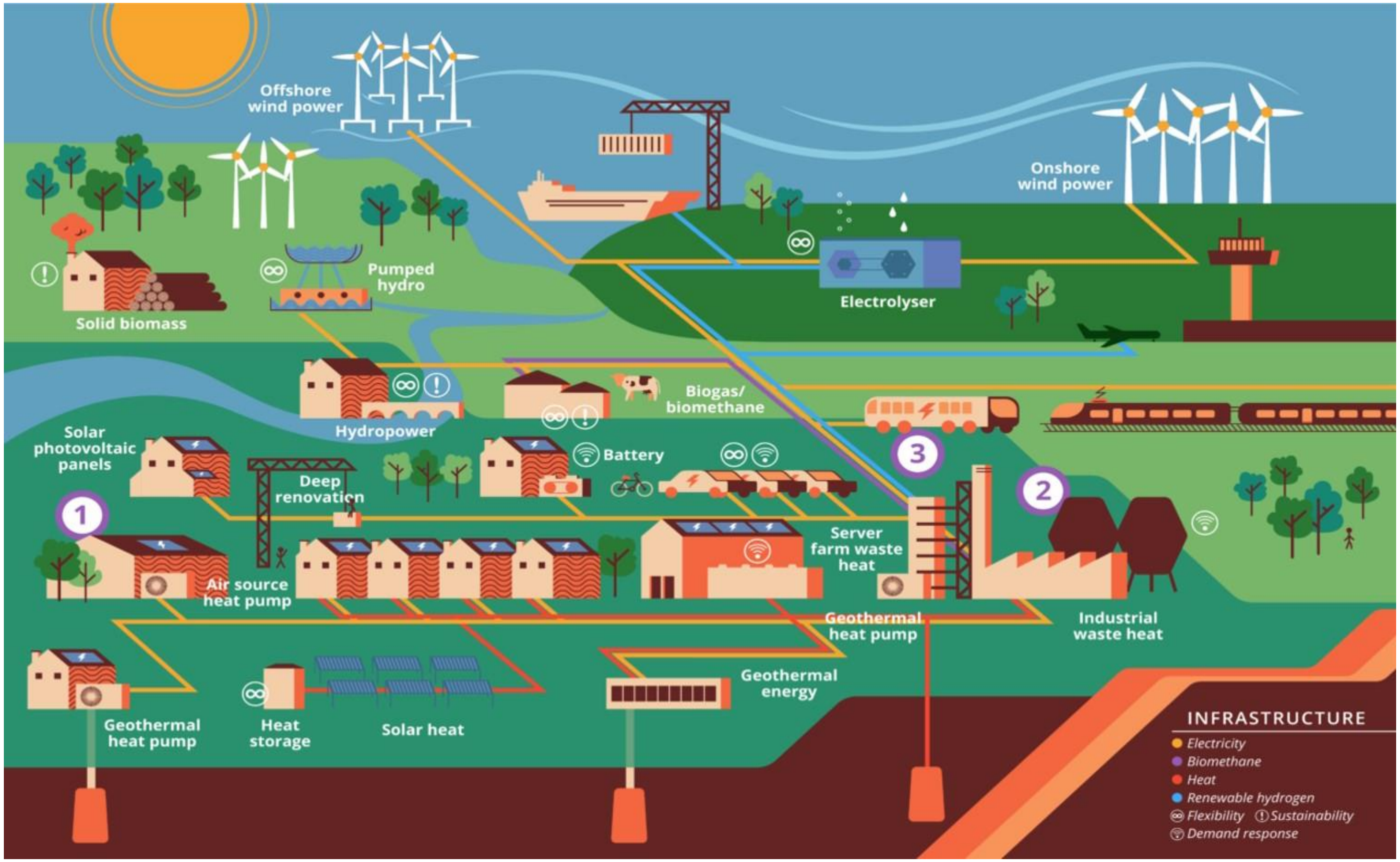
SFDR Market Trends and Developments

- **ESMA fund names and marketing guidelines:** EU fund managers and managers of funds marketed into the EU since November 2024 need to comply with minimum sustainability requirements when using sustainability related terms
  - National regulators (NCAs) must follow the so called "comply-or-explain" procedure, meaning that they had to notify ESMA until 21 October 2024 whether they (i) comply, (ii) do not comply, but intend to comply, or (iii) do not comply and do not intend to comply with the ESMA Guidelines
- **Market feedback and SFDR 2.0:** May 2024, the European Commission published a Summary Report on responses to a consultation on the SFDR, which sets out feedback on the industry's views on SFDR, including the need for specific guidance on the definition of "sustainable investment" and establishing more standardised sustainability disclosures for financial products in the EU
  - June 2024, three European Supervisory Authorities (ESAs) published a joint opinion on the assessment of SFDR acknowledging that the current disclosures to investors are complex by nature and difficult to understand, in particular for retail investors (as shown by recent consumer testing exercises). The ESAs recommend new categories of:
    1) **Sustainable product category**
    2) **Transition product category**
  - Expectation for change to SFDR in 2025 but timing is unclear

