NEWSLETTER

NISHIMURA & ASAHI

Pushing for ESG Due Diligence in Thailand

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1 What is ESG DD？

In recent years, potential buyers and investors[1] all around the world have begun to place emphasis on conducting Environmental, Social & Governance (ESG) Due Diligence ("ESG Due Diligence") on target companies they are looking to invest in or acquire. As a consequence, ESG issues are now fundamental to the investment decision-making process of investors.

In practice, ESG Due Diligence may have various elements, including:

(A) negative screening (i.e., using an exclusion list or policy to comb through and flag/eliminate companies that have a history of violating international standards or regulations, or which engage in illegal or controversial businesses, such as the manufacturing and sale of tobacco and nuclear weapons[2]);

(B) enhanced legal due diligence, in which the scope or depth of the due diligence is tailored to address the buyer's specific, material concerns;[3]

(C) analysis of the existing ESG risk management system of the target company, to identify deficient business practices and key areas for improvement after the acquisition or investment has taken place; and

(D) performance of risk-based Responsible Business Conduct (RBC) due diligence (based on the OECD Due Diligence Guidance for Responsible Business Conduct[4]) at the pre-transaction phase.

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1 The term "investor," in the context of this article, refers to those who are looking to invest in target companies.

2 *E.g.,* https://regulatory.allianzgi.com/en/esg/sri-exclusions

3 *See e.g.,* MSCI, *ESG Industry Materiality Map*, https://www.msci.com/our-solutions/esg-investing/esg-industry-materiality-map (last visited Jan. 2, 2024).

4 The OECD Due Diligence Guidance for Responsible Business Conduct provides detailed explanations and examples of due diligence recommendations, as well as how to implement these due diligence recommendations, to companies and businesses in order to promote a common understanding of due diligence (*see* OECD, *OECD Due Diligence Guidance for Responsible Business Conduct*, https://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf (last visited Jan. 2, 2024)).

2 Why do buyers need to conduct ESG Due Diligence?

1. Self-regulation: double materiality[5]

(1) Business risks

The purpose of conducting ESG Due Diligence is to identify potential threats to business transactions in order to determine, for example, possible remedial actions to be taken prior to and after consummation of the transaction. These business risks subsequently may be addressed through contract covenants, as well as representations and warranties in the definitive agreements.

(2) Impact on people and plant

ESG Due Diligence often reveals the target company's environmental impact (e.g., how emissions from its manufacturing process affect workers and nearby communities) as well as its societal impact (e.g., whether the company purchases or procures materials and services from conflict areas or areas known to relate to slavery and human trafficking). The results of ESG Due Diligence help identify weak areas and increase stakeholder engagement/participation, to ensure that the target company's business operations are not detrimental to the community and the environment.

2. External pressure

(1) Peer pressure

By conducting ESG Due Diligence, companies may compare their ESG performance with that of peers within the industry, as well as industry standards, and identify deficient business practices and key areas for improvement after the acquisition or investment has taken place. Companies that are not on par with peers within an industry may draw in fewer investors and find themselves unable to compete with their peers.

(2) Investor pressure

Although ESG is not as popular in Thailand as in Europe, companies in Thailand nonetheless should consider incorporating ESG factors into corporate strategies and governance if they wish to attract major foreign investors. Of the 325 investors that participated in PwC's 2021 Global investor survey, 79% consider how a company manages ESG risks and opportunities to be an important factor in investment decision-making, and a further 49% were willing to divest from an investment if the relevant company was not taking action to address

[5] The term "double materiality" refers to the idea that businesses should report on financially material topics that influence enterprise value (i.e., "financial materiality") as well as topics material to the economy, environment, and people (i.e., "environmental and social materiality") (*see*, Denielle Harrison & Charlotte Bancilhon, *Why Companies Should Assess Double Materiality*, https://www.bsr.org/en/blog/why-companies-should-assess-double-materiality (last visited Jan. 2, 2024)).

ESG issues.[6] Furthermore, it appears that greenwashing[7], or vague ESG reporting, is not sufficient, as investors may request that ESG reports clearly indicate a company's actual progress towards ESG goals.

