Trends in Social and Environmental Responsibility

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The global economy faces near-term uncertainties. Fraying trade agreements, rising debt and political instability in emerging markets, and tariffs and trade barriers pose risks to investment and increasingly globalized supply chains. Longer-term trends, however, may play a greater role in future economic activity, including in the context of project finance, mergers and acquisitions, supply chain and reputational management, regulatory compliance, and public disclosures. Enhanced focus on governance of environmental, health and safety, and social (EHSS) issues in particular will require increasing consideration and internalization into corporate strategic planning.

Notwithstanding shifting social and political winds, certain resources critical for the twenty-first century economy exist in limited geographic locations. This is true for the extractive industries, energy and natural resource sectors, and manufacturers or distributors reliant on global supply chains. Subject to economic cycles, this dynamic will remain and perhaps intensify irrespective of efforts to decarbonize the global economy given shifts toward green and renewable energy resources and enduring non-energy resource needs.

This article explores social and environmental responsibility trends affecting economic decision-making, including emerging risks and opportunities. We first examine social and environmental sustainability drivers impacting financial institutions and their lending or investment decisions. Next, we survey other factors affecting corporate decision-making. We conclude by considering strategies to manage evolving and expanding EHSS risk.

Obtaining project finance is a prerequisite for many large-scale projects; institutional debt or equity also often is deployed in cross-border mergers, acquisitions, and other investment strategies. Capital-intensive projects in the extractive industries and energy and natural resources sectors are critical to enhancing sustainability of the increasingly global economy—however, these commercial activities also may pose the risk of adverse impacts to the environment or local communities if not properly managed. Thus, as economic activity and supply chains have extended their reach to developing regions around the globe, financial institutions have been criticized for financing assets that may have negative environmental or social consequences.

In response, the World Bank Group's International Finance Corporation (IFC) and several major international financial institutions developed the Equator Principles (EPs). The EPs apply globally, including 92 financial institutions in 37 countries, covering the majority of international project finance debt within developed and emerging markets. The EPs provide a framework to assess and manage EHSS risk, a due diligence standard, and monitoring protocol supporting responsible risk assessment and decision-making. The EPs oblige member financial institutions to make informed investment decisions and withhold financing on projects or assets not conforming with good international industry practice (GIIP). The EPs incorporate IFC's Environmental and Social Performance Standards (IFCPS) and World Bank Group Environmental, Health, and Safety Guidelines.

The EPs apply directly to member financial institutions and are imposed contractually on companies agreeing to accept their financing terms. In "non-designated countries" (i.e., developing or emerging economies) the EPs require environmental and social impact assessments (ESIAs) identifying impacts and mitigation measures conforming to both host-country law and GIIP, which must be imposed on the project or facility's development, operation, and decommissioning. Conceptually, this is similar to the environmental impact statement (EIS) process under the National Environmental Policy Act (NEPA). In the United States, however, EIS procedures are governed by the Administrative Procedure Act and constitutional due process standards in addition to specific statutory and regulatory procedures. Under the EPs, by contrast, the ESIA must survey and adopt public consultation, dispute resolution, and procedural standards conforming to GIIP in addition to substantive EHSS mitigation standards.

Why would financial institutions or their corporate clients agree to adopt the EPs? Reputation is one significant reason. Social media and other electronic information sharing platforms have dramatically increased visibility and scrutiny of commercial activity around the globe. Nowhere has the light shined brighter than on EHSS impacts. Images of oil spills in South America, child labor in Africa, or ecosystems and communities impacted by Southeast Asia natural resource projects can go viral and circle the globe in hours. For financial institutions and their corporate clients, the implications can be significant: such a scenario can damage stock valuation and career prospects of executives and board members; jeopardize supply agreements and consumer loyalty; and amplify risk of government investigations, enforcement, and litigation.

The EPs focus on developing economies, requiring adoption of GIIP to mitigate EHSS risks by surveying and borrowing relevant standards of developed economies. Hence, a mine in Africa may need to evaluate similar projects in Arizona and Australia in addition to local regulations. And, if adopted in a project's lease, concession, or permit, these "imported" GIIP standards may become legally enforceable through both governmental and contractual obligations.

Originally enacted in 2003, the EPs were updated in 2013 but have received recent criticism from nongovernmental organizations (NGOs) and other stakeholders. For example, the requirement to adopt GIIP standards exceeding host-country law is inapplicable in "designated countries," presumably under the assumption that developed countries' substantive and procedural requirements suffice without importing best practices from other jurisdictions. Critics argue this bifurcation should be eliminated and the EPs should require GIIP conformance in *all* countries.

The Dakota Access Pipeline project (DAPL) has been cited as an example justifying expansion of the GIIP requirement to designated countries. The project proposed multistate crude oil transport from the Bakken fields in North Dakota and was funded by financial institutions adopting the EPs. DAPL became controversial, in part, because of perceived risks to groundwater, surface waters, and sacred Native American burial grounds. As DAPL came under scrutiny, so did financial institutions funding it, implicating their reputational interests. While the IFCPS require robust procedures governing consultation of indigenous peoples, the GIIP requirement was not applied given DAPL's location in the United States. At least one financial institution funding DAPL later stated its "current approach to consulting indigenous peoples in the U.S. does not align with international standards, and the policies that we have used to evaluate those consultations during due diligence are not sufficient." Citi Blog, *Our Review of the Dakota Access Pipeline and What's Ahead* (Apr. 27, 2017), *available at* https://blog.citigroup.com/dakota-access-pipeline-review-whats-ahead.