The UK Sustainable Disclosure Requirements

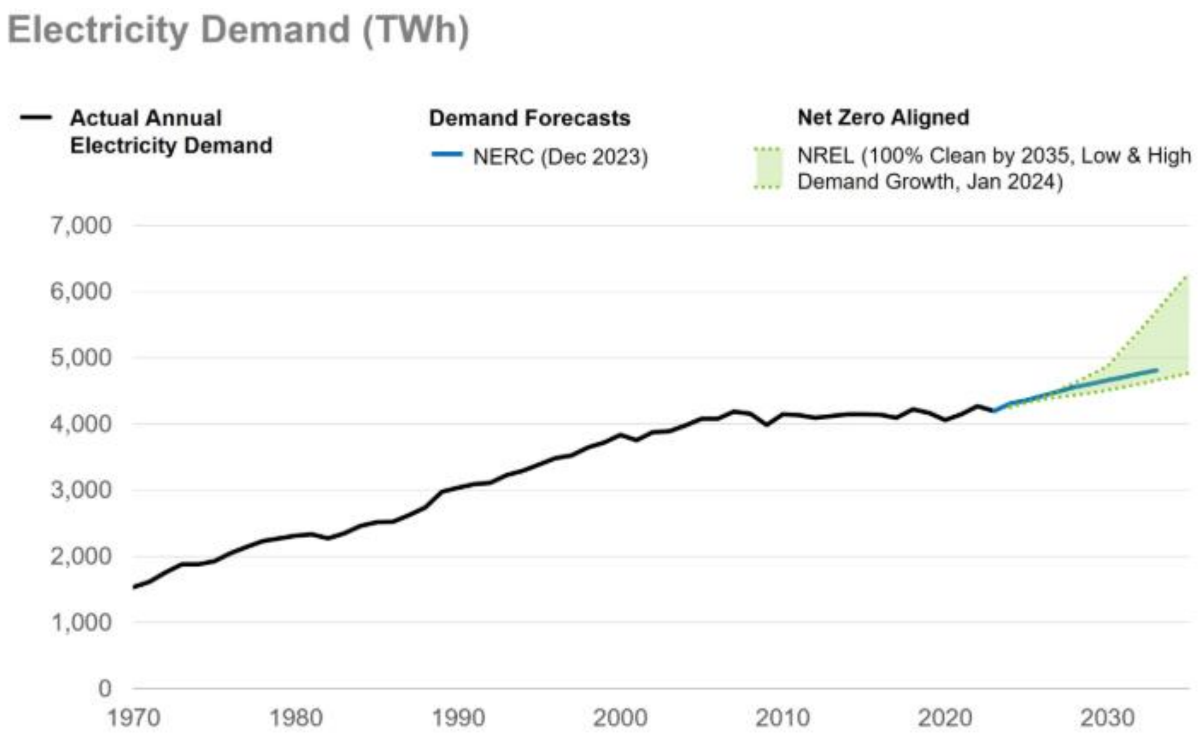
- The FCA introduced the sustainability disclosure requirements (UK SDR) regime and a set of consumer-friendly sustainability labels, with the aim to clamp down on greenwashing and protect consumers
- The core elements of UK SDR apply to:
  1) Fund managers based in the UK managing UK funds
  2) Portfolio managers based in the UK
- At least initially, overseas funds will be out of scope and the rules do not currently apply to UK firms undertaking "portfolio management" and to UK managed accounts. The FCA will consult on extending the scope of the regime at a later date
- Under UK SDR, three types of product label exist, each with clear qualifying criteria. These are not in hierarchy, but rather are different labels to describe different profiles of assets. Fund managers can opt to categorise in-scope funds offered to institutional investors (assuming the relevant criteria apply) in accordance with these labels
  1) **"Sustainable Focus":** Funds with an objective to maintain a high standard of sustainability in the profile of assets by investing to (i) meet a credible standard of environmental and/or social sustainability; or (ii) align with a specified environmental and/or social sustainability theme. Funds will typically be active and highly selective, applying extensive screens to allocate assets that are reasonably regarded as primarily environmentally and/or socially sustainable
  2) **"Sustainable Improvers":** Funds with an objective to deliver measurable improvements in the sustainability profile of assets over time. These funds are invested in assets that, while not currently environmentally or socially sustainable, are selected for their potential to become more environmentally and/or socially sustainable over time, including in response to the stewardship influence of the firm
  3) **"Sustainable Impact":** Funds with an explicit objective to achieve a positive, measurable contribution to sustainable outcomes. These are invested in assets that provide solutions to environmental or social problems, often in under-served markets or to address observed market failures
- Pre-contractual disclosure obligations apply (since June 2024) and ongoing sustainability-related performance information should be provided (from June 2025) in connection with a fund which opts to use a sustainable investment label
- *UK SDR also introduced an anti-greenwashing rule and naming and marketing rules*

