# THE GUIDE TO ENVIRONMENTAL, SOCIAL AND CORPORATE GOVERNANCE

Editors
Antonia Stolper and Robert O'Leary

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# The Guide to Environmental, Social and Corporate Governance

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**Editors**

Antonia Stolper and Robert O'Leary

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# Publisher's Note

Latin Lawyer and LACCA are delighted to publish *The Guide to Environmental, Social and Corporate Governance*.

Edited by Antonia Stolper and Robert O'Leary, partners at Shearman & Sterling LLP, this guide brings together the knowledge and experience of leading experts from a variety of disciplines and provides guidance that will benefit all practitioners.

Environmental, social and governance (ESG) matters are taking centre stage in Latin America. The region has some of the most biodiverse ecosystems in the world, all of which are highly vulnerable to the increasingly significant effects of climate change, not to mention that many of its economies are heavily reliant on extractive industries and other sectors that depend on those natural resources and ecosystems. In addition, there is a need to narrow sizable socioeconomic gaps and improve gender equality across Latin America, all of which have led to a boom in sustainable finance involving both sovereigns and corporates in recent years. For companies operating in the region, it has become increasingly clear that not having an ESG strategy in place can jeopardise the primary goals of maintaining profitability and staying competitive. Pressure from both investors and consumers means that businesses of all sizes have been seeking the advice of outside counsel in order to mitigate risks, but also to identify opportunities. This Guide draws on the expertise of highly sophisticated practitioners to draw out trends and outline the tools needed to navigate the fast-moving ESG landscape across the region.

We are delighted to have worked with so many leading firms and individuals to produce *The Guide to Environmental, Social and Corporate Governance*. If you find this useful, you may also like the other titles in the Latin Lawyer series, including *The Guide to Mergers and Acquisitions*, *The Guide to International Arbitration in Latin America*, *The Guide to Restructuring*, *The Guide to Corporate Compliance* and *The Guide to Corporate Crisis Management*.

My thanks to the editors for their vision and energy in pursuing this project and to my colleagues in production for achieving such a polished work.



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# Introduction

**Antonia Stolper and Robert O'Leary**[1]

Environmental, social and governance (ESG) criteria are evolving as reporting and investment metrics at a rapid pace. While the term 'ESG' and the push to integrate ESG criteria into a central role in corporate reporting and investment are relatively new, as a conceptual matter ESG has been on the minds of regulators and corporate monitoring organisations for several decades. The recent increased focus on ESG criteria can be viewed as a call for companies to take a longer-term view of enterprise value, in contrast to focusing so heavily on short-term financial returns. Indeed, to some observers the ESG movement is something of a re-examination of – or even, a referendum on – the modern capitalist focus on maximising returns above all else.

At its broadest, incorporating ESG criteria into business activities requires a more holistic and people-centric approach to business. Countries that require ESG reporting and companies that are benchmarking their operations against ESG standards are declaring their intention to prioritise environmental, social and governance criteria. ESG touches all aspects of a business and has short-, medium- and long-term implications. That being said, 'measuring' ESG performance is a monumentally complex endeavour, and Latin America – and the world – continue to grapple with how to do so.

For investors, environmental, social and governance considerations are a growing priority as ESG performance has been shown to correlate strongly with financial performance. Stock prices of companies with high ESG rankings tend to be more stable. In contrast, companies that experience controversial ESG events can see their stock lose significant value in the market. Among society's many current challenges, climate change, social inequality and diversity are

1 Antonia Stolper is of counsel and Robert O'Leary is counsel at Shearman & Sterling LLP.



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often top of mind, and the ESG movement seeks to engage private companies in addressing such issues by requiring that they report on their performance with respect to such ESG matters. What is made clear by the chapters in this book is that all levels of governments, international governmental organisations and non-governmental organisations are grappling with ESG and how to ensure that ESG considerations are primary in governmental and corporate decision-making. Stakeholders and regulators are using a combination of ESG adoption, measurement and accompanying disclosure to try to achieve this.

