The role of climate change in post-M&A arbitration

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Climate change elements are becoming increasingly common in international commercial disputes. During the 2022 Paris Arbitration Week, Fieldfisher hosted an enlightening discussion on the role and impact of climate change in M&A transactions and post-M&A disputes. The panel included Annette Magnusson (Climate Change Counsel), Patrick Baeten (ENGIE), Eliseo Castineira (Castineira Law), Marily Paralika (Fieldfisher Paris) and Maxime Berlingin (Fieldfisher Brussels).

Since the beginning of the 21st century, the number of disputes involving a climate change element has snowballed. What began in the US as a few isolated cases is now a firm legal trend, numbering 2,000+ cases filed in more than 40 countries to date.

Pressure on companies and their boards to align business activities with the targets laid down in the 2016 Paris Agreement is increasing to the extent that climate change mitigation measures are becoming a legal obligation, rather than a voluntary practice.

This was clearly evidenced by the Milieudefensie et al. v Royal Dutch Shell plc case in the Netherlands, where in May 2021 the Hague District Court ruled that Shell is obliged to reduce the CO2 emissions of its group activities by 45% by the end of 2030, relative to 2019, following a legal challenge by seven environmental groups and 17,000 Dutch citizens.

In March 2022, international legal pressure group ClientEarth commenced legal action against Shell's board over what it calls "mismanagement of climate risk" in a first of its kind case that seeks to hold directors personally liable for "net zero failures".

Having purchased shares in Shell, ClientEarth alleges that Shell's board is in breach of its duties under UK company law, pursuing near-term profit at the expense of enduring company viability.

What is particularly interesting about this case is that ClientEarth is suing Shell in its capacity as a shareholder rather than an NGO or private citizen. While pressure groups taking shares in companies for the purposes of protesting against their activities, usually through AGMs and shareholder votes, is not a new tactic, direct litigation is a novel development and one that promises to have significant consequences for businesses.

Legislation is also starting to set clear rules on what companies are responsible for in the course of their business activities.

In addition to various pieces of national legislation on emissions and environmental impacts, in February 2022, the European Commission published a proposal for a directive on corporate sustainability due diligence. The directive is aimed at imposing on companies obligations regarding human rights and the environmental impacts of their operations and those of their subsidiaries and upstream and downstream value chains.

If the proposal is adopted, companies will face regulatory scrutiny of the accuracy of their statements in these areas and risk being accused of misleading customers or shareholders if they come up short.

In this context, regulatory authorities as well as shareholders are bringing claims regarding mitigation of climate risk or the veracity of corporate climate change and sustainability commitments.

With this in mind, investors are shifting climate change considerations from the margin to the core when choosing between and negotiating investment possibilities in different sectors, driving greater liability risk associated with corporate decisions.

Using law to tackle climate change

Legislation is increasingly seen as an essential tool in combatting climate change. An Intergovernmental Panel on Climate Change (IPCC) report entitled "Climate Change 2022: Impacts, Adaptation and Vulnerability", published in February 2022 and which derived its findings on key climate change risks and mitigation measures from more than 35,000 scientific studies, states that "vulnerabilities and climate risks are often reduced through carefully designed and implemented laws, policies, processes, and interventions that address context specific inequities."

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It therefore seems clear that lawyers across all practice areas are likely to come into contact with the consequences of climate change at some point, if they haven't already.

Climate change-related disputes look set to fall into two broad categories: direct, where climate change is at the core of the issue in dispute, for example in transactions involving renewable energy projects or climate change mitigation technologies; and indirect, where other kinds of M&A transactions give rise to claims that, for example, a company has failed to observe its obligations regarding climate change pursuant to its corporate policy or other substantive instruments of climate policy.

The indirect category is likely to be where we see the majority of international commercial arbitrations.

As the number of cases against private businesses increases, the arguments and strategies to prove that companies are failing to protect the climate in ways that are detrimental to the claimants' interests are developing.

Challenges seen to date tend to rest on allegations of insufficient communication, inaction or inadequate ambition by companies in respect of climate change.

