The Green Promise – Contract Law and Sustainable Purpose Bonds*

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In order to mitigate climate change, monumental investments are required in the transformation into a sustainable economy. The financial markets play a crucial role in funding the necessary investments in new technology and infrastructure.[1] This entails, among other things, an increased focus on the potential of green loans and bonds. A green loan or bond is a debt instrument where the borrower undertakes to apply the borrowed money for environmentally beneficial purposes. But how should one understand that "green" element of a bond in a Swedish contract law context? There is no prevailing view today of what happens if a borrower fails to apply the borrowed funds for green purposes, or if its green activities turn out to be unsuccessful.

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[1] Notable Swedish examples of institutions active in this field are the Center for Sustainable Finance (https://www.sei-international.org/-news-archive/3827) and the SSE Mistra Center for Sustainable Markets (https://www.hhs.se/en/research/institutes/misum-start-page/).

For an overview of efforts on an EU level, see:

- "Defining Green in the context of Green Finance" at https://publications.europa.eu/en/publication-detail/-/publication/0d44530d–d972-11e7-a506-01aa75ed71a1/language-en.
- Basic information on the Capital Markets Union at https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union_en.
- The Final Report of the High Level Expert Group on Sustainable Finance at https://ec.europa.eu/info/publications/180131-sustainable-finance-report_en (referred to in this paper as the "HLG Final Report").
- Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions Action Plan: Financing Sustainable Growth (COM/2018/097 final) (referred to here as the "**EU Action Plan**").

1. Background

This paper will discuss how to establish what constitutes the agreement and the nature of green promises between issuers and investors of green bonds. As we shall see, the green bond exists in a regulatory setting that has developed without envisaging this particular kind of instrument. While a traditional bond finances general purposes of a borrower, a green bond is issued specifically to finance environmental investments, such as projects to lower the carbon footprint of buildings.[2]

My purpose with this paper is to contribute to shedding light on a somewhat overlooked aspect of the green finance universe. In doing this, I hope to spark further discussion on a question of principal importance for the wider idea of the debt capital markets as a force for the common good: What would be the best legal structure for debt instruments that are intended to promote a certain societal purpose?

To this end, I will provide a Swedish legal context for the green bond phenomenon and begin to lay out a tentative methodological path from a contract law perspective. The contractual model for borrowing that is currently dominant within green finance in Sweden will be the starting point for analysis.

The first green bond was issued by the European Investment Bank in 2007. Since then, the market has expanded continuously. In 2017, 162 billion U.S. dollars in green bonds (including those referred to as environmental or sustainable bonds) were issued, which was about double the volume of 2016. The issuance for 2018 has been estimated at 167 billion U.S. dollars.[3] In Sweden, 30 % of bond issuers that filed base prospectuses in 2017 and 2018 had included the possibility of issuing green bonds.[4] In addition, four prospectuses were published in 2018 relating to stand alone issuances of green bonds. Although this may seem hopeful, "*Europe has to close a yearly investment gap of almost EUR 180 billion to achieve EU climate and energy targets by 2030*."[5]

2 The Swedish government inquiry SOU 2017:115 (*Att främja gröna obligationer*) provides a thorough account of the green bond market, but it does not address the contractual properties of a green promise. Nor do the HLG Final Report or the EU Action Plan.

3 The amounts refer to bonds that are aligned with the Climate Bond Initiative ("**CBI**") definitions and as calculated by the CBI: https://www.climatebonds.net/.

4 As published on www.fi.se/prospektregistret. This does not include municipalities or other entities that are exempt from the obligation to publish a prospectus.

5 EU Action Plan p. 2.

The market for green bonds has developed on a self-regulatory basis through initiatives such as the Green Bond Principles ("**GBP**")[6] and the Climate Bond Initiative ("**CBI**")[7]. Ancillary services have arisen to support the market, such as third-party certifiers.[8] The GBP, the CBI and the emerging new EU Green Bond Standards[9], all contain ambitious guidelines in terms of green project eligibility criteria, use of proceeds and reporting. They all however remain silent on the lawyer's first question: What happens if, after an issuance of a bond that is classified as green, the green criteria are not complied with? What should be deemed to have been part of the actual agreement with investors, and why?[10]

More clarity in this area would presumably mitigate the risk of obstructing the development of a sustainable economy due to the lack of a coherent legal foundation. Risks include reputational damage to issuers and investors, consumers that are let down by a promise to invest "green" and adverse effects on the environment due to the bankruptcy of an issuer of green bonds. Political resolve and economic incentives are necessary but not sufficient to support the transformation into sustainable financial markets. Market participants must also have practical tools such as sufficiently adequate documentation in order to efficiently issue and invest in green loans.[11]

6 The Green Bond Principles 2018 are available at https://www.icmagroup.org/green-social-and-sustainability-bonds/green-bond-principles-gbp/. Please be aware that the standards are regularly updated, and new versions may be available at the time this paper is printed.

7 The Climate Bond Initiative standard for green bonds can be found at https://www.climatebonds.net/files/files/Climate%20Bonds%20Standard%20v2_1%20-%20January_2017.pdf. Please be aware that the standards are regularly updated, and new versions may be available at the time this paper is printed.

8 SOU 2017:115 Chapter 5 contains an account of the use of third-party certifiers.

9 EU Action Plan p. 2. The technical expert group appointed in accordance with such action plan will be tasked with, among other things, specifying standards for instruments that will be labelled as "EU Green Bonds".

10 Examples of questions of this nature are found in e.g. Green Bonds: Mobilising the debt capital markets for a low carbon transition (OECD 2015) (found at https://www.oecd.org/enviroment/cc/Green%20bonds%20PP%20[f3]%20[lr].pdf) p. 11. Also see "Greening the Financial System" by Clifford Chance LLP (http://www.cliffordchance.com/content/cliffordchance/briefings/2017/11/greening_the_financialsystem.html) p. 33.