Climate impacts represent another issue that could significantly impact EPs' implementation in designated countries. The Trump administration has expressed intent to withdraw from the Paris Agreement under the United Nations Framework Convention on Climate Change. Further, trending federal policy seeks to limit U.S. regulation of greenhouse gases (GHGs); revision of oil and gas sector fugitive methane emission regulations is a recent example. Notwithstanding these attempts to constrain U.S. climate regulation, if the EPs were amended to require GIIP in designated countries, GHG standards of other nations may be imposed on U.S. projects or commercial operations receiving funding from financial institutions adopting the EPs.

Imposition of the GIIP standard in designated countries could have other significant implications for U.S. parties. Project developers and industrial facility operators requiring financing for plant upgrades or expansions would face the risk of becoming subject to EHSS standards exceeding U.S. law if they accept funding from a financial institution adopting the EPs, or seeking alternate funding potentially at higher cost. Where imported EHSS standards exceeding current U.S. law are imposed on U.S. projects or industrial operations, such facilities also may run the risk of those GIIP standards being incorporated in government-issued permits, of raising the baseline for existing regulatory standards tied to best demonstrated technology or practice (e.g., Clean Air Act "best available control technology" standards), or of precipitating legislative or regulatory amendments adopting more stringent U.S. standards conforming with GIIP.

The EPs currently are under review, with revisions expected in 2019 (EPs revision updates can be accessed at https://equator-principles.com/2018/10/)—but similar trends toward convergence of global EHSS standards are emerging outside the EPs framework. For example, the recently adopted United Nations 2030 Sustainable Development Goals seek to address systemic global economic, social, and environmental challenges through broad goals providing a common international framework; over 70 percent of the world's largest corporations reportedly have committed to these goals. Similarly, some industries and NGOs have developed voluntary frameworks like the EPs but more calibrated to a particular commercial endeavor. Examples include sustainability guidelines of the International Council on Mining and Metals, International Petroleum Industry Environmental Conservation Association, and the Roundtable on Sustainable Palm Oil.

Given these trends toward uniformity of international corporate social and environmental responsibility standards, what best practices should global financial institutions, business organizations, and their counsel adopt to help achieve sustainability targets while effectively managing legal, reputational, and commercial risk? Depending upon the assets or project, a well-designed due diligence or internal audit plan can be a critical component in managing risk both before and after financing, acquisition, or operation. Too often, key risks are overlooked or not adequately managed due to rushed or improperly focused due diligence.

But issues critical in one jurisdiction may be moot in others; the underlying political, economic, and social environment can have as much impact as legal standards on risk factors affecting the audit or due diligence. Assets located in developed economies typically are governed by the host country's comprehensive environmental regulatory and procedural standards and relatively stable political and legal regimes. By contrast, local standards in less developed jurisdictions may be less comprehensive, less stringent, and subject to political or legal instability; nonetheless, international EHSS standards such as the EPs and IFCPS may apply—or may become legally binding in the future—whether through contractual obligation, lease, concession, or permit, and thus should not be neglected.

Particularly for assets with inherently higher EHSS impact potential, attempting to manage risk through purchase and sale agreements, development, off-take, waste disposal, or other operational agreements alone may not suffice. Post-acquisition integration or stakeholder engagement plans, insurance, and other third-party risk management strategies, or carving out high-risk assets can be among the more effective means of managing EHSS risk. But these each require careful strategic planning by a team of professionals with the skills and experience to navigate a transaction's complexities, particularly in a cross-border or multijurisdictional context.

It's not enough to focus only on external standards. Many sophisticated international companies have adopted corporate social responsibility or sustainability commitments exceeding legal requirements; counsel should understand how such internal EHSS frameworks align with external legal and contractual standards. As the environmental profession becomes more specialized, it's increasingly important to ensure coverage of key risks beyond the most obvious issues such as soil contamination and government permits. This is particularly true for cross-border transactions or multinational business organizations, considering the increasing trend toward convergence of more uniform international EHSS standards.

In both domestic and cross-border contexts, worker exposure, social responsibility, corruption, and political considerations with a nexus to environmental impacts also may pose significant legal, commercial, or reputational risk. Again, the audit or due diligence plan should encompass such issues, including considering country risk and voluntary or contractually obligated EHSS standards in addition to host-country regulatory standards. Although shifts in global politics and economic cycles may be challenging to predict, enhanced focus on corporate social and environmental responsibility is a trend requiring correspondingly enhanced focus on EHSS risk management by financial institutions and corporate decision-makers alike. Further recommendations for navigating environmental due diligence may be accessed at www.huntonnickelreportblog.com/2018/10/risk-management-roadmap-navigating-environmental-due-diligence-in-multi-jurisdictional-transactions.

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