While climate change concerns are often used synonymously with the term 'ESG' in the media and in common parlance, it is helpful to recall that ESG is comprised of three separate components: environmental, social and governance. Environmental standards refer to a company's or government's environmental impact and environmental risk management practices. Factors when assessing a company's or government's environmental impact could include greenhouse gas emissions, water quality, waste management and energy efficiency. Social criteria refer to a company's or government's relationship with its employees, consumers and society at large, including its performance with respect to human rights, labour standards in the supply chain, child labour laws, workplace health, community impacts and safety. Finally, governance refers to how a company or government is managed or led with respect to its different stakeholders. This criterion relates to a well-defined corporate governance system that supports a company's long-term strategy.

Politics are inherently embedded at all levels of ESG efforts. Although, as noted above, the scope of ESG criteria is much broader, recently climate change has been the primary motivator for the heightened focus on ESG criteria. Climate change was the focal point of the Paris Agreement of 2016. UN member countries committed in the Paris Agreement to try to limit the global temperature increase above pre-industrial levels to 1.5°C, which does not appear likely to be achieved.[2] The signatory countries followed up the Paris Conference with the UN Climate Change Conference in Glasgow (or COP26), which took place in November 2021 and resulted in the Glasgow Climate Pact. Among other commitments, the countries agreeing to the Glasgow Climate Pact targeted a 45 per cent reduction in global carbon dioxide emissions in order to reach net zero by 2050.

2 See 'The world is going to miss the totemic 1.5°C climate target', *The Economist*, 5 November 2022, available at https://www.economist.com/interactive/briefing/2022/11/05/the-world-is-going-to-miss-the-totemic-1-5c-climate-target.



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At the time of writing, UN member governments had just concluded the UN Climate Change Conference in Sharm-el-Sheik, Egypt (or COP 27), and one of the resulting agreements was that developed and high-polluting countries will compensate the developing countries that are hardest hit by the impacts of global warming. On the other hand, COP27 was itself controversially accused of promoting greenwashing. Both the venue – Egypt, a country with a significantly checkered record on human rights – and one of the main sponsors – Coca-Cola, the world's largest plastics polluter – were openly challenged in the global media with respect to their involvement in the event.[3]

In each country, the regulation of ESG disclosure has fallen mainly on securities and stock exchange regulators. There is something of a natural fit for these authorities given that they already regulate financial reporting and projections. In certain countries such as the United States, Latin America's most important trading partner, there is currently a wave of political backlash against the focus on ESG as an investment strategy and as a regulatory topic, with certain politicians and pundits railing against the use of ESG criteria as an investment tool or subject worthy of regulatory oversight. Nevertheless, given that ESG criteria are at base a tool for measuring long-term enterprise value, the political backlash will likely amount to more noise than actual policy. Major businesses have already made ESG criteria an important investment and evaluation tool and are seeking to promote themselves as ESG-friendly.[4]

In a region such as Latin America, where economic development is critical and there is a substantial energy and infrastructure gap, balancing ESG frameworks and standard-setting with development goals can be difficult. Though many governments and companies in Latin America are rightfully pursuing more sustainable energy, infrastructure and industry practices, the need to develop and maintain economic stability for their citizens in the short- and medium-term will still often take precedence. The challenge is to balance the short-term demands of electoral politics and putting food on the table with the longer-term threats to the planet and society that can result from a failure to deal with the issues encompassed by ESG. Many of the countries, if not most, in the region have

3 See 'At COP27 in Egypt, Climate Change Accountability Will Be Challenging', Posner, Michael, *Forbes*, 21 October 2022, available at https://www.forbes.com/sites/michaelposner/2022/10/21/at-cop-27-in-egypt-climate-accountability-will-be-challenging/?sh=3fd228991bbc.

4 See 'The tenacity of ESG investing', Buttonwood, *The Economist,* 16 November 2022, available at https://www.economist.com/finance-and-economics/2022/11/16/the-tenacity-of-esg-investing.



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a significant percentage of impoverished citizens and large informal economies – people living and trying to survive under such circumstances can hardly be expected to make ESG-mindedness a priority. Some smaller, relatively wealthier, and more homogeneous countries, such as Costa Rica and Chile, have shown an ability to redirect their political economy towards an ESG-centric approach in relatively short order. On the other hand, larger, more diverse, and populous countries in the region are finding it much more challenging to prioritise ESG criteria while balancing development needs.