11 As the Swedish Financial Supervisory Authority points out in its mandatory opinion on SOU 2017:115 (Fi2018/00116) (p. 3) (my translation): "*It is pressing to ensure that a green bond lives up to the expectations given to investors. Such actions contribute to ensuring trust in the market and improve the prospects for green bonds contributing to a sustainable development.*"

2. Introduction to Green Finance

2.1 Market background

The financial markets are divided into segments for different types of investments. This paper only deals with what is referred to as the *debt capital markets*[12], hence excluding investments in the equity of a company (such as shares). On the debt capital markets, companies can obtain funds by entering into loan agreements with lenders or by issuing a variety of debt instruments.

Green finance in the context of the debt capital markets can be described as dealing with loans with an environmentally beneficial purpose. Within the concept of *sustainable* finance, which is a wider term, one also finds other types of designated purpose financing.[13] A borrower that promises to use the borrowed funds towards an objective that is defined as "*green*", attracts investors that wish to allocate funds in a way that allows them, in their turn, to label their investments as green.[14]

Transactions involving green bonds implicate a number of stakeholders and relationships, giving rise to an array of legal questions, for example relating to fiduciary duties, capital adequacy regimes, and the liability of an issuer's board of directors, brokers or dealers in case of misleading information.[15] The focus of this paper however is on the relationship between the issuer (borrower) and the investor (lender).

Although there is no generally accepted definition of a "green" bond, common features include an independent verification of the use of proceeds and a report on environmental effects.[16] Under the GBP and the CBI there are four main techniques of achieving this. The type most commonly used in Sweden is a standard recourse-to-the-issuer debt obligation where the pro-

[12] See (in Swedish) Riksbanken: Den svenska finansmarknaden 2016 p. 15.

[13] Green Bond Principles (GBP) p. 1 and SOU 2017:115 p. 137.

[14] For example, http://ir.folksam.se/2017/02/20/film-folksamgruppens-investeringar-i-grona-obligationer/.

[15] Information to investors will typically be subject to the prospectus rules (see in particular the Financial Instruments Trading Act (*Sw*: *lag (1998:880 om handel med finansiella instrument*) Chapter 2 Section 32 and the Swedish Companies Act (*Sw: Aktiebolagslag (2005:115))* Chapter 29 Section 1 in relaton to the liability of the board). Arrangers/resellers of bonds are subject to MiFID II (Directive 2014/65/EU), the Financial Markets Act (*Sw: lag (2007:528) om värdepappersmarknaden*), and MAR (Regulation (EU) No 596/2014).

[16] See the GBP, the CBI and http://business.nasdaq.com/list/listing-options/European-Markets/nordic-fixed-income/sustainable-bonds.

ceeds are earmarked for green purposes, meaning that the creditors have a claim on the issuer and against the same assets as any pari passu creditor.[17]

In addition to raising a green loan in the form of a bond, a borrower may obtain financing for environmentally beneficial purposes directly from one or more banks[18] (or from potential other sources that have not yet, but may well in the future become important, such as crowd funding[19]). Although there is significant interconnectivity between the two, given the different dynamics of the bank loan and bond markets, I will discuss an approach to the agreement between issuer and investor in the context of a bond only.

There is always a risk that a borrower fails in its business endeavors – whether green or not – and is unable to repay its debts as they fall due. The likelihood of economic failure is at the heart of any loan arrangement and greatly impacts the assessment and pricing of risk.[20] Green bonds are not (yet) generally considered to be different from other debt obligations from a risk perspective and cannot, with any general application, be said to fetch more attractive interest rates for issuers.[21] One of the great areas of develop-

[17] Based on a review of listed bonds at fi.se/prospektregistret and SOU 2017:115 pp. 170–171. The term "pari passu" is commonly used to describe that one creditor is ranked (in the bankruptcy of the debtor) the same as all other unsecured and unsubordinated creditors against the same debtor.

[18] Non-financial corporations within the EU are mainly financed by bank loans, which account for 82 % of their debt funding. See Towards a Green Finance Framework, report by the European Banking Federation (28 September 2017), p. 7.

[19] Crowdfunding is commonly understood as a way of financing projects or companies through many smaller contributions. The phenomenon is not subject to targeted regulation in Sweden.

[20] "Understanding Ratings" p. 2:"*Credit ratings are opinions about credit risk. /…/about the ability and willingness of an issuer, such as a corporation or state or city government, to meet its financial obligations in full and on time.*" Credit rating agencies are regulated on an EU level through Regulation (EC) No 1060/2009.

[21] SOU 117:115 p. 42: "*A problem with the most common form of green bond is that it is not, from a risk perspective, different from a traditional bond./…/ This is due to the fact that both instruments are exposed to the risk in the same assets on the issuer's balance sheet.*" (my translation). For two market perspectives, see CBI report from Q4 2017 "Green Bond Pricing in the Primary Market" at https://www.climatebonds.net/files/reports/greenium_q4-07b.pdf and https://www.ft.com/content/49fdf388-7910-11e8-bc55-50daf11b720d (French Green Debt fetches a premium from investors") 26 June 2018. The Swedish Bankers' Association (*Sw: Bankföreningen*) on p. 2 of its mandatory opinion on SOU 117:115 states that (my translation) "*Since interest rates have been politically steered to levels that render a fair pricing of risk impossible, diversification between green and other risk cannot be realized at this time*." The opinion can be found at: https://www.swedishbankers.se/media/3772/f180427y.pdf. However, support exists for an effect on pricing on the U.S. market: Baker, Bergstresser, Serafeim and Wurgler: Financing the Response to Cli-

ment and research internationally is therefore how to properly assess the cost of unsustainable investments and to thereby enable the financial markets to work in a sustainable direction.[22]

