THE ALP REVIEW

The Importance of ESG and its effect on International Arbitration

Introduction

In recent years, the global world has experienced an upsurge in ethical standards on Environmental, Social and Governance (ESG) issues, as well as a growing awareness of the systemic and financial consequences of climate change and environmental damage. As Africa's largest economy and one of the leading oil producing countries in the world, Nigeria is a test case of this renewed social awakening particularly by communities of the Niger Delta area with large crude oil deposits, as well as other stakeholders in the civic and energy spaces. This has no doubt prompted corporate stakeholders to pressurise businesses in many sectors and jurisdictions to be transparent about ESG due-diligence, risk management and reporting. Consequently, regulators have issued a suite of legislative interventions to promote ESG in their environments and markets. In Nigeria, for example, the recently passed Petroleum Industry Act , contains elaborate provisions on ESG in response to the age-long protest and clamour by host-communities for adequate intervention in their human and environmental wellbeing hampered by oil exploration activities.

Again, as legal and commercial pressures on companies to move net zero and protect workers' human rights ratchet up, many companies, particularly multinationals are beginning to overhaul, not only internal policies and practices, but also contractual relationships that underly their businesses as well. As a result, ESG-based clauses are increasingly finding their way into commercial contracts as a risk-mitigation strategy.

Indeed, to say that businesses are witnessing an 'ESG revolution' is not hyperbole. As recent trends have shown, active engagement with ESG issues is no longer a choice. Their impacts are dominating public and private conversations and increasingly shaping policy across all sectors of the global economy as was recently seen in the COP26 climate change conference which laid a solid foundation for the global community's procession towards a more sustainable environment.

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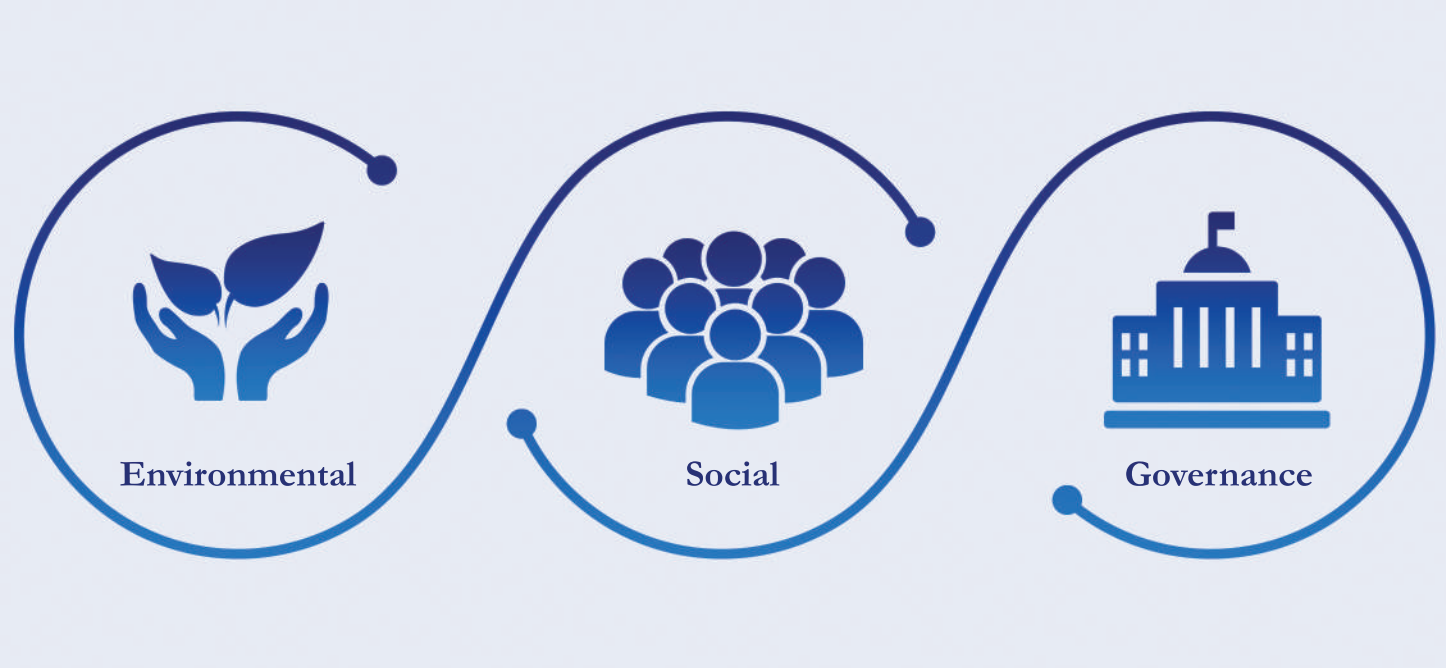
[1] 2021
[2] https://www.linklaters.com/en/insights/blogs/arbitrationlinks/2021/december/resolving-esg-disputes-in-african jurisdictions-through-arbitration-assessed 1 July, 2022
[3] Illuminating the top trends in international arbitration, 2022, Freshfields Bruckhaus Deringer

