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Legal Guides**



Practical cross-border insights into ESG law

**Environmental, Social &
Governance Law**

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1 Setting the Scene – Sources and Overview

1.1 What are the main substantive ESG-related regulations?

In Portugal, there are several legal instruments directly or indirectly linked with substantive ESG matters.

On the one hand, EU legislation imposes relevant standards in ESG-related areas. Notably, the Taxonomy Regulation – Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, the Low Carbon Benchmark Regulation – Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 as regards EU climate transition benchmarks, EU Paris-aligned benchmarks and sustainability-related disclosures for benchmarks, and the Air Quality Directive – Directive 2008/50/EC of the European Parliament and of the Council of 21 May 2008 on ambient air quality and cleaner air for Europe, establish essential standards on environmental matters.

Additionally, domestic legal instruments also set out important rules in ESG matters. Regarding the environmental component, it is important to point out that the Portuguese Criminal Code sets out different types of environmental crimes and that environmental damages may determine the attribution of compensation according to the Portuguese Civil Code. Law n. 19/2014 determines the foundations of environmental policy and from it stem several regimes regulating specific subjects in a more detailed manner, such as: (i) Decree-Law n. 178/2006 on waste management; (ii) Decree-Law n. 151-B/2013, which transposes Directive 2011/92/EU and Directive 2014/52/EU, establishing the Legal Regime of Environmental Impact Assessment; (iii) Law n. 58/2005, transposing Directive 2000/60/CE known as the “Water Law” as it sets out the institutional framework for sustainable water management; and (iv) the National Action Plan for Energy and Climate, establishing, in accordance with Directive 2012/27/EU and Directive 2009/28/EC, the national energy strategy for the period of 2021–2030.

Concerning social matters, arbitrary discrimination is prohibited in all areas of the Legal Order, from the Portuguese Constitution, Criminal Law, Civil Law and, more specifically in

certain areas, Labour Law. In addition, Law n. 93/2017 establishes the regime for prevention, prohibition and combatting of discrimination and Law n. 62/2017 establishes the regime for a balanced representation between men and women in management and supervisory bodies of corporate public sector entities and listed companies.

Lastly, governance matters are mostly regulated by the Commercial Companies Code and the Portuguese Securities Code for companies in general. There are also additional corporate governance rules in force for financial firms, namely stemming from the Portuguese Banking Law, the Portuguese Insurance Activity Law and the Portuguese Regime on Investment Funds. Moreover, some developments have been observed concerning the regulation of certain companies with social objectives; for example, through Law n. 18/2015 determining the Legal Regime of Social Entrepreneurship Funds. Soft law instruments are also relevant in corporate governance matters, namely the IPCG Corporate Governance Code (2018), which presents a set of recommendations applicable to listed companies.

1.2 What are the main ESG disclosure regulations?

Disclosure standards are often included in the substantive regimes regulating ESG matters. Nevertheless, it is important to point out that there are instruments particularly focused on disclosure, such as in the case of: (i) Regulation (EU) 2019/2088 (the SFDR); (ii) the abovementioned Taxonomy Regulation; (iii) Decree-Law n. 89/2017, transposing Directive 2014/95/EU on the disclosure of non-financial and diversity information by certain large undertakings and groups; (iv) the Portuguese Securities Code, transposing Directive (EU) 2017/828 in respect to institutional investors’ disclosures; and (v) Decree-Law n. 28/2021, establishing the Energy Labelling Scheme, through the transposition of Directive 2010/30/EU.

1.3 What voluntary ESG disclosures, beyond those required by law or regulation, are customary?

Presently, there are no uniform global standards for ESG disclosures. The abovementioned EU regulations (see *supra* question 1.2) have begun an important path of convergence in ESG disclosure matters, but it is too soon to tell if we are close to

achieving a truly worldwide standard in this respect. However, companies have increasingly started to disclose information on this matter, through the adoption of sustainability policies, the publication of ESG commitments, and even in companies' annual accounting reports. Currently, 84 Portuguese companies, enterprises or entities are members of the UN Global Compact, meaning that they have committed themselves to improve their corporate responsibility by assessing, defining, implementing, measuring and/or communicating their sustainability strategy. Furthermore, the Portuguese securities market regulator, the Securities Market Commission (CMVM), has approved a non-binding template for disclosure of non-financial information, which has inspired some voluntary ESG disclosures by major listed companies.