This book will examine the ESG movement across a variety of timely topics. There is a mix of topics and approaches – a couple of the chapters are partial surveys, in particular Chapter 1, which looks at the developing reporting landscape, and Chapter 3, which looks at the range of ESG-related financing products available in the international and local financial markets. Other chapters are monographs, which take a deep dive into how a particular country is dealing with a particular ESG issue. It is a truism, but each country in Latin America is unique in its history and current politics; nevertheless, countries can learn from each other and can adopt ideas that are working in one country and apply them in another. Likewise, legal practitioners in the region can draw on the observations, lessons learned and successes highlighted in this book to better execute ESG-related transactions in their practice, and to help them influence and shape ESG policy in their countries. The ESG movement is dynamic politically and economically and lawyers play an important role in the shape and direction it takes.

The first half of the book reviews ESG's influence on regulation, corporate practices, financing tools, country policy and disputes. Chapter 1 examines the current state of play with respect to ESG framework and standard-setting, including the potential for greenwashing and the likelihood of more consistent standardisation in reporting. Chapter 2 reviews what is happening in the corporate boardroom and how companies are addressing surging ESG reporting requirements. Chapter 3 reviews the range of financing instruments being utilised to generate sustainable development and the preservation of natural resources, such as blue and green bonds. Chapter 4 reviews the steps that Costa Rica is taking to translate its COP26 commitments into concrete action at home. Chapter 5 reviews the current landscape of ESG-related litigation and arbitration.

The second half of the book dives into specific ESG-related trends and practices. Chapter 6 takes a hard look at the essential nature of the social licence in the natural resources sector in Mexico, including recent case studies, lessons learned and what steps extractive companies can take to ensure they remain 'onsides' with the local communities in which they operate. Chapter 7 examines the evaluation tools that private equity investors are using in Latin American when making



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ESG investments. Chapter 8 discusses ESG trends in commercial real estate investment in Brazil, while Chapter 9 reviews ESG in the real estate industry in Mexico. Chapter 10 examines the state of the carbon credit markets in Latin America and the extent of their success. Chapter 11 looks forward at the opportunities for green energy in Latin America, its potential and likely challenges to its growth.

The book concludes with information about the many contributing authors and provides their contact information.

As editors, we want to especially thank our colleagues who are not named authors herein but who contributed significantly to the editing of the chapters in this book, including Dan Feldman, Mehran Massih, Malcolm Montgomery, Chris Ryan, Cynthia Urda Kassis and Dhruti Tummalapalli.



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# Part II

## ESG Trends and Practices

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**CHAPTER 10**

# Carbon Markets in Latin America

**Whitney Debevoise**[1]

Carbon markets in Latin America are poised for take-off. With a rich history of involvement in hydrocarbon production and huge natural carbon sinks, such as the Amazon, Latin America has tremendous potential in the creation of carbon credits. Further, a growing number of countries stand ready to activate trading in carbon credits, whether through voluntary or compliance markets, and a growing number of companies are announcing net zero targets that will only be achievable through access to functioning carbon trading markets.

The evidence of climate change is ever present and increasing, and investors and the public have increased their scrutiny of companies and their greenhouse gas (GHG) emissions. Many companies are answering the call to establish net-zero emissions targets, as are the countries in which they work and are based, many of which have pledged to reduce emissions in the context of the Paris Accords. These factors drive demand for functioning carbon markets, and the governments in Latin America are starting to respond.

Some governments have imposed carbon taxes, whether at the national or subnational level. Others provide subsidies promoting low-carbon technologies, and others are working to promote the development of carbon capture and storage technologies with their existing energy infrastructure. This chapter focuses on the carbon trading markets, which have certain attractions for governments in terms of revenue generation potential. An expanded supply of carbon credits from Latin America could also increase the global competitiveness of credits and encourage further development of carbon markets globally.