As had been highlighted, the consequences for stakeholders, particularly corporate stakeholders are very instructive: companies must rise to meet the demands for ESG accountability and transparency with proper risk management, due diligence and reporting, or risk shareholder and employee activism, investor divestment and/or exclusion[4] which may also result in avoidable ESG-disputes. It is in this light that this paper considers the importance of ESG vis-à-vis international arbitration.

ESG?



ESG is an acronym for Environmental[5], Social[6] and Governance[7] issues. As a concept, it has been in use for more than a decade as a label for a range of factors that are relevant in assessing whether an economic activity is sustainable for the purposes of investment decision making [8]. These factors were used, for example, by large investors and asset managers to decide on allocation of capital with a view to ensuring sustainability and financial performance over the long term [9]. Recently, the label has been applied more broadly to an ever-expanding scope of regulations, standards and expectations regarding the responsible management of a wide range of issues.

However, while ESG factors have not traditionally been seen as financial performance indicators, there is increasing acceptance of their potential to pose material financial risks. For these reasons, governments and corporations are focused on the need to promote effective ESG risk management, both to achieve sustainability goals and to manage risks to investors, capital markets, and the financial system.[10]

[4] https://www.corrs.com.au/insights/esg-disputes-is-arbitration-the-answer
[5] These ordinarily includes climate change and greenhouse gas (GHG) emissions, energy efficiency, resource depletion, including water, hazardous waste, air and water pollution, deforestation, etc.
[6] Issues under the social component are human rights, working conditions, including slavery and child labour, local and indigenous communities, conflict, health and safety, employee relations, diversity and inclusion.
[7] Executive pay, bribery and corruption, data protection, board independence, diversity and structure, tax strategy, transparency, shareholder rights, etc.
[8] Herbert Smith Freehills, The Rising Importance of ESG and its Impact on International Arbitration, July 27, 2021, available at https://www.herbertsmithfreehills.com/latest-thinking/the-rising-importance-of-esg-and-is-impact-on-international-arbitration, accessed on 1 July, 2022.
[9] ibid
[10] Some of these effective ESG risk-management measures include: assessing and understanding ESG risks in business operations; taking steps to avoid or mitigate those risks; complying with reporting and disclosure requirements; engaging effectively with stakeholders including regulators, investors, employees, consumers and communities; and ensuring robust governance and accountability at board level and integration of material ESG factors into strategic decision making.

The dynamics of ESG-related disputes in Arbitration

As had been highlighted, the incorporation or adaptation of ESG-related practices into pre-existing social and governance models adopted by companies, would be disruptive for corporate stakeholders. Already, one of the ways in which companies are managing ESG risks is by the use of ESG conditions in commercial contracts. In 2018, the American Bar Association (ABA) launched the first version of model contract clauses (MCCs[11]) aimed at the protection of human rights involved in international supply chains mainly through far-reaching representations and warranties to suppliers. The inclusion of such clauses in modern contracts no doubt suggests the increasing importance of ESG-factors to companies. But more importantly, in the context of this analysis, it serves as potential source of disputes if the relevant terms and conditions are not complied with, or where some of those material warranties turn out to be false.

ESG-related contracts and conditions have also been observed in long-term investment contracts, particularly the energy, mining and infrastructure sectors. These would typically take the form of obligation on investors to comply with relevant environmental and host-community ESG standards. Such contracts may also incorporate carve-outs to stabilisation clauses, allowing governments to introduce new regulations concerned with ESG issues.[12]

As many of these contracts will contain provisions nominating international arbitration as the preferred dispute resolution mechanism, given the often-international disposition of the parties involved; accordingly, where disputes arise in relation to these ESG provisions, arbitral tribunals will certainly be inundated with claims bordering on ESG clauses in contracts. This raises the pertinent question of the suitability of international arbitration, its rules and principles in the settlement of ESG-related disputes.