(3) Regulatory pressure

At the moment, a requirement to comply with ESG reporting duties is implemented only on companies that are listed on the Stock Exchange of Thailand (SET). However, with the recent rise in direct investment by foreign investors in Thai companies, investors wishing to acquire Thai businesses, particularly in the manufacturing or production industries, which are part of global supply chains, are likely to be interested in businesses that have clear ESG goals. In addition, Thai manufacturing companies with parent companies headquartered in the European Union (EU), or which are part of global supply chains, may nonetheless undertake ESG reporting to ensure compliance with international regulations and standards and due to a fear of difficulty trading with EU partners. In addition, certain laws and regulations may require Thai companies to comply with ESG principles in order to maintain licenses or permits that are required for their business operations.

(4) International pressure

Due to the fact that Thailand is one of the world's largest exporters of seafood, many major food conglomerates in Thailand are under pressure from international society, which is calling for boycotts of seafood and other food products that are linked to slave labor in Thailand. For example, in 2016, the EU threatened to boycott the Thai seafood industry unless it tackled illegal fishing and allegations of human trafficking. Nestlé, a Swiss global conglomerate, even discovered evidence of slavery-like conditions in its Thai supply chain during the course of an internal investigation, following reports of alleged poor working conditions within the manufacturing of its shrimp, prawns, and pet food by news outlets and non-governmental organizations.[8]

Other overseas buyers, such as U.S. retail and food service suppliers, initiated a boycott of Thai shrimp products in 2016, after news reports of human rights violations at various shrimp processing houses in Thailand made headlines.[9] Following those news reports, Thai Union Group, a leading producer of seafood-based food products in Thailand, promised to implement more sustainable practices, to bring all seafood processing in-house, and to cease contracting to third party processors that are linked to forced labor.

3 How do companies conduct ESG DD?

Some of the specific issues on which investors may wish to conduct ESG Due Diligence, with respect to each ESG factor, may include the following:

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[6] PwC, *PwC's 2021 Global Investor Survey*, https://www.pwc.com/gx/en/services/audit-assurance/corporate-reporting/2021-esg-investor-survey.html (last visited Jan. 2, 2024).

[7] The term "greenwashing" refers to the act or process of conveying a false or misleading impression about a company's environmental impact in order to deceive customers and consumers into believing that a company's products or business operations are environmentally friendly or have a greater positive environmental impact than they actually do.

[8] Jonathan Head, *Thai Seafood Industry Crackdown Sparks Arrests*, BBC News, Feb. 2, 2016, https://www.bbc.com/news/world-asia-35457036.

[9] Christine Blank, *Are US Buyers Boycotting Thailand Shrimp?*, SeafoodSource, Jan. 13, 2016, https://www.seafoodsource.com/news/supply-trade/are-u-s-buyers-boycotting-thailand-shrimp.

1. E - Environmental factors

These factors generally concern anything that relates to a company's sustainability practices and environmental impact. Examples include how the company deals with waste management, climate change, energy efficiency, sustainable sourcing of raw materials, and use of natural resources, to name a few.
Some key questions to consider under Thai law include:

- *Does the target company comply with the environmental regulations applicable to its business operations, including but not limited to the Enhancement and Conservation of National Environmental Quality Act, B.E.2535 (1992) as amended (the "**Enhancement and Conservation of the Environment Act**")?*
- *How does the company manage pollution and waste control, and whether waste management procedures are in compliance with law, including but not limited to the Enhancement and Conservation of the Environment Act, Factory Act B.E. 2535 (1992) as amended, and the Hazardous Substance Act B.E. 2535 (1992) as amended?*
- *Other than compliance with Thai legal requirements, does the company adopt and comply with universal environmental standards and goals set by international organizations?*