1 Whitney Debevoise is a partner at Arnold & Porter.



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Currently, Latin America is the second largest source of carbon credits in the world, generating approximately 20 per cent of all carbon credits globally in 2020 and 2021.[2] The regulatory frameworks vary across the region, with one country – Colombia – developing a national emissions trading system (ETS) and four countries and three sub-national regions imposing carbon taxes. The World Bank and other multilateral sources have provided strong support and technical assistance to these efforts. In particular, the World Bank's Partnership for Market Readiness (PMR) is working in 23 countries, among them Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico and Peru, to design and deploy carbon pricing instruments (CPIs), whether in the form of carbon taxes or cap-and-trade systems.

Carbon taxes are a popular instrument for promoting emissions reductions in Latin America. In Colombia, the revenue from the country's carbon tax supports the Sustainable Colombia Fund, which deploys the funds in sustainability projects in conflict areas. Also in Colombia, PMR has conducted an evaluation of ETS system design, an impact assessment of an ETS on sectoral competitiveness, and a study on design options for a mandatory GHG reporting programme. Argentina and Brazil are also advancing toward the deployment of CPIs.

The following section describes the progress in several major economies in the region.

## Brazil

In May 2022, Brazil published Decree No. 11.075, designed to support the development of green investments and the reduction of GHG emissions. It represents the first step toward the establishment of a National System for Reducing Greenhouse Gas Emissions (SINARE), a central and digital registry with the potential to serve as a filter for the registration of high integrity, socio-environmentally sound programmes and projects, with real benefits for the climate. With this system, the quality of 'Made-in-Brazil' credits could improve and give a significant boost to Brazil's voluntary carbon market, which is predicted to grow up to 20 times if one projects the scope of REDD+ and alternative energy projects available. To get there, Brazil will need to overcome a series of technical issues as well as legal gaps. With the recent election of Luis Inácio da Silva as President of Brazil, this effort could gather steam.

2 See IETA report, 'Status and Trends of Compliance and Voluntary Carbon Markets in Latin America.' (2021). According to data from Verra, Gold Standard, ACR and CAR, cumulative carbon credit issuances in Latin America exceeded 173.3 MtCO2e by the end of 2021.



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The decree has its legal basis in the National Climate Change Policy (PNMC), adopted by Brazil as law in 2009. The PNMC envisioned the possibility of sectoral agreements for GHG emissions reductions, for example in the energy, agriculture and transport sectors. It also introduced the idea of a Brazilian Market for Emission Reduction: an ETS.

In the 13 years since 2009, no sectoral plans have emerged, but there have been positive developments toward the development of carbon markets in Brazil with the establishment of the Forest + Carbon Program in 2020, and the National Payment Policy for Environmental Services in 2021, under Law No. 14,119. With SINARE, credits registered there may be in demand from regulated companies in Brazil that will need to meet the sectoral goals (which are to be established).

There is still a long regulatory path ahead for Brazilian carbon markets, including some complex technical issues and legal gaps such as the legal nature of carbon credits and the adoption of social and environmental safeguards for the registration of credits with SINARE. Some of these gaps could be filled by proposed Law No. 528/2021. The Lula administration may also adopt a fresh approach to these matters. The approach to decarbonisation reflected in Decree No. 11,075 and proposed Law No. 528 is decidedly one of emphasis on markets and not on taxes, consistent with the findings in a recent World Bank carbon pricing report, which found that worldwide in 2021 the total value generated via carbon markets was approximately US$56 billion, while carbon taxes collected a lesser amount of US$28 billion. These numbers, of course, reflect activity with the creation of carbon credits (purchase of allowances and first sale in the voluntary market) and not trading volumes, which are surging past US$1 billion.

## Colombia

Colombia adopted a carbon tax in 2016 of approximately US$5 per metric ton of $CO_2$ that covers only fossil fuel emissions. It is possible to purchase carbon offsets only from projects within Colombia. The government also launched a Colombian Voluntary Carbon Market Platform, although integrity concerns have bedevilled that marketplace.

In 2018, Colombia adopted a National Climate Change System (SISCLIMA), mandating the adoption of an ETS: the National Program of Greenhouse Gas Tradeable Emission Quotas. This programme is still at the development stage. It envisages a system of carbon allowances and allocations, as well as credits for voluntary GHG reductions that are properly verified and certified. Colombia has been working with the World Bank on this system.