Hot Topics in Energy Transactions



Source: Climate Action Network Europe, CAN_Energy_transition_infographic_full_v6.pdf (caneurope.org)

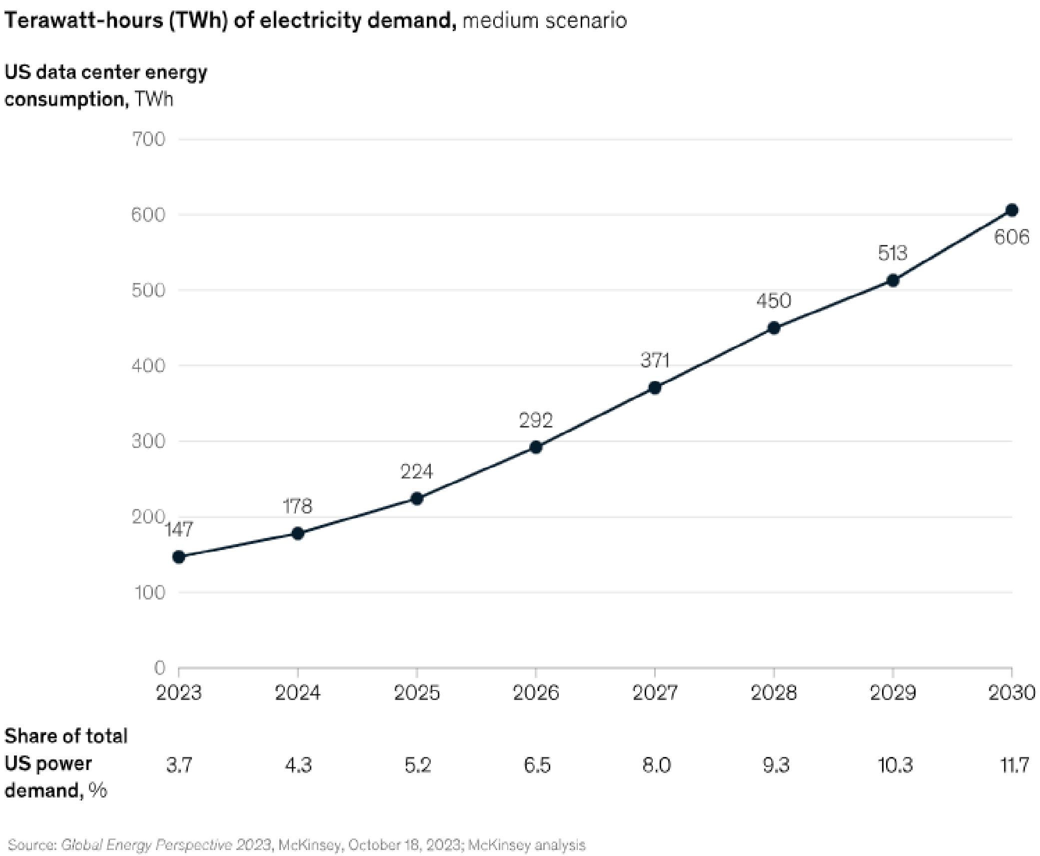
Electricity Demand is Rapidly Growing



Source: U.S. Department of Energy "*Clean Energy Resources to Meet Data Center Electricity Demand*"