2.2 Introduction to the documentation of green bonds in Sweden

A bond in this context is a debt instrument (Sw: *obligation*). In our scenario it is a publicly traded security in book-entry form registered pursuant to the Swedish Financial Instruments Accounts Act[23]. Bond investors will typically be financial institutions, insurance companies and funds. Bonds that are offered to the public or admitted to trading on a regulated market in Sweden are subject to the publication of an information document called "prospectus", which is reviewed and approved by the Swedish Financial Supervisory Authority (the "SFSA") (Sw: *Finansinspektionen*).[24]

The easiest way to grasp the typical documentation for a green bond is probably to look at examples from Swedish issuers.[25] I will nevertheless provide an account of the main contents of such documentation – and where to find the green elements – in the following paragraphs.

The terms and conditions of a bond will contain, *inter alia*, provisions on repayment, interest rate, undertakings of the issuer and early termination rights (defaults). Such terms and conditions are produced by the issuer and its advisors and are accepted by investors upon subscription or purchase of

mate Change: The Pricing and Ownership of U.S. Bonds (Brookings 2018), available at: https://www.brookings.edu/wp-content/uploads/2018/07/Wurgler-J.-et-al.pdf.

[22] Of immediate interest is Moody's research methodology for green bonds (https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_188333), the SFSA on p. 6 of its mandatory opinion on SOU 2017:115 and "The Green Bond Markets in the Nordics 2018", prepared by the CBI and commissioned by Svenska Handelsbanken AB (publ) (https://www.climatebonds.net/resources/reports/green-bond-market-nordics) at p. 7 on the integration of sustainability criteria into the investment decisions made by e.g. the Swedish state owned pension funds.

[23] *Sw*: Lag (1998:1479) om värdepapperscentraler och kontoföring av finansiella instrument.

[24] The Financial Instruments Trading Act Chapter 2 (implementing the relevant EU directives) and Regulation (EU) 2017/1129. EU Regulations are directly applicable in Sweden (Article 288, (2012) OJ C326/47 (Treaty on the Functioning of the European Union)). There are certain exceptions to the requirement to publish a prospectus, where for example Swedish counties and municipalities are exempt.

[25] For a recent summary of all Nordic issuers of green bonds, see "The Green Bond Markets in the Nordics 2018", prepared by the CBI and commissioned by Svenska Handelsbanken AB (publ) (https://www.climatebonds.net/resources/reports/green-bond-market-nordics). Issuers publish their prospectuses (including terms and conditions) and green frameworks on their websites.

a bond. Swedish companies have a history of issuing green bonds either in stand-alone issues (where a single loan is issued under one set of bond documentation) or under base prospectuses for the continuous issuance of medium-term notes ("MTN")[26]. This has predominantly been achieved by amending three parts of a standard MTN documentation, listed as (i) – (iii) in the following paragraph.

In order to identify a bond as green one would expect to find:

i. in the section on risk factors included in an issuer's prospectus, warnings about the green elements of a bond not satisfying all investors' expectations and not being enforceable;
ii. sometimes, a reference to the green promise in the general terms and conditions of a loan, stating that a breach against the green criteria or framework does not give rise to a default under its "breach of other obligations" clause (a default is a circumstance that will, unless remedied, give rise to a right for the investors or their agent to declare the loan due and payable prior to its maturity); and
iii. in the form of final terms for each loan, an option to include a reference to a green framework or green projects under the heading "use of proceeds".

Whereas the drafting in (i) and (ii) above opens up the document to enable (but not compel) the issuance of bonds that are classified as green, the election in (iii) is what makes a green bond come to life. Sample wordings from two Swedish issuers to illustrate said sections of the bond documentation has been included in a schedule at the end of this paper.

In addition – but outside of the actual bond documentation – the issuer and arrangers of a bond will refer to the greenness for marketing purposes and there will have been an effort made to publish a green framework satisfying the requirements of either the GBP or the CBI.

[26] Chapter 2 Section 13 and 16 of the Financial Instruments Trading Act. "MTN" or Medium Term Notes are understood as debt securities with a maturity between 1 and 15 years. Reasons for *not* providing for the issue of green bonds within one's debt program include that green projects are financed through other means, or that one's line of business is not suited for the relevant kinds of investments.

2.3 General comments on the documentation of green bonds in Sweden

The terms and conditions of bonds issued under a Swedish base prospectus for an MTN program are highly standardized and follow an established practice since at least the 1990s. But the concept of inserting a sustainable purpose and designated use of proceeds into the MTN documentation is new. Statements regarding the purpose of a loan or use of proceeds in accordance with a green framework published by an issuer is referred to herein as the "green promise".[27]

A review of the terms and conditions under which green bonds have been issued on the Swedish market to date displays that although most of them follow the basic outline set out above, not only are they different in what the green promise contains. They are also on the face of it different in respect of what kinds of non-compliance would (or would explicitly not) give investors a right to demand early repayment of their loans.[28] Possible failures by an issuer would include not applying the borrowed funds towards green projects but for general corporate purposes[29], failing to report on investments in accordance with the green framework, or failing to achieve the expected green results.

To clarify, green bonds may very well incorporate a stronger protection on the use of proceeds than in our current examples. By including features

[27] SOU 2017:115 p. 248 assumes (without elaborating) that the green promise is to be understood as an undertaking: *"On the issue of green bonds, the issuer undertakes to invest the capital obtained in an environmentally and climate sustainable manner.*" Further, on p. 376: "*It follows from the agreement /…/ that the funds are applied towards investments that are specified in the issuer's framework for green bonds*" (my translations).

