

Environmental and Climate Due Diligence in M&A: A Strategy for Protecting Value

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For investors, the priority is clear: financial performance. That's why due diligence is a critical step in any M&A transaction. Traditionally centered on corporate and financial aspects, due diligence must now evolve to include environmental and climate risk assessments. In a market shaped by transparency and sustainability metrics, overlooking these factors can lead to the acquisition of depreciated or low-resilience assets, impacting expected returns.

Different Focus, Shared Purpose

Environmental and climate due diligence are often grouped together, but they serve distinct purposes and require separate approaches. Both are essential to making informed investment decisions and protecting long-term value.

Environmental due diligence should verify regulatory compliance (licenses, permits, authorizations, and enforcement history), identify environmental liabilities (such as contaminated sites and obligations for restoration or reforestation), assess potential conflicts with protected areas (including conservation units, Indigenous lands, and permanent preservation areas), and flag legal contingencies (like lawsuits and administrative investigations). These issues can result in substantial costs and even operational shutdowns.

Climate due diligence, on the other hand, must address two categories of risk. Physical risks, such as droughts, floods, wildfires, and rising sea levels, can disrupt supply chains and threaten business continuity. Transition risks stem from regulatory changes, carbon pricing, and shifts in market dynamics and consumer behavior. These factors influence competitiveness, capital costs, and investor access.

In short: environmental due diligence helps uncover hidden liabilities; climate due diligence helps avoid assets that may lose value over time.

Why Investors Can't Afford to Overlook Environmental and Climate Due Diligence

Regulatory momentum and market expectations are making environmental and climate analysis a non-negotiable part of M&A. In Brazil, the CVM has taken a pioneering step with Resolutions 193/2023, 217/2024, and 218/2024, which require companies to disclose environmental (S1) and climate-related

(S2) information¹ in line with ISSB standards.² At the international level, the European Union's Regulation on Deforestation-Free Products³ (EUDR) imposes strict traceability requirements, which directly impact various Brazilian export chains⁴.

Due diligence findings should be strategically incorporated into deal negotiations. Price adjustments can gauge the impact of identified liabilities; indemnity clauses and escrow mechanisms allocate risk clearly; and post-closing obligations guide mitigation and remediation efforts. These tools help preserve operational continuity and reduce the likelihood of future disputes.

Environmental liabilities can have immediate financial consequences. Remediation provisions and compliance obligations reduce operating income; fines and penalties squeeze margins; license suspensions and embargoes cut into revenue while fixed costs remain; and adaptation requirements can increase Capex and operating expenses. A heightened perception of risk also tends to drive up insurance and guarantee costs. Together, these factors erode EBITDA, trigger asset repricing, and affect the acquired company's valuation.

The consequences of environmental liabilities go beyond the balance sheet. Acquiring an asset with unresolved environmental issues – especially if misaligned with the transaction's strategic goals – can pose serious reputational risks. Those risks aren't confined to the target company: they can extend to parent entities, affiliates, and successors, increasing exposure across the entire corporate group.

In today's climate of heightened socio-environmental awareness, reputational damage can result in lost contracts, exclusion from ESG indices, and restricted access to capital, increasing the severity of the risk. Conversely, when the acquisition of environmentally challenged companies is part of a deliberate strategy, carrying out recovery plans can enhance reputation, improve sustainability metrics, and unlock additional economic value.

Informed Decisions, Protected Value

The strategic upside is clear: better-informed investment decisions aligned with shareholder expectations; value protection through the identification and mitigation of hidden liabilities and climate risks; and stronger access to green capital, with increased credibility for labeled issuances (green, sustainability-linked) and attracting investment by impact-driven funds.

Integrating environmental and climate considerations from the outset of a transaction isn't a cost – it's a safeguard. This approach reduces uncertainty, protects pricing, and ensures long-term asset resilience, supported by auditable evidence and contractual mechanisms that guarantee the execution of mitigation plans.

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NOTES

1. For fiscal years starting January 1, 2016.
2. See .
3. See .
4. Production chains for the following commodities: beef; cocoa, including chocolate and its derivatives; coffee; palm oil; rubber, including tires; soybeans; and firewood and charcoal.

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