[11] https://www.americanbar.org/groups/human_rights/business-human-rights-initiative/contractual-clauses-project/-assessed 1 July, 2022

[12] A well-known example is Paragraph 2(d) of the BTC Human Rights Undertaking from 2003, which provides that the Baku-Tbilisi-Ceyhan Pipeline Company's shall "not seek compensation under the 'economic equilibrium clause' or other similar provisions […] in such a manner as to preclude any action or inaction by the relevant Host Government that is reasonably required to fulfil the obligations of that Host Government under any international treaty or human rights […], labour or HSE in force in the relevant Project State from time to time to which such Project State is then a party".

International Arbitration as a dispute resolution method for ESG-related contracts

ESG disputes are bound to emerge from commercial contracts, investment treaties and financial redress for climate change and sustainability damages particularly against corporations involved in activities with potential harm to the environment. For years, arbitration has been a principal and preferred means of resolving commercial disputes, both their local and cross-border components. Thus, ESG related disputes would be no different. As a matter of fact, there are important precedents in arbitration where compliance with environmental laws or human rights issues formed material part of the dispute.[13]

According to the 2020 Annual Report of Statistics on Dispute Resolution of the International Chamber of Commerce (ICC), published in 2021, construction, engineering and energy disputes represent, historically, the highest number of ICC cases, constituting 30% of all the new cases registered in 2021, alone[14]. These areas, by their nature, have ESG components because of their ties with climate change, environmental protection and human rights. A well-known ESG issue which was litigated by way of arbitration, was the claims related to the safe production of readymade garments in Bangladesh, following the 2013 Rana Plaza garment factory collapse in Dhaka[15].

While the nuances are different, ESG dimensions are equally applicable in commercial arbitrations[16]. First, arbitration offers a neutral form and flexible procedure. It also offers parties the chance to appoint arbitrators with the relevant skill and expertise in the subject matter of the dispute, with the high prospect of more reasoned awards. Experience has also shown that international arbitrators are more adept at determining or resolving disputes from a multi-disciplinary legal background. Perhaps more importantly, the opportunity of global enforcement under the New York Convention makes international arbitration the most effective means of resolving ESG related disputes.

Other characteristics of the rules of arbitration particularly relevant for conflicts with ESG components are: the possibility of obtaining interim measures before the constitution of the arbitral tribunal or during the arbitration, which are especially relevant in the case of imminent or irreversible environmental damage, or of serious violations of human rights, and the possibility for the arbitrators to hear third parties during the proceeding (amicus curiae), which, if agreed by the parties, enables the participation, for example, of civil associations that have played a crucial

[13] See for example: SCC Arbitration V2013/153 Isolux Infrastructure Netherlands, B.V. v./ Kingdom of Spain, Award, July 17, 2016; SCC Arbitration Case No. V 062/2012, Charanne B.V., and Construction Investments v./ Kingdom of Spain, January 21, 2016. In these two cases, the investors sued Spain for revoking regulatory measures that incentivized investment in renewable energies, under which the claimants had made their investment; ICSID Case No. ARB/07/26, Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v./ Argentina, December 8, 2016, where Argentina filed a counterclaim against the investor alleging that the contractual breach by the investor also amounted to a violation of the human right to water and health.

[14] ICC Dispute Resolution 2020 Statistics, 2021, P.7 available at: https://iccwbo.org/publication/icc-dispute-resolutionstatistics-2020/ assessed 1 July, 2022

[15] https://link.springer.com/chapter/10.1007/978-3-030-73835-8_9, assessed 1 July, 2022

[16] (2021) M. Manzano, A. Toimill; The role of arbitration in ESG disputes

role in tackling climate change, in promoting environmental and human rights protection, and in denouncing corporate practices that threaten them. Thus, the multidisciplinary nature of the ESG disputes and their particular needs can best be accommodated in the flexible and sophisticated arbitral proceeding[17].

The international community has continued to drive the evolution of the arbitral proceeding toward standards specifically contemplated for addressing the particular needs of these types of disputes. For example, in 2014, the UNCITRAL Rules on Transparency in Treaty-Based Investor-State Arbitrations entered into force to encourage higher standards of transparency in investment arbitrations. Other efforts equally valuable for establishing models and best practices in arbitrations with ESG components are the Report of the ICC Task Force on Arbitration in Climate Change Related Disputes; the PCA Optional Rules for Arbitration of Disputes Relating to the Environment and/or Natural Resources; and The Hague Rules on Business and Human Rights Arbitration.