[28] Available at www.fi.se/prospektregistret. Swedish issuers have also issued green bonds under their EMTN programs (for the euro market) and municipalities and counties that have issued green bonds (and are not required to issue prospectuses) do so on the back of information materials.

[29] "*Many European green bond issues allot a certain portion of the proceeds, typically between 1% and 5%, to cover transaction expenses. Certain green bonds will allot a specific portion of the proceeds to "cash on the balance sheet" or "general corporate purposes"; again, typically not more than 5%.*" Franklin, Davies, Green, Lione, and Irvine: Green Bonds; Financing a Sustainable Future, PLC Magazine July 2017, p. 21. Differently described for the U.S. Market in Baker, Bergstresser, Serafeim and Wurgler: Financing the Response to Climate Change: The Pricing and Ownership of U.S. Bonds (Brookings 2018) p. 7. A case that has been discussed in the market is that of the Syracuse Industrial Development Agency green bonds where funds were not in fact applied towards the indicated green projects (see https://www.climatebonds.net/2015/05/reflections-legal-issues-associated-green-bonds-reflection-climate-bonds-senior-fellow).

such as a truly segregated account and/or security in favor of investors, the contractual set-up can relieve the issuer of effective control over the green bond proceeds and hence the opportunity to use funds in breach of the green framework. Such solutions remove some of the legal uncertainty surrounding the green promise but on the other hand impose the burden of additional restrictions and administration costs on the issuer.

3. An investigation into the nature and limits of the green promise

What then is a green bond when viewed from a contract law perspective? The green promise must mean *something*, since a green bond is not fungible with other notes should they be issued with otherwise identical properties.[30] Let us therefore take a typical case for building, brick by brick, a method of establishing the contents of the agreement between the issuer of a green bond and each of its investors. More specifically, to consider how to determine the enforceability of an issuer's green promise to the investor. By enforceability, I mean that the promise is of such import that a breach thereof will grant the investor a right to early repayment and that actions taken by the investor on the basis of such breach would hold up in the bankruptcy of the issuer.[31]

Since the use of debt instruments to promote the common good is an emerging field, authoritative legal resources[32] are scarce. No legal precedents or writings of any authority in Sweden can be invoked to clearly support a

[30] As explicitly stated in the Informal Supplementary Document on Green Bonds to Key Recommendation No 5 in the HLG Final Report: (p. 2) "*It is important to note that EU Green Bonds should not be considered fungible with bonds that do not meet the definition of an EU Green Bond and are not aligned with the four core components of the EU Green Bond Standard.*"

[31] A distinction must be made between the typical sanctions under e.g. a purchase contract, and the relevant sanctions under a loan. For the latter, the focus of the parties is on the right for the investor to demand early repayment. This does not exclude the theoretical possibility of other sanctions such as damages, but they fall outside of the scope of this paper. For privately negotiated green loan agreements, some parties have included a mechanism where a breach of the green promise will trigger a higher interest rate for the borrower, instead of making such breach grounds for premature termination. Such mechanism and its moral hazard implications would make an interesting topic for another paper.

[32] By authoritative legal resources, I mean laws and their preparatory works, supreme court precedents and to the extent available legal doctrine (scholarly works of high standing). For an outline of the sources of Swedish law, see pp. 108–112, Bert Lehrberg, Praktisk Juridisk Metod, 10 ed., Iusté (2018).

theoretical approach to the agreement between issuer and investor. As with other contracts, the contents will depend on individual circumstances and the drafting in each case. Rather than employing the full palette of factors that may be relevant for contract interpretation at once, we shall attempt to discuss such factors or principles if and when their evoking circumstances appear.

3.1 The base case

Starting out, an issuer has borrowed money from an investor and issued a negotiable promissory note to evidence that loan. The provisions of a unilaterally issued promissory note require contract law principles to be applied to determine their meaning. We shall treat the written provisions before us as the starting point for finding out what has been agreed regarding the scope of the issuer's undertakings and any conditions for early repayment.[33] From that position, we move on to determine the common intention of the parties, if there is one.[34]

3.2 Adding the promise to apply funds for a specified purpose

Imagine then that the issuer has included a typical green bond purpose clause in its promissory note, saying "the proceeds of the loan will be used in accordance with my Green Framework". First, let us consider the possibility of finding generally held perceptions or views of such provisions in the market

[33] As Joel Samuelsson points out in "Avtalsrätt efter historiens slut", inaugural lecture at Uppsala Universitet, Juridisk Tidskrift 2016–17 no 3 p. 646, even though a subjective approach comes first according to generally accepted principles for contract interpretation, we turn to the written terms when we first look for the intention of the parties. Bert Lehrberg in Avtalstolkning (7 ed.), Iusté (2016) navigates by moving from a party oriented (or subjective) approach, to a content oriented (or objective) one.

[34] See (i) von Bar, Christian & Clive, Eric (ed.), Principles. Definitions and Model Rules of European Private Law, Draft Common Frame of Reference (DCFR), Full Edition, 2009 8:101-9:109; and (ii) Lando, Ole and others (ed.), Restatement of Nordic Contract Law, 1 st. edition (2016) § 5-1 on the common intention of the parties as the paramount factor for determining the contents of an agreement. Interesting precedents include NJA 2007 s. 35, NJA 1999 s. 35, NJA 1992 s. 403 and NJA 1990 s. 24. Notable cases for the court's reasoning where loan agreements are concerned are NJA 1997 s. 382 (Wasa Kredit), NJA 2005 s. 142 (interest adjustment in leasing contract), HD 2016:10 (Finnish case on interest adjustment) and NJA 2010 s. 467 (transfer of negotiable promissory note).

that may support the quest for a common intention, and/or become a tool for interpretation if they are found to signify established trade practices.[35]