These publications are often in accordance with the European Commission's non-binding guidelines on non-financial reporting or influenced by the Guidelines for a Sustainability Report issued by the Portuguese Institute of Internal Audit, based on the Global Reporting Initiative guidelines.

Moreover, the Bank of Portugal published a commitment to sustainability and financing in 2020 and became a member of the Network of Central Banks and Supervisors for Greening the Financial System in 2018.

Finally, ESG disclosure scrutiny is becoming more embedded in commercial transactions in general. Namely, it is becoming more and more common to include ESG factors in the due diligences carried out before M&A transactions.

1.4 Are there significant laws or regulations currently in the proposal process?

At this juncture, one of the most significant legislative proposals being discussed is the Climate Law Framework, which aims to determine the guidelines for public policies in all areas concerning climate, namely by establishing decarbonisation targets, measures regarding the electricity production system (particularly concerning energy efficiency and energy poverty), a monitoring entity and planning and financing instruments.

At the EU level, attention must also be paid to the important EU Proposal for the Corporate Sustainability Disclosure Regulation. This Regulation will amend Directive 2014/95/EU, significantly enhancing the standards and imposing the audit of non-financial information.

The adoption of an instrument regarding human rights in the Digital Era is also being discussed, as well as changes to the Consumer Rights Law in order to ensure a right to environmental protection and sustainable consumption.

1.5 What significant private sector initiatives relating to ESG are there?

An increased commitment to ESG and its connecting areas can be observed throughout the private sector. Besides the already mentioned reporting commitments assumed by several companies, there are a number of associations promoting the implementation of ESG standards.

These associations can either be directly connected to companies, as is the case for the Business Council for Sustainable Development, a company association that aims to strengthen recognised norms and practices aligned with management, ethical, social, environmental and quality standards, or can be non-governmental organisations (NGOs) advocating for the implementation of ESG concerns, as is the case for ZERO, Quercus and the Portuguese Environment Agency. Flexdeal,

a Portuguese listed management company, is also developing a relevant ESG project for small and medium-sized enterprises with the advisory support of SÉRVULO.

Additionally, the role of the press and of academic institutions has been essential to raise awareness for ESG issues, both through the publication of articles and news pieces, as well as through the organisation of events and conferences on the matter. Law firms are increasingly playing a relevant role through the creation of departments or services focused on ESG law, as is namely the case for SÉRVULO.

2 Principal Sources of ESG Pressure

2.1 What are the views and perspectives of investors and asset managers toward ESG, and how do they exert influence in support of those views?

There is increasing concern amongst investors and stakeholders regarding the impacts of their investments. Stakeholders are starting to look for opportunities that also encompass ESG standards and promote positive social changes, which is reflected in the gradual growth of funds complying with these criteria.

Asset managers are also starting to increase their offer of ESG products as a way to keep up with international trends, which consequently increases the interest of investors in these types of products (i.e. banks are converting funds in ESG products, imposing ESG criteria on existing funds, and offering funds with ESG stamps).

Currently there are seven products in the market following sustainability criteria, which are responsible for the management of approximately 400 million euros. Mostly, these funds exclude entities that directly or indirectly cause negative externalities, through exclusionary screenings based on the Stoxx Sustainability Index or the Barclays MSCI Euro Corporate SRI + ESG Index.

2.2 What are the views of other stakeholders toward ESG, and how do they exert influence in support of those views?

Increasingly, stakeholders besides investors are gaining awareness of the importance of ESG standards. In all sectors of civil society, a growing concern regarding ESG matters can be observed.

On the one hand, companies' shareholders have become more concerned with the compliance of ESG standards in the companies they invest in, which determines more frequent discussion of these topics in General Meetings of companies. Consequently, companies have been adopting governance structures that are aligned with ESG criteria and seek to develop more active and intervening strategies on the matter, which is increasingly seen as a competitive factor by the market.