- Electricity demand is expected to grow in the U.S. 15 - 20% in the next decade and double by 2050, driven by manufacturing and industrial growth, data center expansion (due to generative AI, crypto, digitalization of data, etc.) and electrification in the transport, building and industrial sectors

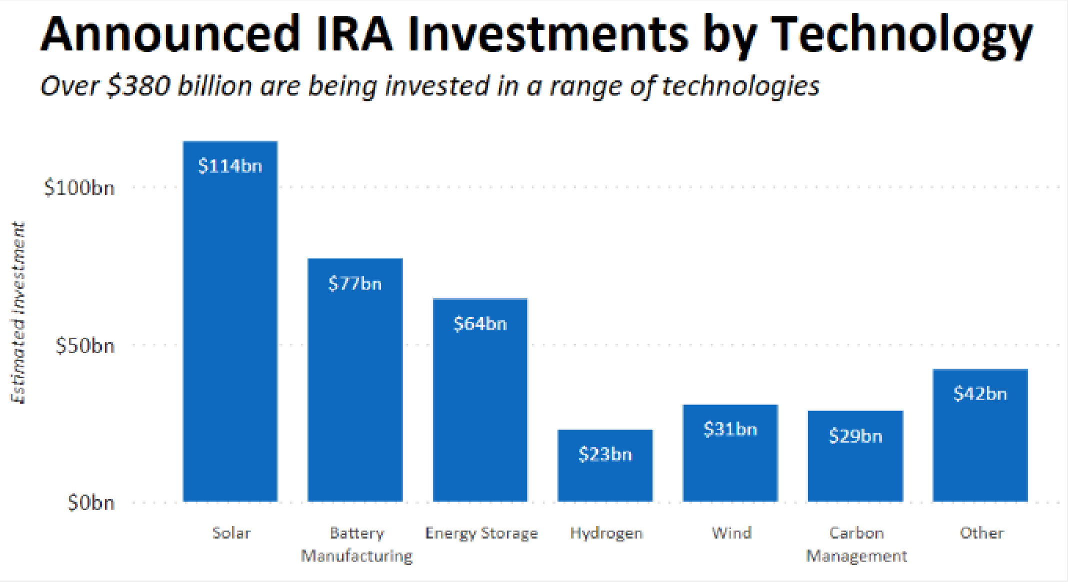
Data Centers Are Power Hungry



- By some estimates, the power needs of data centres alone may grow up to 3 times higher than the current needs by the end of the decade, going from 3-4% of the total US power demand today to 11-12% in 2030
- Many companies in the US, including tech companies like Amazon, Google, Meta and Microsoft, have expressed goals to reduce their carbon emissions in their operations in not so distant future
- Together with clean technology manufacturing and carbon industries, they want to meet a significant portion of their load growth with power generated by clean energy technologies

Energy Investment Supercharged by the IRA

- The Inflation Reduction Act ("IRA"), CHIPS and Science Act, and Infrastructure Investment and Jobs Act represent the largest investment U.S. has made to date in supporting energy development and domestic manufacturing
- The IRA has extended existing, and introduced certain new, federal tax credits for the energy transition technologies and manufacturing (e.g. renewables, battery storage, hydrogen, EV infrastructure)
- It has also allowed for the sale of such credits to third parties for cash and in some cases, to elect direct pay in lieu of a tax credit, thereby increasing available financing sources for clean energy
- Since the IRA has passed in 2022, ~ $400 billion investments have been announced in clean energy and infrastructure:



Source: Rhodium Group/Clean Investment Monitor (CIM)

Recent Investment Trends in the Energy Sector

Traditional Energy

- Continued interest in upstream and midstream oil and gas assets (as well as related products and services) from strategics and private equity sectors

Repurposing or Retrofitting Infrastructure

- Solar on former landfills or mine sites
- Carbon Solar Capture & Storage

Nuclear

- Increasing interest, supported by some major corporate power offtakers, but private equity is steering clear

Renewables & Energy Storage

- Solar & Onshore Wind – proven technology, continued interest
- Battery Storage – investment on the steep rise (both stand alone and coupled with renewables) **HOT!**
- Distributed Generation / Microgrids

Alternative / Transitional Energy

- Hydrogen
- Direct Air Capture
- Renewable natural gas/biofuels
- Next generation geothermal

Broader Transitional Ecosystem

- Products, services, manufacturing **HOT!**

- ***Need to balance rising energy demand, grid resilience and national security, against ESG targets and goals***
- ***Energy companies can focus investment on Energy Addition vs Energy Transition***
- ***Private equity has the investment approach / dilemma – transition "sleeve" or broader "infrastructure"***