As mentioned, issuers of green bonds have not generally been rewarded with lower interest rates. This may support the idea that a certain issuer has not intended to accept additional documentary restrictions. To ensure that there can be no "green breach" is perceived by some as a way of mitigating the issuer's risk of triggering a cross default[36] under its other financial obligations. The issuer's references to a green framework, although semantically in the form of undertakings – expressing that funds "shall" or "must only" be used towards a green purpose – should arguably then be treated like other policies that do not impose binding obligations upon which counterparties are expected to rely.[37]

The absence of an enforceable green promise could also be argued to be in line with the GBP.[38] Further, for companies that depend on the capital markets for their financing, the damage inflicted on their reputation in case of a failure to deliver on a green promise could hurt the prospects for refinancing. Some institutions appear to take the view that such deterrent

[35] The Swedish Sale of Goods Act (1990:931) (*Sw: Köplagen*), Section 3, provides an important basis for where to look for the agreed terms between commercial parties (stating that the provisions of the law apply unless otherwise follows from the agreement, from practices formed between the parties, or from customs or trade practices that must be considered binding upon the parties (my translation)). A similar provision is found in the Contracts Act (1915:518) (*Sw: Avtalslagen*) Chapter 1, Section 1, 2nd paragraph. One would I believe based on the immaturity, disparity and international character of the market for green bonds, encounter difficulties in identifying customs or trade practices to be implied in the agreement.

[36] A "cross default" is a standard provision in financing agreements, stating that if the borrower breaches its other major financing agreements, the creditors under that particular agreement where the cross default is included are also entitled to demand early repayment of their loans.

[37] For an interesting parallel, see the discussion "CSR-villkor och avtalsrättsliga normer, Bidrag till Nordiskt Juristmöte 2014" by Christina Ramberg. In Juridisk Tidskrift Nr 2 2017/18 p. 321 (Corporate Social Responsibility – en marknadsrättslig fråga?), Hajo Michael Holtz discusses among other things to what extent a company's corporate social responsibility (CSR) policies can become binding through the application of marketing law. CSR as a concept or tool is not part of this discourse.

[38] GBP p. 29 and its Q&A take the view that it will not be grounds for early repayment if an issuer does not follow the GBP recommendations. For Anglo-Saxon perspectives on the enforceability of green promises, see Latham & Watkins in PLC Magazine July 2017 (Aaron Franklin, Paul Davies, Michael Green, Francesco Lione, and Lee Irvine: Green Bonds; Financing a Sustainable Future) p. 22 under the heading "Green Promises" and White & Case at https://www.whitecase.com/publications/alert/green-loans-pave-way-green-clos-and-green-rmbs.

renders formal contractual remedies redundant. The importance of goodwill could also entail that an issuer in breach of its green promise would volunteer to repurchase the bonds from investors, leading to the same result as if there had been an actual right to early repayment.

Two caveats are in order when thus referring to opinions or perceptions at the time of drafting the relevant bond terms. First, an experience of consensus in a healthy market may well be replaced by disagreement in a financial downturn, with investors looking for ways to recover as much as possible from any feasible source. This would not alter retroactively the views held by the parties at the time of drafting, however it would presumably complicate any evidence on the subject. The second caveat is in relation to the approach to the market as being adequately and sufficiently responsive to reputational risk. This may be true for early entrants, being large companies that are either listed on a regulated stock exchange or state owned. But as the market for green bonds expands, lesser companies will enter and for them, reputation does not hold the same significance.

Abandoning (for now) the quest for a common understanding of the green promise among market participants, we move on to consider how to view the reference to a framework that the issuer generally undertakes to comply with. Is a set of rules referred to in the terms and conditions of a bond (i) *part of the agreement* between issuer and investor; or (ii) *supporting facts* to inform an interpretation of the agreement? The answer to this question may significantly affect our conclusion on the scope of the green promise. Sources that address the incorporation of standard terms and other contents from outside the core text of an agreement are of particular interest here.[39] Given however that a green framework is not standard terms as such, any argument solely based on existing precedents and doctrine would not be a silver bullet.

Noting that the document is drafted in English but is governed by Swedish law, we must also deal with the relationship between (in particular) Anglo-Saxon concepts and Swedish contract law.[40] The Nordic debt capital

[39] Such as NJA 1993 s. 436 regarding (among other things) the role of a preamble and NJA 2011 s. 600 on incorporation of standard terms in relation to a consumer. Swedish contract law is thought to allow the incorporation of standard terms by reference, unless the terms are surprising or unreasonably burdensome (Axel Adlercreutz & Lars Gorton, Avtalsrätt II, 2010, Chapter 8.5.3; Jan Ramberg & Christina Ramberg, Allmän avtalsrätt, 2014, Chapter 8.3).

[40] As discussed in e.g. Christina Ramberg: Mot en gemensam europeisk civillagstiftning,

markets are heavily influenced by the London market. Under English law, not only does a purpose clause typically give the lenders a right to demand repayment if money is applied towards an unpermitted purpose. It may also give rise to a "quistclose trust", ensuring the lenders a right to their funds back from the bankruptcy estate of the borrower.[41] What, if anything, can the English law implications of a use of proceeds clause tell us about the intended or reasonable meaning of that clause when inserted into Swedish law terms and conditions?