The support for ESG has also been highly influenced by financial regulators, as well as the legal sector overall, as academia and law firms have engaged in the definition of standards and policies. The role of civil society has also been essential to raising awareness of these matters, as well as through the adoption of more informed and sustainable consumption habits.

2.3 What are the principal regulators with respect to ESG issues, and what issues are being pressed by those regulators?

ESG issues, in general, are regulated by public entities, thus each component of ESG is more particularly regulated by specialised entities.

The issues connected with the environmental component are mostly regulated by the Ministry of Environment and Climate Action, in cooperation with the Ministry of Agriculture and the Ministry of the Sea. Public entities such as the Portuguese Environment Agency, the Inspectorate-General for Agriculture, Sea, Environment and Land Management and the Directorate-General for Energy and Geology (IGAMAOT) perform an important role in the implementation of regulations and the observance of already adopted rules.

Regarding social issues, although all areas of activity may potentially influence its regulation, the Ministry of Labour, Solidarity and Social Security and the Ministry of the State and the Presidency, namely through the State Secretariat for Citizenship and Equality and the State Secretariat for Integration and Migrations, play the most prominent regulation roles in the matter. Additionally, the Authority for Work Conditions (ACT) and the Portuguese National Human Rights Committee monitor and supervise labour and human rights issues, respectively.

Governance matters are essentially regulated by the Ministry of Economy and Digital Transition. However, in the financial sector, the Bank of Portugal, the Insurance and Pensions Authority (ASF) and the CMVM play a vital role in the regulation of ESG standards as well.

2.4 Have there been material enforcement actions with respect to ESG issues?

Enforcement actions with respect to ESG issues are mostly led by regulators that, while monitoring entities within their competency, identify a situation of non-compliance with imposed standards.

These actions may include actions imposing the compliance of environmental standards by IGAMAOT, which may lead to administrative fines, as non-compliance with imposed standards often constitutes an administrative environmental offence.

Similarly, non-compliance with anti-money laundering and anti-corruption regulations may lead to the imposition of fines in investigation procedures initially led by the Bank of Portugal.

Non-implementation of proper work regulations and conditions is monitored by the ACT, while the violation of human rights often determines the opening of judicial procedures. The ACT has namely put in place a permanent compliance programme regarding the gender pay gap.

2.5 What are the principal ESG-related litigation risks, and has there been material litigation with respect to ESG issues, other than enforcement actions?

The Portuguese legal system does not have a strong tradition in litigating matters concerning ESG issues, although some administrative offences may evolve into judicial procedures and liability actions may be entered into by different stakeholders.

The possibility of being held liable for damages is an important risk with ESG-related litigation, especially concerning environmental matters. For instance, there is currently an ongoing civil class action against the national steel industry in Seixal for environmental damages, namely atmospheric pollution, which was proposed by an environmental NGO. The application of the NGO requests for the immediate suspension of operations until the steel industry complies with basic administrative environmental requirements and for the payment of 500 million euros.

Also currently underway is a procedure brought by NGOs in the Lisbon Administrative Court to prevent the construction of

a new airport in Montijo as, according to the organisations, the Environmental Impact Statement reflecting the project's environmental assessment does not comply with EU law.

Moreover, there are relevant reputational risks associated with ESG-related litigation, particularly in the case of non-compliance with anti-money laundering or work condition rules, as these matters tend to be highly mediated. Additionally, greenwashing cases, framed as unfair commercial practices, are expected to arise as public awareness to advertising that does not have a real green impact is increasing.

2.6 What are current key issues of concern for the proponents of ESG?

The increased general awareness over ESG issues creates a growing concern of consistent implementation of standards and of developments in this area.

Besides this eagerness for consolidation of these matters, the main issues that are currently being discussed revolve around strategies to avoid greenwashing and to ensure proper transparency and reporting standards, namely through the approval of green quality labels. In this matter, the transposition and implementation of the EU Taxonomy Regulation also constitutes an important incentive and matter of concern.

The application of the EU Recovery Fund and its use in a fair climate transition is also a key concern for ESG proponents, as it can effectively determine change for widespread development and implementation of ESG standards and rationale in the economic and market paradigm.