Hot Topics and Important Considerations in Energy M&A

- Source of capital: fund requirements will drive permitted energy sector investments, including any ESG covenants and reporting obligations to be included in post-acquisition operating agreements.
- Change of administration in the US: impact on government incentives (underwriting full or partial repeal of the IRA) and private sector's commitment to emissions reduction goals and targets.
- Bankability of transition projects, including analysis of the following risks:
  - Tax credit eligibility and tax equity and/or tax credit transfer structures
  - State and local incentives and market for environmental attributes
  - Revenue agreements (including inflation adjustments and repricing options)
  - Supply chain vulnerabilities
  - Increased or additional tariffs
  - New or "newer" technology
- Repurposing infrastructure & stranded asset risk
- Decommissioning and any remediation obligations
- Cybersecurity
- Early local stakeholder engagement in the case of projects

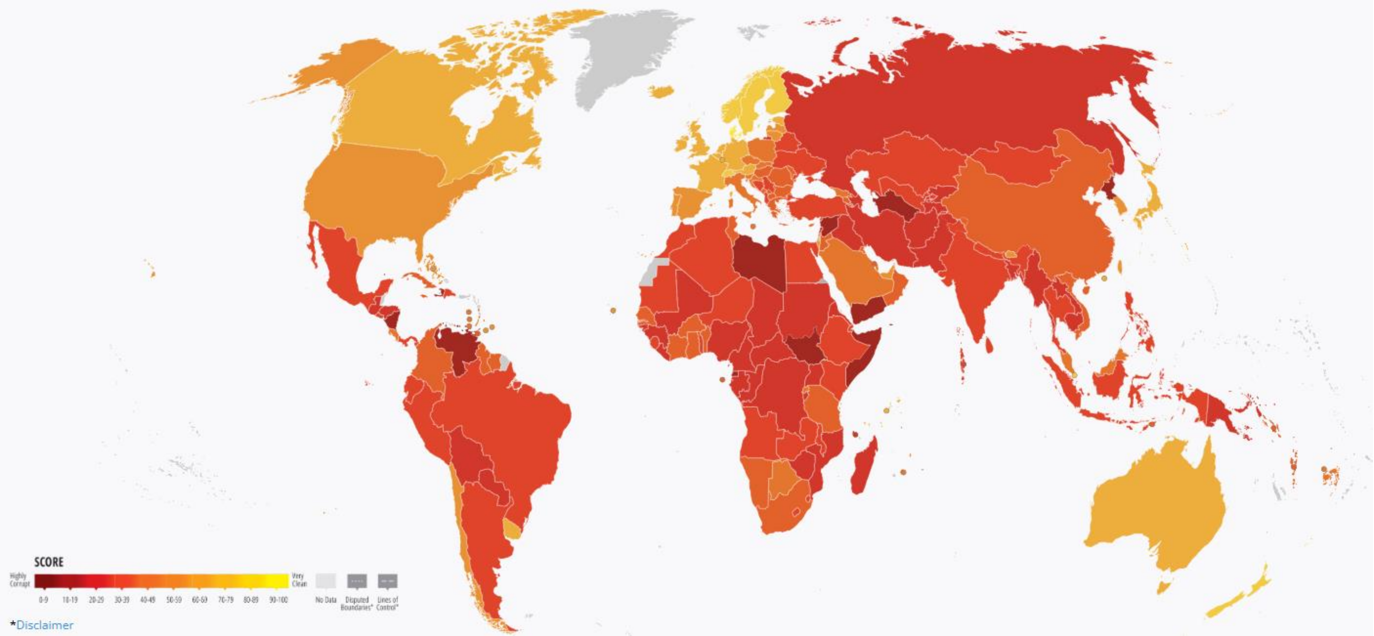
ESG Due Diligence: Scoping

- Deal counsel to clarify at earliest stage possible the scope of ESG-related due diligence, responsibilities (of counsel and others such as consultants), and expected deliverables
  - Many public companies and large PE firms have dedicated sustainability teams; helpful to have a point person on deal team who is well-versed in ESG topics who can liaise with their counterpart at the client
- Coordinate with subject matter experts on the range of ESG-related topics of relevance to the deal