As you will remember, the brief statement in the final terms of a loan that the use of proceeds will be in accordance with the issuer's green framework will be qualified by what is going on elsewhere in the bond documentation. In this phase of our analyses, we look at the default provisions in the general terms and conditions for guidance on how to understand the green promise. The general terms and the final terms of a bond are to be read as one single agreement, but the lack of consistent drafting will ensure that both sides in an argument about enforceability will have plenty of ammunition. The supreme court's reasoning in NJA 1998 s. 364 and NJA 2015 s. 741 could support a type of contextual argument about one provision (in our case the green promise) lacking meaning unless a certain other provision (in our case a sanction for breaches against the green promise) is also found to have been agreed.[42]

Where, as may well be the case, the green bond provides limited scope for finding a common intention of the parties, one may try turning to an objective approach, focusing on the language of the documents as it would be understood by a reasonable person. However, a strictly literal approach to interpretation would not in my opinion be suitable, since the market is immature and no widely accepted standard wording has been established. Instead, in each of the instances where the greenness of a bond is addressed, issuers and their advisors have chosen slightly different words.

Svensk Juristtidning 2004 p. 459 and Lars Gorton: Globalization and the Law Related to Credit and Finance – some Remarks, Scandinavian Studies in Law, Volume 57, 2012.

41 The quistclose trust is a principle under English law that is derived from the decision in *Barclays Bank Ltd v Quistclose Investments* [1970] AC 567. Funds that were lent for a specific purpose were found to give rise to a trust for that purpose and did not become part of the borrower's estate. A "trust" is a common law concept somewhat similar to a Swedish foundation "*stiftelse*" but not a legal person. Sweden has not ratified the (Hague) Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition.

42 The reasoning in NJA 2014 s. 960 also demonstrates the contextual or system-oriented argument.

In addition to going through the elements of both a subjective (or party oriented) and objective (content/language oriented) approach, and having failed to find any reliable customs or trade practices, one might evaluate the merits of enforceability of the green promise in light of the purpose of the agreement.[43] One purpose of the green bond could be to ensure that money is directed to environmentally sustainable projects, and hence the realisation of that purpose should be a paramount factor in evaluating the merits of any interpretation. Another purpose might however be for the issuer to be able to borrow money on good terms while the investor obtains an attractive investment, which can all be achieved by labelling the bond as "green". If both purposes exist simultaneously (and interdependently), and point to different interpretations of the agreement, which carries the most weight?

A related question is whether a court considering the nature of the green promise would openly consider the potential societal consequences of a certain solution, and in particular if the courts could and should expand their consideration of policy objectives in commercial disputes to include environmental sustainability (in addition to more established policy objectives such as legal certainty, foreseeability, creditor protection and economic efficiency).[44]

In summary: By adding the green "purpose of the loan" element to our promissory note, we have introduced six main groups of contract law considerations. First, whether there are solid perceptions in the market on the meaning of the green promise. Second, the effect of referencing a document external to the contract itself such as a "green framework". Third, the problem of inserting, into a Swedish law document, phrases in the English language that bear a certain significance in their jurisdiction of origin. Fourth, the contextual argument, i.e. the consequences of the purpose clause when read in conjunction with default provisions and other parts of the agreement. Fifth, we have investigated the merits (or lack thereof) of an objective or language-oriented approach. Finally, we might look for guidance based on

[43] See 1995 Principles of European Contract Law (PECL) 5:102(c) and DCFR II-8:102(e). Also see NJA 2015 s. 741.

[44] Bert Lehrberg, Praktisk Juridisk Metod, (10 ed.), Iusté (2018), pp. 108–112. This is supported, I think, by the idea that we may want to distinguish between the historical explanation of a rule – the purposes expressed in connection with its creation – and the purposes upon which to base future decisions. Discussed by Jan Hellner at pp. 89–90 in Metodproblem i Rättsvetenskapen, Studier i Förmögenhetsrätt (2001) (Elanders Gotab).

the purpose of the agreement and as a related matter started to consider what policy objectives might be invoked to support our proposed solution.

3.3 Introducing the element of issuance to several investors

Adding the next brick to our construction, we divide the promissory note into several bonds in book-entry form, held by multiple investors. Before continuing on the path of contract interpretation, I believe one cannot bypass the systematic question of the nature of a bond in book-entry form. Supposedly in the eyes of the law a unilaterally issued debt obligation, it is subject to elaborate terms and conditions, sometimes even (as in the case of the green bond) found in ancillary documents.[45] The systematic problem and matter of distinguishing the debt instrument from the "agreement" however deserves an entire discussion of its own.[46]

A green bond is documented by the issuer and its advisors, and its terms are not individually negotiated but explicitly accepted by each investor upon subscribing for or purchasing a bond. We must therefore approach the interpretation of the agreement differently than we would in relation to a loan agreement that has been subject to specific negotiations. This dynamic may prompt us to review precedents that deal specifically with the situation where terms are drafted by only one party and accepted by multiple recipients.[47]

As mentioned, even though a standard exists for terms and conditions for the issuance of MTN on the Swedish market, the insertion into such terms of a (green or any other) use of proceeds clause is new. The Swedish Securities Dealers Association has procured for the publication of model terms and conditions for high yield bonds (where "high yield" refers to issuers and loans

[45] For an introduction to the problem where mutual obligations or restrictions on rights of the creditors are involved, see Johanna Svartz' thesis at Juridiska Institutionen, Stockholms Universitet (2015): Intercreditoravtal vid förvärv av företagsobligationer – särskilt om bundenhet och tolkningen av 4 kap. 19 § LKF.

[46] One idea to try out could be to consider the consequences if the green bond would be seen primarily as an agreement to invest in and carry out green projects on behalf of the investors.

[47] Interesting cases include NJA 2015 s. 741, NJA 2015 s. 110 and NJA 2012 s. 3. Because (i) green bonds may (if subject to a retail issue) be held by smaller investors, (ii) green bonds make up at least some of the assets of the green pension funds that may be selected by private individuals, and (iii) there is ideological consanguinity between consumer and investor protection; the court's reasoning in these cases would not necessarily be inapt as guidance even where they involve the relationship between a corporate party and a consumer.

with typically higher risk and return than MTN) that customarily include a designated use of proceeds.[48] A breach against the promised use of proceeds under such terms will typically constitute an event of default unless remedied (if capable of remedy). In the high yield bond segment, the terms and conditions will often have been subject to bespoke negotiations although not every investor will have participated.