3 Integration of ESG into Business Operations and Planning

3.1 Who has principal responsibility for addressing ESG issues? What is the role of the management body in setting and changing the strategy of the corporate entity with respect to these issues?

ESG is a broad topic and therefore, some distinctions are useful to be drawn beforehand.

Firstly, some basic differences separate regulated and unregulated companies. In respect to unregulated companies, the responsibility for addressing ESG issues lies mainly with the boards.

Within the catalogue of board member duties, the Portuguese Companies Code refers explicitly to loyalty duties, which take into account the long-term interests not only of shareholders but also other stakeholders relevant for the sustainability of the company (Article 64). This rule was apparently influenced by Section 172 of the UK Companies Act 2006. It applies to any company, irrespective of its form.

In relation to supervised companies (listed companies and financial institutions), regulators have been adopting an increasing role in respect to ESG topics. Portuguese regulators with competences in this area include the Bank of Portugal (banking), the CMVM (capital markets), and the ASF (insurance and pension funds).

3.2 What governance mechanisms are in place to supervise management of ESG issues? What is the role of the board and board committees?

Corporate governance is not solely one of the ESG pillars (the "G" pillar). It also represents the decision-making processes

and procedures by which ESG gains traction and is effective. ESG is to be embedded in the governance system, and therefore there are multiple mechanisms that are adequate to manage ESG issues.

In Portugal, according to corporate law, board committees are not mandatory, and ESG committees are still an exception rather than the rule. However, some examples are found in listed companies, such as Corticeira Amorim (ESG committee) and GALP (sustainability committee).

On the other hand, ESG risks are often integrated into the mandate of risk committees. One example of this is EDP, where risks related to sustainability are monitored under the risk committee. EDP also publishes quarterly ESG information.

3.3 What compensation or remuneration approaches are used to align incentives with respect to ESG?

The IPCG Corporate Governance Code (2018), currently in force for listed companies, has some indications regarding remuneration policy and namely recommends the following:

- In the annual report, the managing board should explain in what terms the strategy and main policies defined seek to ensure the *long-term success of the company and which are the main contributions resulting therein for the community at large*.
- The remuneration policy of the members of the managing and supervisory boards should allow the company to attract qualified professionals at an economically justifiable cost in relation to its financial situation, induce the alignment of the member's interests with those of the company's shareholders – taking into account the wealth effectively created by the company, its financial situation and the market's – and constitute a factor of development of a culture of professionalisation, *sustainability*, promotion of merit and transparency within the company.
- Directors should receive compensation that: (i) suitably remunerates the responsibility taken, the availability and the expertise placed at the disposal of the company; (ii) guarantees a performance aligned with the long-term interests of the shareholders and promotes the *sustainable performance of the company*; and (iii) rewards performance.

Two examples merit to be indicated in this context. On the one hand, GALP has a remuneration policy for corporate bodies that incorporates, as a key performance indicator, the safety and environmental sustainability of the company's relevant activities.

On the other hand, Jerónimo Martins' remuneration policy is based, in addition to other factors, on priorities of a qualitative nature considered fundamental to the long-term sustainability of the business.

3.4 What are some common examples of how companies have integrated ESG into their day-to-day operations?

An increasing number of companies are starting to integrate ESG into their cultures. Below you may find some examples of sustainable measures that companies have adopted in Portugal.

GALP has committed to acting ethically and responsibly, engaging with stakeholders, valuing human capital, and has commitments regarding energy and climate, among others. Its goals are to achieve 33% of women on its board of directors after 2022, to implement human rights impact assessments in the most significant geographies, to ensure 70–100% of local

purchases, to promote an autonomy, responsibility and meritocracy culture, to reduce the carbon intensity of its assets and operations, and others. For this purpose, GALP has appointed a sustainable committee, established a diversity policy for its management and supervisory bodies, and endorsed the Plan for Gender Equality 2020. GALP has already reached 75% of local purchases, launched the Leading@Galp programme that aims for self-knowledge and sharing future experiences and skills, reviewed recruitment standards, and reinforced its commercial offer of renewable energy to clients.