Climate change & transition, & emissions	Energy consumption & efficiency	Water & other natural resources usage; biodiversity	Recycling	Waste	Air & water pollution	
Labor & employment	Workforce diversity, equity & inclusion	Workplace & product safety	Human rights including slavery & child labor	Charitable contributions & community programs	Local and indigenous communities	Data privacy, cybersecurity & AI
Executive compensation	Bribery and corruption	Political contributions & lobbying	Board independence, diversity, structure & effectiveness	Tax strategy / Transparency	Shareholder rights	

ESG Due Diligence – Considerations Common to Anti-Corruption, Sanctions, and International Trade Diligence

- Geographical Risk Profile
  - In which countries does the target or other counterparty have subsidiaries, offices, and employees?
  - From which countries does the entity derive revenue, directly or through channel partners?
  - In which countries does the entity have suppliers, agents, or other third parties acting on its behalf or in connection with its business?



ESG Due Diligence – Considerations Common to Anti-Corruption, Sanctions, and International Trade Diligence (2)

- Industry Risk
  - Does the target or other counterparty operate in a highly-regulated sector?
  - Does its business involve vices from which certain investors may have excuse rights?
  - Does the business implicate national security or foreign policy issues, or otherwise present elevated reputational risks?
- Government Dealings (Particularly in High-Risk Countries)
  - Does the company derive revenue, directly or indirectly, from government or state-owned entities?
  - Does the company require licenses or permits, or is it otherwise subject to regulatory oversight by local authorities?
  - Does the company engage in lobbying activities, make political contributions, or provide gifts, travel, or other hospitality to government officials or commercial counterparties?

ESG Due Diligence – Human Rights in the Supply Chain

- Due diligence in the transactional context is increasingly focused on identifying human rights issues that could raise significant reputational risk for the acquirer if missed or inappropriately priced
  - Focus on the target as well as Tier 1 suppliers and further into the supply chain as appropriate (e.g., depending on the region, product/service, and personnel involved)
- Diligence relating to human rights may include:
  - Screening for litigation and enforcement actions, and negative media
  - Risk-based assessment (e.g., depending on region, product/service, personnel involved)
  - Review of procurement processes including updated questionnaires
  - Review of supplier code of conduct, policies, procedures and training
  - Review of contract terms requiring compliance with applicable laws, ability to require remediation or terminate, and reporting, monitoring and audit rights
- Utilize regulatory tools and other guidance on mitigating supply chain risks

ESG Due Diligence – Human Rights in the Supply Chain (2)

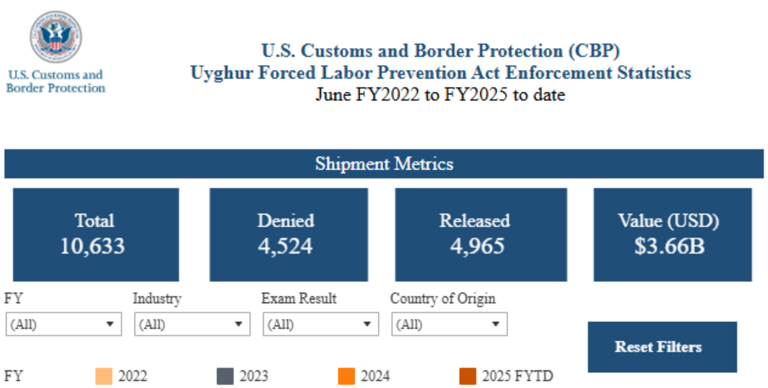
- U.S. law has addressed (albeit very ineffectively) issues relating to human rights in the supply chain for over a century
  - McKinley Tariff Act (1890) banned the importation of goods manufactured with convict labor
  - Section 307 of the Tariff Act of 1930 prohibited importing any product of forced labor, including forced or indentured child labor
    - However, Section 307 focused on protecting domestic producers from competition with products of forced labor
      - Exception if no comparable product was made in the U.S. or domestic production did not meet consumptive demand
  - Trade Facilitation and Trade Enforcement Act (2015) eliminated the consumptive demand exception
  - Still, prior to June 2022, goods were denied entry into the U.S. on the basis of forced labor concerns <100 times

