TRAVERS SMITH

Responsible Investment and Environmental, Social & Governance

Regulatory developments, mounting shareholder pressure and growing media, NGO and consumer scrutiny mean that ESG performance and concerns are increasingly informing business and investment decisions. As a result, investors, private equity houses and portfolio companies are focussing on these non-financial issues like never before. However, it is important to take the time to fully consider and understand which of the myriad of potential concerns are actually relevant. Only then can robust yet pragmatic approaches be developed. Travers Smith has considerable experience in this area and is currently advising both investors and companies on a range of ESG related challenges and opportunities.

Doug Bryden, Head of Environment & Safety Law

THE RISE OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG)

Consumers, the media and NGOs are increasingly scrutinising business activities and ethics. The recent furore over tax planning in the UK by large multi-nationals, bribery and corruption scandals and activism by the likes of Greenpeace on manufacturing practices in China and emerging economies, provide stark evidence of how reputational and compliance risk factors can impact on business value, performance and investment risk.

Unsurprisingly, therefore, ESG performance, management and reporting issues (whether under the banners of responsible investment, ESG, sustainability, corporate social responsibility, etc.) are appearing higher on the agenda of businesses.

Although prompted in part by developments in the UK, EU and international legislation (including the UK's Bribery Act 2010 and new carbon reporting rules), these changes are largely being driven by institutional investors, shareholders and customers.

In addition, recent case law also points to a harsher, less forgiving approach to enforcement, as well as increasingly substantial fines and damages for regulatory non-compliance and failings in relation to ESG type issues. Notably, the English courts have recently shown a willingness to circumvent the corporate veil and find parent companies liable for the safety breaches of their subsidiaries.

Our recent work providing legal support to members of the UK delegation at the UN's Rio+20 conference demonstrated, if nothing else, that companies will need to be more transparent about how they perform in relation to a range of environmental, climate change, social and governance indicators. Failure to do so may not only damage reputations and give rise to legal liabilities, but also limit funding and investment opportunities. It is also becoming increasingly clear that simply making general and often aspirational policy statements will no longer suffice.

The challenge, however, is developing a strategic and targeted approach to ESG management that is both realistic and appropriate considering the scale of the organisation, its activities, locations and ESG ambitions. Once a strategy has been agreed, robust policies and procedures should be developed and implemented (in particular, in relation to the reporting of performance).

Care will also need to be taken when diligencing investment opportunities as well as ensuring both the funding and equity documents provide sufficient powers and flexibility to allow for the effective management of (and ability to report on) ESG issues.

ESG is not just about risk management and compliance – there is growing evidence linking good ESG management with tangible improvements in business performance.

“Good ESG issue management might lead to a small uplift in EBITDA multiples on exit and will improve saleability of the asset.”

European-headquartered PE house

“We decided to advocate that a global treaty be developed by the member states at the UN Conference on Sustainable Development. We were advised by Travers Smith on the legal questions around the treaty and I found their advice, professionalism and support exemplary.”

Chief Responsible Investment Officer, Aviva Investors

However, to maximise its value, ESG management must be focussed. Organisations should take the time to fully consider and understand which ESG issues are material to them before developing an approach. It is all too easy to invest significant time and money developing a detailed ESG strategy only to find it is unfocussed, or worse, 'gold plated' and only achievable through the investment of considerable time and money.

Taking the right advice at the outset will allow you to improve your ESG performance, without wasting time and money on over ambitious or disproportionate programmes.

FIDUCIARY DUTIES AND ESG: A CHANGING LANDSCAPE

Fiduciary duties are duties imposed upon a person who exercises some discretionary power in the interests of another person in circumstances that give rise to a relationship of trust and confidence.

Historically, those seeking a greater regard for ESG issues in investment decision-making often encountered resistance on the basis of a belief that fiduciary participants in the investment chain (such as pension fund trustees) are legally prevented from taking account of such issues and are instead required to maximise short-term financial returns on an investment-by-investment basis.

However, the landscape is changing and it is increasingly being accepted that this is not an accurate reflection of the true legal position.

Indeed, many now agree that fiduciaries can and should look beyond short-term financial returns when making their investment decisions and include consideration of ESG issues where appropriate. As a result, pressure on fiduciaries to consider ESG issues is increasing, with a knock-on impact on investees and other participants in the investment chain. This pressure is further enhanced by the growing range of mandatory ESG reporting obligations applicable to companies and institutional investors.

UN PRINCIPLES FOR RESPONSIBLE INVESTMENT (PRI)

One way in which investors can demonstrate that they are giving appropriate consideration to ESG issues is through participation in initiatives such as the United Nations-backed Principles for Responsible Investment (PRI).

The PRI are a set of six guidelines devised by the international investment community to provide a voluntary framework by which investors can incorporate ESG issues into their investment decisions and ownership practices. The Principles clearly state that they are to be applied only in ways that are consistent with fiduciary duties.

PRI signatories publically commit to incorporating ESG issues into their investment analysis and decision-making processes, as well as their ownership policies and practices. They also commit to publically reporting on their progress in implementing the PRI annually, with a revised reporting framework due to be introduced in October 2013 (following a pilot in 2012).

The new reporting framework has both mandatory and voluntary components. The mandatory components are intended to represent the minimum set of (non-commercially sensitive) information indicators that signatories will be required to report and disclose from 2013 to demonstrate their progress, as well as to ensure the accountability of the PRI Initiative.

As a result of initiatives like PRI, a growing number of investors are pushing for greater ESG disclosure to enable them to judge potential investee exposure to, and management of, key ESG risks and opportunities. For ESG analysis to be an effective investment screening process, investors need access to good quality information about the ESG issues that are material to that particular business or fund.

Funds are, therefore, increasingly engaging with potential and existing investees on ESG issues as an integral and active part of their approach to managing, protecting and enhancing the long-term value of the capital they invest.

HOW WE CAN HELP...

We are currently advising both investors and companies on a range of ESG related challenges and opportunities.

Areas where we can help include:

- Developing robust policies, procedures and reporting strategies to maximise ESG performance and minimise risk
- Contractual protection to ensure ESG priorities are properly implemented, managed and communicated
- Due diligence (which highlights opportunities as well as the risks)
- ESG and carbon reporting
- Fund and equity documents
- Regulatory compliance and risk management
- Litigation, regulatory defence and emergency response
- Product liability and supply chain concerns

"...a force to be reckoned with ...specialist expertise in regulatory and risk management issues, corporate governance and ethical investment"

Chambers & Partners (UK)

"...intellectually very strong, commercial acumen, clear drive"

Senior Manager, Talisman Environmental

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