

ESG In Contract: Ensuring Sustainability Through Legal Framework

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Environmental, Social, and Governance (ESG) considerations are increasingly shaping the way businesses operate, invest, and manage risk. What began as a framework for voluntary corporate responsibility is now embedded into regulatory regimes, investment criteria, and stakeholder expectations. Contracts are emerging as a critical mechanism for companies to implement ESG commitments – whether in supply chains, joint ventures, service arrangements, or transactions. In fact, ESG-related commitments and obligations may also be included in certain tenancy agreements (for example, obligations to maintain “green building” statuses) and financing contracts (for example, where sustainable financing is concerned).

As regulatory and investor scrutiny intensifies and reputational stakes grow, ESG contracting is no longer just good practice; it is fast becoming a business imperative. This article explores how ESG considerations are being incorporated into commercial and M&A contracts, the key legal issues involved, and practical recommendations for legal professionals navigating this evolving landscape.

Common Themes And Trends For ESG Clauses

Environmental

Environmental clauses are increasingly common in contracts involving manufacturing, logistics, and infrastructure. Parties may commit to reducing greenhouse gas emissions, adopting energy-efficient technologies, using sustainably sourced materials, or aligning with science-based climate targets. These provisions may reference third-party standards (e.g., ISO 14001) or require suppliers to obtain sustainability certifications. In some cases, climate-related performance metrics are embedded into key performance indicators (KPIs) or pricing formulas.

Social

The "S" in ESG often centres on labour practices, diversity and human rights. Commercial contracts may include requirements for fair wages, safe working conditions, anti-discrimination measures, and respect for collective bargaining rights. In cross-border supply chains, human rights due diligence clauses are gaining traction, particularly in light of legislation such as the UK and Australian Modern Slavery Acts and the EU Corporate Sustainability Due Diligence Directive (modelled after the German Supply Chain Due Diligence Act). These are usually supported by audit rights, training obligations and remedies such as grievance and termination procedures and rights.

Governance & Compliance

Governance-related clauses typically address anti-corruption, transparency and ethical business conduct. It is now common for contracts to include anti-bribery warranties, compliance with internal codes of conduct, whistleblower protections and obligations to report material ESG incidents.

Legal & Drafting Considerations

Contractual Certainty – A key challenge in ESG contracting is ensuring that clauses are precise and enforceable. Vague or aspirational language such as: *"the parties shall endeavour to reduce emissions"* may lack legal effect due to lack of clarity and provide little recourse in case of non-compliance as such wording would be difficult to enforce. Contracting parties should consider whether ESG commitments should be phrased as binding obligations or remain as guiding principles, depending on the commercial context and risk appetite of both parties.

Enforcement – Effective ESG clauses are often linked to measurable outcomes. This can include KPIs, audit mechanisms, third-party certifications and reporting obligations. Enforcement tools may include financial penalties for non-compliance, indemnities, or even termination rights. However, enforcement must be calibrated carefully to avoid overburdening counterparties or jeopardising commercial relationships. Parties should ensure that contractual obligations and enforcement are proportionate to the specific circumstances and standing of each party, in order to ensure contractual and business longevity.

Jurisdictional And Regulatory Considerations – ESG contracting is not uniform across different jurisdictions, especially between regions such as the EU and Asian or ASEAN jurisdictions, or even the EU and the United States of America. Regulatory developments in jurisdictions with generally higher contracting power (such as the EU Corporate Sustainability Due Diligence Directive) directly influence how ESG clauses should be framed in other jurisdictions wishing to maintain contracts with their EU counterparts.

Parties must consider the applicable laws in both home and host countries and ensure consistency with voluntary frameworks and best practices, but in such a manner that is proportionate, practical and appropriate to each contracting party's jurisdiction and local business customary practices. This issue directly relates to the “trickle-down” of ESG obligations throughout global supply chains, addressed directly below.

Trickle-Down Clauses in Supply Chains – To ensure ESG standards are met throughout the supply chain, companies—particularly those in jurisdictions with heavier ESG regulation such as the EU, United Kingdom, and Australia—increasingly require suppliers and subcontractors to “trickle down” or “flow down” relevant obligations. Such clauses may mandate compliance with specific ESG policies, provide audit rights against third parties, and impose remedies and indemnity for breaches. Parties should ensure these clauses are consistent, proportionate, and legally enforceable across jurisdictions.

ESG In M&A Contracts – ESG considerations are increasingly relevant in mergers and acquisitions. During due diligence, buyers are scrutinising ESG risk factors (such as including environmental liabilities, compliance history and supply chain exposure). In sale and purchase agreements (SPAs), ESG-specific warranties, covenants, and indemnities may be negotiated and incorporated. For example, sellers may be required to ensure and warrant compliance with environmental permits or modern slavery laws. ESG issues can also influence deal valuation, particularly where reputational risks or remediation costs are material. Post-completion, integration plans may include harmonising ESG policies and reporting systems of the buyer into the target.

Practical Recommendations For ESG Contracting

Contracting parties should ensure that ESG provisions in their agreements align with their internal policies and operational capabilities, as misalignment may lead to legal exposure or reputational harm. Further, it is important to ensure that ESG obligations in their agreements align with their capabilities and legal obligations to reduce the risk of issues with enforceability. Given the cross-functional nature of ESG, internal stakeholders within companies should collaborate closely across sustainability, procurement, compliance, and finance teams to ensure that commitments are practical and achievable (by the parties obliged to meet such commitments) and enforceable (by the parties imposing such commitments). Companies may wish to work with legal counsel to develop standardised ESG clause libraries and playbooks that can streamline the drafting process, with flexible options to reflect varying risk profiles that can be applied appropriately. It is equally important for companies to also monitor and review their ESG clauses and commitments in order to ensure compliance.

Companies looking to integrate ESG terms into their contracts should seek legal advice to ensure obligations are clearly drafted and tailored to the relevant legal and commercial context.

Conclusion

As ESG moves from policy to practice, contracts are becoming a key vehicle for embedding these compliance obligations. Whether in a services agreement, supply chain contract or M&A transaction, the integration of ESG clauses have become increasingly relevant, especially for cross-border contracts or where contracting parties are subject to external ESG compliance obligations due to their part in the global supply chain. For most companies, the challenge lies in balancing enforceability with flexibility and commercial viability – it is important to negotiate clauses that are commercially sensible and achievable, legally robust and adaptable to the relevant legal and regulatory obligations in the relevant jurisdictions.

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