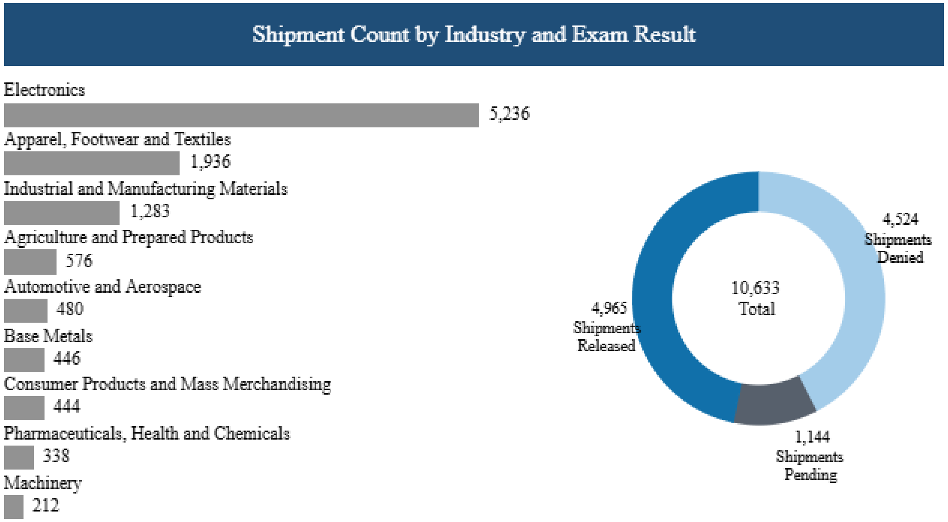
ESG Due Diligence – Human Rights in the Supply Chain; UFLPA

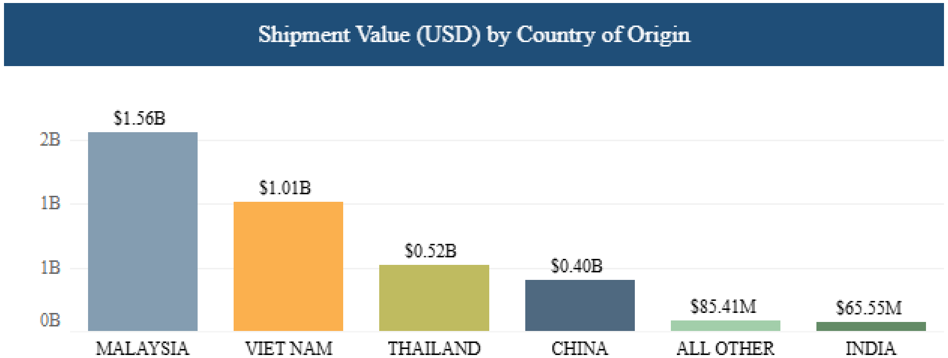
- The Uyghur Forced Labor Prevention Act (UFLPA), which took effect in June 2022, has dramatically changed the enforcement landscape
  - Established a rebuttable presumption of forced labor with respect to any goods, wares, articles, or merchandise mined, produced, or manufactured, in whole or in part:
    - In the Xinjiang Uyghur Autonomous region of the PRC (Xinjiang); or
    - By an entity on the UFLPA Entity List (20→107, as of 11/25/24)
  - As such, unless the presumption is overcome, such items are denied entry
  - Since June 2022, approximately 10,600 shipments have been stopped under the UFLPA, of which approximately 4,500 have been denied and 5,000 released, with approximately 1,100 pending

ESG Due Diligence – Human Rights in the Supply Chain; UFLPA (2)

- Great data available on CBP's UFLPA website
  - Statistics are filterable by country and industry and can be used effectively in risk assessment and diligence processes







ESG Considerations in Integration

- Leverage ESG-related diligence findings when planning for integration
- Common ESG-related focus items include:
  - Compliance and ethics program policies, procedures, training, communications and resources
  - Supplier management
  - Human capital matters such as employee classifications (employee vs independent contractor, exempt vs non-exempt) and DEI programs
  - Data privacy and cybersecurity
  - Internal controls, disclosure controls and procedures, and assurance-related processes
  - ESG-related data methodology, assumptions and estimates
  - Emissions and resource usage
  - ESG-related targets and goals, and statements giving rise to “greenwashing” risk
  - ESG-related oversight
  - Enterprise risk management
  - Subsidiary governance