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## Chile

In 2017, Chile introduced a carbon tax at the rate of US$5 per metric ton of emissions of $CO_2$. This level of taxation has been criticised as inadequate and Chile is considering an increase that could go as high as US$40 per ton.

More generally, Chile adopted a legal framework on climate change that came into force in June 2022 and includes measures intended to achieve carbon neutrality for the country by 2030. Like Brazil's May 2022 decree, the Chilean framework adopts a sectoral approach, and Chile's Ministry of the Environment is tasked with creating an emissions mitigation plan with sectoral limits, and specifications for GHG emission limits by source according to their technology, sector or activity. Regulated entities that exceed performance requirements can have their surplus emission reductions certified, which will enable them to sell the credits to others for use in complying with their reduction obligations.

## Mexico

Mexico introduced a General Climate Change Law (GCCL) in 2012 and a carbon tax in 2013. The tax is based on emissions exceeding a standard set for natural gas usage. Mexico also established MexoCO2, a platform for the exchange of voluntary carbon credits.

Subsequently, in 2019, Mexico amended the GCCL to give its environmental authority, the Secretariat of Environment and Natural Resources (SEMARNAT), a mandate to establish an ETS. It would operate as a pilot for two years and go fully operational in 2023. The pilot phase includes approximately 300 industrial and energy plants with annual emissions in excess of 100,000 metric tons of $CO_2$-equivalent between 2016 and 2019, representing about 45 per cent of national emissions. The pilot phase is designed to test system design and build capacity in emissions trading, as well as develop reference values for the traded credits in the operational phase.

## Opportunity in Latin America

With the return of President Lula Inácio da Silva to the Presidency of Brazil on 1 January 2023, there may be substantial opportunity for the expansion of the supply of carbon credits in connection with avoided deforestation (REDD+) due to the significant forest resources in that country. Carbon credits associated with REDD+ projects already have a strong presence in the region. With a renewed emphasis coming out of the Glasgow COP26 on nature-based solutions, there is a real opportunity to integrate local communities into the carbon credit process for improved societal returns. Appropriate metrics for this dimension will need to



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be developed, together with an improvement in the standards for monitoring and verifying carbon credits for REDD+ projects, which have been criticised for lack of oversight and inaccurate accounting.

As explained above, 20 per cent of all carbon credits are now being generated in Latin America. Many of these credits are being applied in jurisdictions outside the region. As the integrity of carbon credits continues to improve, the volume of credits generated in Latin America should continue to grow. Further, as more countries engage seriously with their national commitments under the Paris Accords, carbon markets in Latin America will continue to grow, whether that be in the compliance market or the voluntary market. In short, these are markets whose growth will generate much activity both for governments and business, as well as lawyers in both government service and the private sector. All have an important role to play in the further development of carbon credits in Latin America, and the growth in carbon credits and trading will make an important contribution towards achieving the emission reduction goals of the Paris Accords.



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**APPENDIX 1**

# About the Authors


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Whitney Debevoise is a partner in the law firm of Arnold & Porter, resident in the Washington, DC office. Mr Debevoise practises in the fields of sovereign finance and the international economic policy of the United States. He is a former US Executive Director of the World Bank with more than 15 years of exposure to climate issues. He is also a member of the board of Forest Trends, a non-profit organisation dedicated to the promotion of sustainable uses of forests globally. Mr Debevoise has lived and worked in Latin America and speaks Spanish, Portuguese and French. He is a graduate of Yale College and the Harvard Law School.


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Published by Latin Lawyer and LACCA, edited by Antonia Stolper and Robert O'Leary, partners at Shearman & Sterling LLP, *The Guide to Environmental, Social and Corporate Governance* will benefit all practitioners acting in Latin America's fast-moving ESG landscape. This guide draws on the expertise of highly sophisticated practitioners to provide an overview of the main elements of ESG affecting the region's businesses and markets. Its aim is to be a valuable resource for business people, investors and their advisers as they embark on their ESG journey.

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