Jerónimo Martins has also announced its objectives on respecting the environment, buying with responsibility, supporting surrounding communities, becoming a reference employer, among others. In 2018–2020, its objectives were to reduce its carbon footprint by 5%, per 1,000 euros of sales. Jerónimo Martins has also initiated at least one community investment project per year aimed at protecting/benefiting children, young and elderly people from vulnerable backgrounds and has improved the quality of life of collaborators through the social responsibility programmes, and others. In 2020, Jerónimo Martins published a document that demonstrates its progress regarding these objectives. Some of them were fulfilled, such as a 37% reduction in its carbon footprint, the purchase of food products from local suppliers, the support of 157 local causes from an investment of 150,000 euros, and the support of more than 1,100 employees through the Social Emergency Fund.

Finally, TAP Air Portugal has also endorsed environmental and social commitments. In 2020, TAP created the project RECICLA+, which intends to increase the rate of waste going to recycling. TAP also has a Disposable Plastic Reduction Program. Under this programme, TAP has already introduced wooden coffee mixers to replace the previously used disposable plastic ones. Regarding TAP's social commitment, TAP has created a programme called TAP Donate Miles. This initiative allows its clients to donate miles to various non-governmental and non-profit organisations, which are then converted into travel.

4 Finance

4.1 To what extent do providers of debt and equity finance rely on internally or externally developed ESG ratings?

In Portugal, internal ESG ratings are not common. Most financial intermediaries rely on external ESG ratings, such as Morningstar, Fitch, and Moody's. Furthermore, ESG ratings are yet to be regulated in our jurisdiction. At a global level, it is interesting to note that the International Organization of Securities Commissions has prepared a set of recommendations addressed at ESG ratings.

4.2 Do green bonds or social bonds play a significant role in the market?

Green bonds are still a growing trend in our market. However, there are some Portuguese companies that have issued green bonds.

The first Portuguese green bond issuer was EDP, which issued its first green bond in the amount of 600 million euros in October 2018 that intends to finance or refinance renewable projects, solar and wind. In January 2019, EDP issued its first green hybrid bond worth a billion euros. In September 2019,

EDP issued its third green bond worth 600 million euros, and issued another green hybrid bond in 2020 worth 750 million euros. The last transaction was in April 2020, a green bond in the amount of 750 million euros. EDP's total green bonds have reached 3.7 billion euros, which represents 27% of the total debt that EDP holds.

In 2019, Grupo Pestana became the first hotel group to issue a green bond. This green bond, worth 50 million euros, refinanced two projects: Pestana Troia Eco-Resort; and Pestana Blue Alvor.

Moreover, in February 2019, Sociedade Bioelétrica do Mondego issued a green bond, in the amount of 50 million euros, for the development of a 34.5 MW-capacity biomass power plant.

Another relevant transaction was the issue of green bonds by Corticeira Amorim worth 40 million euros in December 2020.

4.3 Do sustainability-linked bonds play a significant role in the market?

Although the green bond market is rapidly growing, as mentioned above, we have not yet found any sustainability-linked bond issuers in Portugal.

4.4 What are the major factors impacting the use of these types of financial instruments?

One major factor is transparency. There needs to be a release of non-financial information so that investors can make a clear investment decision. Companies must be transparent and accurate regarding their non-financial information and, through data-based information and third-party assurance, should avoid the risks and pitfalls arising from misleading information. These are critical aspects to avoid greenwashing.

4.5 What is the assurance and verification process for green bonds? To what extent are these processes regulated?

Presently, there is no mandatory assurance and verification process for green bonds. However, the European Commission has presented a Proposal for a European Green Bond Standard, which intends to be a voluntary standard for how companies can issue green bonds and help reduce the risk of greenwashing. The European Green Bond Standard will be open for issuers located outside of the EU, and will be helpful for issuers and investors.

In some cases, green bonds are second-party opinions referred to in the offer documents, namely in the following cases: Grupo Pestana turned to DNV GL for a second-party opinion; and EDP consulted Sustainalytics, such as Sociedade Bioelétrica do Mondego, and Corticeira Amorim.