Climate change in post-M&A disputes

The growth of climate change litigation is already having a direct effect on the M&A process. As well as affecting the choice and price of target, due diligence is now beginning to probe what an organisation's understanding of climate risk is in terms of physical, investment, market and litigation risk, as well as considering the climate change impact of the proposed transaction.

France's "Devoir de vigilance" (Law n° 2017-399 of 27 March 2017), a national predecessor to the EU's proposed directive on corporate sustainability due diligence, is now part of the French M&A deal process.

In the US, on 21 March 2022, the Securities and Exchange Commission (SEC) published proposed rule changes that would require US public companies to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks that are "reasonably likely" to have a material impact on their business.

This push for greater climate change-related disclosure will undoubtedly translate into representations and warranties, indemnities, force majeure clauses, change of law clauses and material adverse change clauses in M&A contracts.

Aspects of deals such as deferred payment terms are also becoming contingent on climate-related factors that are relevant to the performance of the target – such as rainfall for hydro-electric businesses.
To help with these anticipated changes, organisations such as the Chancery Lane Project are providing model climate clauses, standard climate-related definitions and tools for introducing climate clauses into contracts, including M&A documentation.

The increasing prevalence of climate-related terms at the contract drafting stage means there is inevitably scope for a greater number of climate change-related disputes.

How arbitration can help

As a dispute resolution mechanism, arbitration is well-designed to accommodate post-M&A disputes involving climate change.

Arbitration offers (in principle) a uniform international forum for climate change-related disputes, which may be particularly valuable in cases revolving around international agreements such as the Paris Agreement, as well as the ability to use party-appointed experts who can be integrated into the proceedings at an early stage and help the tribunal focus on and define the relevant climate issues.

Arbitration also allows for efficient resolution of urgent disputes, which may be necessary to prevent irreversible consequences of climate-damaging actions through emergency proceedings.

The provision of arbitration-specific tools, such as sample wording and case management techniques are also helpful in resolving complex disputes.

Arbitral proceedings are also well equipped to cater to the multi-party aspects of renewable energy projects, which typically involve a variety of agreements.

In addition, enforcement of arbitral awards helps ensure the implementation of climate change-related agreements.

However, arbitration will have to adapt to accommodate this new breed of disputes and make sure this avenue of dispute resolution remains attractive to commercial parties.

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For instance, while confidentiality has traditionally been regarded as a major advantage of arbitration, disputes that involve climate change-related elements arguably have a public interest dimension and may require more transparency.

For ICC arbitrations, the publication of awards has been possible since 2019, however if parties are uncomfortable with awards being published in full, details of the award can be redacted or only published in part.

The publication of awards could also help others from making the same mistakes that led to the dispute in question and lead to the creation of model classes for resolution of climate change-related disputes.

Nevertheless, many corporates are likely to be uncomfortable about the publication of awards, and this may deter them from arbitration and steer them towards other kids of dispute resolution, so an acceptable compromise will need to be found.

Perhaps most importantly, arbitrators will be expected to fully understand the background of climate change issues and be aware of the regulatory, judicial and public policy environment of the contract being disputed.

Lawyers (generally, and certainly at the moment) are not specialists in climate change science. As such, they will need to acquire sufficient scientific literacy so that they can understand terminology, judge accuracy and spot greenwashing language.

A scientific understanding of climate change issues is particularly important for when there is disagreement between party-appointed experts, as arbitrators need to be able to confidently navigate scientific evidence and opinion.

And while arbitrators have broad powers to investigate facts, so that they can make decisions that are technically and legally correct, the time and cost of reaching the right conclusion needs to be balanced against the commercial need for a timely decision.

Arbitrators that understand the issues in debate will be able to reach conclusions more quickly.

Conclusion

Based on recent developments, climate change-related issues look set to play a much more significant role in post-M&A disputes.

Corporates are likely to be increasingly anxious about the commercial choices they make in the context of the growing regularity of climate change litigation.

It should however be remembered that corporates are out to do deals, not disputes, so there is a need for arbitration to quickly develop attractive resolution channels that give businesses confidence to proceed with transactions without the fear of becoming mired in lengthy and expensive litigation.

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