3.4 Adding a final layer of complexity: EU and the requirement to publish a prospectus

Our issuer is now required to publish a prospectus, the contents of which are determined by the prospectus rules and the practice and recommendations of ESMA[49] and the SFSA. The rules governing prospectuses impose restrictions on, among other things, what may and may not be disclosed in the final terms of a bond. To keep transaction costs down and issue green bonds under their regular MTN programs, issuers have included statements about the green promise and its limits in the informative sections of their prospectuses rather than in the actual terms and conditions.[50] We must therefore find a method for determining to what extent the details of an issuer's green promise, and/or a statement of non-enforceability of that promise in the prospectus, is part of the agreement.[51]

This question is not quite the same, albeit similar, to that concerning the effects of making a reference to the issuer's green framework in its "use of proceeds" purpose clause of the terms and conditions.[52] In the matter now at hand, we are dealing with descriptions of greenness *not* referred to in the actual terms and conditions but existing only in ancillary documentation. One may be allowed to assume that the issuer's choices when it comes to the sections on risk factors or "program overview" in a prospectus are largely motivated by the formal constraints of the EU prospectus regime in combi-

48 Available in English and found at http://www.fondhandlarna.se/regler-mm/obligations-villkor.

49 The European Securities and Markets Authority. The SFSA is heavily influenced by the guidelines of ESMA. The basis for this is Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority).

50 Please refer to the schedule to this paper for two different representative wordings.

51 See RH 1995:57 where the contents of a prospectus were considered in determining what had been agreed.

52 See footnote 39 above on references to ancillary documents and especially NJA 1998 s. 364, NJA 2014 s. 960 and NJA 2015 s. 741 re contextual arguments.

nation with practical considerations rather than being driven by a conscious drafting process.

The government bill leading up to the Swedish implementation of the Prospectus Directive states in a discussion on the private or public law nature of prospectus rules (my translation): the "*prospectus rules /…/ decide to a not insignificant extent the contents of the agreement.*" [53] Further, one might consider reasonable that the text of a prospectus, since it embodies the actual terms and conditions of a bond, is natural to include in what investors may trust to have been agreed.

On the other hand, considering the investor protection provided for by law, merging the full information of a prospectus into the "agreement" should not be necessary to ensure access to remedies for investors who have been *misinformed*. Should the descriptions of green bonds in the prospectus be deemed to be part of the agreement, that would give the SFSA in Sweden and the ESMA on an EU level an even greater influence over what may be agreed. The drafting of prospectuses would perhaps also become more challenging, making the issue of debt instruments for environmental purposes more expensive and cumbersome (when we should be making it easier and with lower transaction costs).

After having pondered whether other parts of a prospectus than the actual term and conditions can be part of the agreement, let us consider the impact of the regulatory context. The harmonization of investor protection and the practices of ESMA and the SFSA influence the *format* of the green bond terms to a considerable degree. At the same time, neither the legislative history of the prospectus rules[54] nor the commentaries and guidelines issued by ESMA[55] or the SFSA[56] prescribe that a different approach should be taken to determining the contents of the agreement between issuer and investor, than that applied in each jurisdiction to agreements generally. The rules for contract interpretation are not within the scope of the relevant EU law as such,

[53] Prop. 2004/05:158 p. 60, referring to and concurring with the committee in SOU 1997:22 p. 223. Note the lack of distinction between the equity capital markets and debt capital markets for purposes of the prospectus rules.

[54] In particular see prop. 2011/12:129, and the documentation contained in the EU Legislative Train which is available at http://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-financial-services/file-prospectus-regulation.

[55] See https://www.esma.europa.eu/regulation/corporate-disclosure/prospectus.

[56] The SFSA guidance can be found at: http://fi.se/sv/marknad/vagledning/granskning-av-prospekt/.

even if the contract exists in an EU regulatory context. If that assumption holds, we may encounter certain concerns of imbalance with the results of EU legislation providing for a different contractual outcome in each jurisdiction.[57] And regardless of there not (yet) existing targeted EU legislation on the interpretation of green bond terms and conditions, the influence of the EU prospectus regime would perhaps warrant an argument that emphasizes the interests of transparency and efficiency of the capital markets put forward in the New Prospectus Regulation,[58]along with other policy objectives. The influence of EU law has destabilized, if you will, our national contract interpretation by adding other considerations than those traditionally invoked in a commercial law context.[59] Needless to say, the international features of the debt capital markets and the constant interplay between its participants will also continuously influence the agreement for green bonds, however in more elusive ways.

In summary, there is some support for the point of view that the contents of a prospectus should be deemed part of the agreement. However, since the prospectus is a formally constrained document where the SFSA and ESMA preferences of the day influence the choice of words and their location in the document, I am prone to argue that the statements made in an issuer's prospectus should generally only be an aid in the interpretation of clauses in the actual terms and conditions of a bond and hence not be given an independent meaning. Finally, the influence of EU law on the terms of a bond through the prospectus regime provides for further policy considerations than would have been the case in a strictly national context.

[57] See Gunther Teubner, Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Differences (1998). Modern Law Review, Vol. 61, pp. 11–32. Also see Christina Ramberg, Mot en gemensam europeisk civillagstiftning, Svensk Juristtidning 2004 p. 460: (my translation) "*Sometimes the effect of implementation of an /EU/ directive is to produce more disharmony than prior to such implementation*."