5 Impact of COVID-19

5.1 Has COVID-19 had a significant impact on ESG practices?

It is undeniable that COVID-19 has had a significant impact on ESG, both positive and negative.

It should be stressed that one of the main priorities of Ursula von der Leyen's European Commission was to launch the foundations to ensure that Europe is carbon neutral by 2050,

with the European Green Deal being the cornerstone of such enterprise. However, a few months after the beginning of her mandate, the EU, and the rest of the world, was emerged in fighting back COVID-19 with inevitable impacts on the foreseen dates. As such, one of the most significant and negative impacts of COVID-19 on ESG practices has been the delay on the implementation of new legal solutions, as well as the deviation of attention from private actors, since ESG was no longer the focus at the time. A clear example is the so-called European Climate Law, which was presented by the European Commission in March 2020 but was only approved by both the Parliament and the Council in June 2021.

Taking a more granular perspective, a change in certain behaviours and practices has been noted. For example, there has been a reduction in the reuse of materials, which is clearly against legislative efforts such as Directive (EU) 2019/904 on the reduction of the impact of certain plastic products on the environment but constitutes a necessary measure to contain the spread of the virus.

However, COVID-19 has also had significant positive impacts on ESG practices. In the one hand, the pandemic has fostered the idea that sustainable development oriented towards growing environmental and social awareness is imperative to guarantee resilient societies. On the other hand, COVID-19, by leading to the need for economic and social recovery, is being seen as an opportunity to introduce certain changes that were previewed before the pandemic. Indeed, one should never waste a good crisis.

6 Trends

6.1 What are the material trends related to ESG?

There are different material trends related to ESG concerning each of its different pillars, which are motivated by an increasing awareness of the importance of ESG both at a regulatory level and in the public eye.

Regarding the "E" pillar, the abovementioned European Climate Law assumes a leading role, since it aims to raise the emissions reduction target for 2030 from 40% to at least 55%. Moreover, increasing public awareness regarding greenwashing practices may lead companies to have a more cautious approach when advertising their products as eco-friendly.

Concerning the "S" pillar, we must point out the continuous initiatives to achieve gender equality within the workplace and in labour market access. It should also be noted that the need for employers to comply with human rights standards is also becoming a more mainstream concern, showcased by the growing efforts on disclosure in these matters, especially when it comes to the control of supply chains. Lastly, the forced shift to adopting remote working regimes has led to a rethinking of work patterns, stressing the importance of work-life balance and of rights to be further developed, such as the right to disconnect.

Relating to the "G" pillar, the most interesting trend concerns the use of ESG performance indicators in remuneration policies. This is especially noted in long-term incentive plans and plays a major role in enforcing ESG objectives.

6.2 What will be the longer-term impact of COVID-19 on ESG?

Although COVID-19 is not yet overcome, the reshaping of society allows us to forecast some of the more probable longer-term impacts of the pandemic on ESG.

Firstly, there has been a huge development in the digitalisation of society, which has obvious environmental gains but also raises concerns, with some sectors of the population (elderly and poor people) not having easy access to the necessary technology.

Secondly, COVID-19 has also represented a huge shift from how companies used to be run, which poses interesting challenges in their governance. The flexibility in working from home, workplace safety and employee mental and physical well-being are all concerns that are expected to be increasingly addressed by companies. In fact, healthcare is starting to be seen as a component of ESG criteria, since the pandemic has stressed very well how important it is for the basic functioning of society and the economy.

Lastly, an interesting parallel may be drawn between COVID-19 and the climate crisis. Due to its very clear and palpable effects, COVID-19 has led governments all over the world to stop business as usual and forced them to come up with new and innovative solutions to solve this crisis; the results have been tremendous, with the rapid production of several vaccines being the paramount example. This means that, if the climate crisis was treated with the same urgency (or at least some of it) as the pandemic, we could now be in a less disturbing situation. It is desirable that the way COVID-19 is being tackled is seen as an example to follow and has increased the will of different stakeholders to increase investment in ESG practices leading to a greener, fairer, and more equal society.



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