ESG Considerations in Integration: Disclosure

- Diligence phase to surface potential post-integration disclosure issues, including compliance preparedness with forthcoming ESG-related disclosure requirements such as:
  - SEC climate-related disclosure rules (under challenge; status under new administration TBD)
  - California laws requiring greenhouse gas emissions and climate-related financial risk disclosures (SB 219, amending SB 253 and SB 261) in 2026, and disclosures relating to carbon offsets (among other things) for companies that make carbon neutral or similar claims (AB 1305) (already in effect)
  - EU Corporate Sustainability Reporting Directive (CSRD), requiring extensive sustainability-related disclosures; applies to:
    - “Large Undertaking” – disclosures in 2026 (2025 data): Entity incorporated in the EU whose securities are not admitted to trading on an EU regulated market and that meets at least two of the three following criteria on balance sheet date:
      - Balance sheet total of at least EUR 25 million
      - Net turnover of at least EUR 50 million
      - Average number of employees during the financial year of at least 250
    - “Non-EU Undertaking with Significant Presence in the EU” / “Third-Country Undertaking” – disclosures in 2029 (2028 data): an undertaking not incorporated in the EU and without securities listed on an EU regulated market that has generated a net turnover within the EU of EUR 150 million for two consecutive financial years, and also meets at least one of the following criteria:
      - Has a subsidiary in the EU that meets “large undertaking” thresholds (see above); or
      - Has a branch in the EU that generated EUR 40 million net turnover in the preceding financial year

ESG Considerations in Integration: Disclosure

- International Sustainability Standards Board standards (folding in Taskforce on Climate-Related Financial Disclosures requirements), which will form basis of sustainability reporting requirements in the UK and many other countries
- EU Corporate Sustainability Due Diligence Directive, which will apply to, among others, EU companies and parent companies with over 1,000 employees and annual worldwide turnover of more than €450 million, and non-EU companies and parent companies with annual turnover in the EU of more than €450 million; will require companies to:
  - Integrate risk-based due diligence processes into policies and risk management systems, to prevent, end or mitigate adverse impacts from their activities on the environment and human rights
  - Adopt and put into effect a transition plan for climate change mitigation which aims to ensure through best efforts that their business model and strategy are compatible with limiting global warming to 1.5°C in line with the Paris Agreement and the EU's objective of achieving climate neutrality by 2050

- Identify impact of acquisition on climate-related targets including emissions reductions and measurement on an "absolute" vs "intensity" basis

ESG Considerations in Integration: Anti-ESG

- Companies to consider potential impact of anti-ESG lawmaking in various states, and anti-ESG activism
  - May impact the company/PE firm itself and subsidiaries/portfolio companies
- Boycott laws limiting ability of governments to contract with companies on the basis of ESG factors have been passed in Alabama, Arkansas, Florida, Idaho, Kansas, Kentucky, Louisiana, Montana, North Carolina, Oklahoma, Texas and Utah
  - For example, government entities in Oklahoma and Texas may not enter into a contract for goods and services with a value of $100,000 or more with a company with at least 10 full-time employees unless the company provides written verification that it does not, and will not during the term of the contract, boycott energy companies
  - For example, Tennessee HB 2100 prohibits certain financial institutions and insurers from denying or cancelling services to a person or otherwise discriminating against a person based upon certain ESG-related factors (including political opinions, affiliations and religious beliefs, and use of analysis considering a "social credit score" based on factors including engagement in firearms, fossil fuel, timber, mining or agricultural industries)
- Activists targeting DEI activities including diverse supplier programs, diverse candidate hiring/promotion targets and scholarship and similar programs with gender- or race/ethnicity-based eligibility

Key Takeaways

- Coordinate early on scope of ESG-related issues impacting the deal to ensure team can efficiently:
  - Identify financing sources and related requirements (e.g., SFDR, UK SDRs)
  - Understand how ESG-related topics will feed into deal approval process (e.g., investment committee, board committee) and deal documentation (e.g., SPAs, LLC agreements, side letters), and build in time for drafting, client communications and negotiation
  - Utilize subject matter experts (including consultants as needed) to tailor ESG-related due diligence to the acquiror’s processes and the target’s particular circumstances
- Factor ESG-related issues into post-deal integration including around compliance and ethics policies and procedures, disclosure requirements and targets, and develop roadmap towards compliance
  - Be aware of potential issues involving integration of enterprise risk management systems, internal controls, data gathering and methodology, and personnel expertise
  - Leverage existing policies, processes and controls around materiality assessment, data collection, monitoring, assurance and oversight; liaise with consultants as needed
  - Map what data, diligence and processes can be used for what purposes
  - Uplift diligence and third party management processes as needed
- Stay abreast of rapidly evolving regulatory environment and stakeholder expectations
  - Determine what will apply to the company directly vs as a supplier
- Be cognizant of parent-subsidiary liability risks, and ensure appropriate subsidiary governance