In the future, it is possible that compliance with the anticipated draft Clean Air Act, which aims to specifically regulate businesses and activities that create air pollution (such as factories, businesses, agriculture and transportation, etc.) will become a regulatory requirement. It should be noted that currently there are 7 versions of the draft Clean Air Act (proposed by various political parties) under consideration by the Thai Cabinet, and at the time of this article, it remains to be seen which version of the Clean Air Act will be adopted.
Furthermore, if the Corporate Sustainability Due Diligence Directive (CSDDD) (as proposed by the European Commission and awaiting official approval) is implemented in EU member states, it also may be used as a guideline for conducting environmental due diligence on companies in Thailand, as the CSDDD sets out obligations for large and medium-sized companies in certain sectors with regard to actual and potential adverse impacts on the environment and human rights involving their business chains and activities.10 It also is important to note that direct or indirect third parties, subsidiaries, and suppliers involved in the subject companies must consider the impact that the CSDDD will have on them indirectly.

2. S - Social factors

These factors generally refer to how a company treats people (e.g., employees, suppliers, and customers) and society. Examples include violations of human rights or the use of child labor in a company's supply chain, upholding human rights and labor standards, establishing and maintaining community relations, promotion of gender and diversity, and other relevant factors.
Some key questions to consider under Thai law include:

[10] Council of the European Union, *Corporate Sustainability Due Diligence: Council and Parliament Strike Deal to Protect Environment and Human Rights*, The European Council and the Council of the European Union, Dec. 14, 2023,https://www.consilium.europa.eu/en/press/press-releases/2023/12/14/corporate-sustainability-due-diligence-council-and-parliament-strike-deal-to-protect-environment-and-human-rights/>.

- *In relation to the treatment of its employees, does the company fully comply with its obligations as an employer, as set forth in the Labor Protection Act B.E. 2541 (1998) as amended and the Occupational Safety, Health, and Environment Act B.E. 2554 (2011)?*
- *Whether the company has any programs or policies in place to promote gender and diversity in the workplace, and whether any remedies are available to combat unfair gender discrimination, such as those required under the principles of the Gender Equality Act B.E. 2558 (2015) (the "**Gender Equality Act**")?*
- *Whether the company has policies or internal rules to create an LGBTQ+ inclusive workplace? (e.g., offering a unisex/gender neutral bathroom, etc.) in accordance with the principles set forth in the Gender Equality Act?*

3. G – Governance

This is a broad area, which refers to how a company is run by its management. Examples include whether the company has a set of ethical and fair policies in place (relating to corporate governance, bribery, corruption, whistleblowing system, accounting or auditing, etc.).
Some key questions to consider under Thai law include:

- *Does the company have a set of ethical and fair policies relating to general corporate governance, accounting and auditing practices, such as those required under the Thai Civil and Commercial Code, Public Limited Companies Act B.E. 2535 (1992) (the "**PLC Act**"), and Accounting Act B.E. 2543 (2000)?*
- *Does the company comply with its corporate reporting and filing duties mandated under Thai law, such as the duties set forth in the Thai Civil and Commercial Code, PLC Act, Revenue Code, and the Securities and Exchange Act B.E. 2535 (1992)?*
- *Does the company have any bribery or corruption prevention practices/policies in place in accordance with the Act Supplementing the Constitution Relating to the Prevention and Suppression of Corruption B.E. 2561 (2018)?*
- *Does the company have an internal or external whistle blowing channel to report the occurrence of any illegal, immoral, illicit, unsafe or fraudulent activity?*

4. Conclusion

Upon completion of ESG Due Diligence, the findings from the ESG due diligence generally lead to a request for the inclusion of appropriate covenants, representations and warranties, indemnities, and other ESG mechanisms in the definitive agreements, to protect the investor against future developments occurring or failing to occur.
Reliance on self-disclosure by companies may prove inadequate, and in the near future, conducting detailed ESG Due Diligence may become mandatory, where upon non-compliance with ESG obligations may become an event of default and trigger termination of relations between contracting parties. It is highly likely that ESG-related practices and due diligence will become increasingly widespread across all industries and jurisdictions, and may one day become required for all types of investments/businesses. In addition, the methods of dealing with ESG due diligence findings may vary depending on the type of ESG Due diligence (see Paragraph 1 (A) to (D) above) undertaken.

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