[58] As expressed in Recital (7) of Regulation (EU) 2017/1129 (Prospectus Regulation): "*The aim of this Regulation is to ensure investor protection and market efficiency, while enhancing the internal market for capital*."

[59] To be clear, my references in the preceding sections to instruments such as DCFR and PECL are not an effect of the EU regulatory context discussed here. Rather it reflects that such projects have produced recognized albeit much discussed tools for national contract interpretation. See for example Jori Munukka, Svensk Obligationsrätt i det nya Europa in Svensk Juristtidning 100 år, Iustus Förlag (2016) pp. 87–99 and Transnational Contract Law Principles in Swedish Case Law – PICC, PECL and DCFR, Scandinavian Studies in Law (2012) Vol. 57, pp. 229–252.

4. Final remarks

Given the numerous initiatives promoting the emergence of sustainable capital markets, I believe that their contract law aspects deserve more attention. Since this is a relatively new field, practitioners scramble to put together the best possible documentation, often under tight timeframes. Regulators meanwhile press on to provide the right incentives but are not into the detail wherein, as we all know, the devil lies. With this paper, I hope to have prompted more scholars and practitioners to share their views on what a green promise really is and to what extent it is or should be enforceable.

SCHEDULE

Sample wordings from the legal documentation for two different issuers of green bonds on the Swedish MTN market.

Introductory remarks:

The below are two examples of drafting approaches existing at the time of this paper. Issuer No 1 (in the company of many others) has tried to ensure that a breach against its green framework should not give rise to a default or compensation to the investor. But what about a breach against the promise to *use the proceeds* according to the green framework in the first place? Issuer No 2 has settled for including a warning in its risk factors that a green loan "ceasing to be classified as green" will not give the investor the right to any remedies. But what about if the issuer fails to comply with its green framework?

The terms and conditions of a bond under an MTN program is constituted by general terms and conditions applicable to all loans, together with a set of final terms that apply to a particular loan. In most financing agreements, including bonds, there will be certain events that are designed to give the lender (i.e. the note – or bondholder in our case) a right to demand their money back prior to the scheduled maturity. These circumstances are typically listed as "events of default" in the general terms and conditions. They will include insolvency situations or for example the sale of all the assets of the issuer. They will also include one clause referred to as "breach of other obligations", which gives rise to an event of default in case the issuer breaches (and does not remedy) other provisions of the agreement than those explicitly listed. This is the provision which could, unless a sufficient carve-

out has been made, trigger termination rights for investors upon all kinds of green failures.

Excerpt from the mandatory section on risk factors in the Base Prospectus

Issuer No 1	**Issuer No 2**
Risks associated with Green Loans	**Risks associated with Green Loans**
What constitutes a Green Loan is determined by the criteria set out in the Issuer's Green Terms (as defined in the section Overview of the Programme below) /…/. The Issuer failing to fulfil the Green Terms in relation to a particular Loan will not constitute an event of default or termination event under the Loan, nor are Noteholders entitled to early redemption or repurchase of MTN or any other compensation.	What constitutes a Green Loan is determined by the criteria set out in the Issuer's Green Framework applicable from time to time (the "Green Framework") as in force at the date of a particular Loan. /…/ Noteholders are not entitled to repurchase or repayment of a Loan or to any other compensation, should a Loan cease to be classified as a Green Loan.

Excerpt from the section "Overview of the Program" in the Base Prospectus

Issuer No 1	**Issuer No 2**
Green Loans	**Use of Proceeds**
The Issuer may issue Green Loans under this MTN Program. In such case, the Issuer shall publish or have published a Green Loan Framework on its website setting out the terms and conditions applicable to that Green Loan (the "Green Terms"). In order for the Green Terms to apply to a Loan, the Final Terms of a Loan shall specify that it is a Green Loan. /…/ Failure by the Issuer to comply with the Green Terms for a particular Green Loan will not constitute and event of default or termination event under the Terms and Conditions, and will not give rise to any right to prepayment, early redemption or other compensation in such event.	The MTN program is a part of the Issuer's general debt financing, unless otherwise specified in the Final Terms of a particular Loan. The Issuer may issue MTN where the proceeds are used for specifically selected investments for the purpose of, in whole or in part, financing or refinancing of green projects specified in accordance with the Issuer's Green Framework. Such projects may include, but are not limited to, projects involving green energy initiatives (such as /…/) climate change projects and /or other infrastructure projects. Information on green projects and the terms for these will be described in the relevant Final Terms of a Loan and in the Green Framework.

Excerpt from the general terms and conditions included in the Base Prospectus:

Issuer No 1	**Issuer No 2**
Event of Default section (the "breach of other obligations")	**Event of Default section (the "breach of other obligations")**
The Agent shall /…/ declare in written form, the relevant Loan together with interest (if any) due for payment immediately or at the date determined by the Agent or Noteholders' Meeting (if applicable) if: /…/ (b) the Issuer does not fulfil its obligations in accordance with the Loan Terms relating to the relevant Loan, other than [those stated above in (a)] (and excluding its obligations under the Green Terms)…//.	The Agent shall /…/ declare in written form, the relevant Loan together with interest (if any) due for payment immediately or at the date determined by the Agent or Noteholders' Meeting (if applicable) if: /…/ (b) the Issuer does not fulfil its obligations in accordance with the Loan Terms relating to the relevant Loan, other than [those stated above in (a) /…/.

Excerpt from the form of final terms included in the Base Prospectus:

Issuer No 1	**Issuer No 2**
Form of final terms	**Form of final terms**
Green Loan: [Applicable/Not Applicable]. *If applicable specify below.* [Green Terms dated [•] are applicable to this Loan].	Green Loan: [Applicable/Not Applicable]. *If applicable specify below.* [Green Terms dated [•] are applicable to this Loan].