ESG-related disputes and Arbitration: The African outlook

With the surge in Chinese investment in Africa particularly in mining and other energy-related areas, ESG-related disputes are bound to emerge. In this regard, the China-Africa Joint Arbitration Centre (CAJAC) would be a well-tailored forum for resolving such disputes by way of arbitration. Instructively, the CAJAC Arbitration rules also provide for claims between multiple parties and joinder of additional parties[18], the independence and impartiality of arbitrators[19], investigations by the Arbitration Tribunal[20] and the appointment of experts for the appraisal, audit, evaluation or testing of any issue requiring an expert report.[21]
Even then, several claims bordering on ESG principles have already been resolved in African courts. For example, in *MEJCON-SA & Ors v Uthaka Energy (Pty) Ltd & Ors*[22], the High Court of Pretoria granted the Mining and Environmental Justice Community Network of South Africa's urgent relief for an interdict against Uthaka Energy (Pty) Ltd to prohibit the commencement of mining activities on property which fell within the Mabola Protected Environment. An application for leave to appeal the decision by Uthaka was met with dismissal by the Constitutional Court in November, 2021.

Other ESG-related disputes have also been contested before courts across the continent. These cases straddle environmental and energy-related causes. In *Save Lamu et al v National Environmental Management Authority & Amu Power Co Ltd* [23] for example, the Kenyan Environmental Tribunal set aside the issuing of a license to Amu Power Company for the construction of the Lamu Coal-fired Power Plant. The Tribunal found that the Environmental Impact Assessment (EIA) license had been granted without Amu Power conducting proper and meaningful public participation.
While these disputes essential turn on administrative law, and therefore not arbitrable, it will however be interesting to see how arbitral tribunals engage the question in commercial and investment related arbitrations as the ESG framework comes to maturity on the continent.

Threats and drawbacks

In spite of the widespread acceptability of arbitration as the preferred and most convenient means of resolving ESG related disputes, there are also strong arguments that challenge it. For instance, it has been argued that the disparity in the social status and/or imbalance of resources of the contending parties in a typical ESG related claim (e.g) large corporations vs. government; and the lack of adequate standards of transparency in commercial arbitration

[17] ibid
[18] See articles 18 and 19
[19] Article 23
[20] Article 41
[21] Article 42
[22] (11761/2021) [2021] ZAGPPHC 195 (30 March 2021)
[23] Tribunal Appeal No. Net 196 of 2016

proceedings that involve public interest, raise questions of the suitability of the dispute resolution mechanism[24] which renders it inadequate for resolving ESG disputes[25].

However, with respect to the criticism bordering on transparency standards in commercial arbitrations, recent efforts of arbitral institutions (such as the ICC) to establish presumptions in favour of the publication of information on the composition of the arbitral tribunal and arbitral awards, challenge the basis of such assertion . Ultimately, whatever side one may take, there is no question that the factors that recommend international arbitration as a preferred system of dispute resolution far out-weigh its perceived demerits. Yet, this optimism should not be a justification for complacency. Rather it should motivate stakeholders in the ESG arbitration environment to structurally engage the issues with a view to initiating reforms that will address the challenges.

Conclusion.

As the global world move towards sustainability with businesses and governments re-calibrating pre-exiting models of engaging with the environment towards commercial gain, the traditional and widespread use of arbitration as a means of international dispute resolution will certainly eventuate a considerable increase in the number of arbitrations on ESG matters in the coming years. While certain challenges will make this anticipated surge in ESG dispute resolutions a bumpy ride, the horizon is however clear. But for this to happen, significant efforts must be made towards addressing the identified threats to the use of international arbitration in ESG related disputes. We must note that the bulk of this responsibility rests on arbitrators and arbitration counsel, as primary stakeholders in the global arbitration landscape. A key way of discharging this burden, would take the form of leading knowledge in ESG regulation and standards with a view to responding proactively by adopting relevant traditional arbitration tools and principles within the framework of ESG-related conflicts. This will help to further accentuate the importance of the use of international arbitration in resolving disputes in this fast-emerging area.

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[24] For example, in commercial arbitrations where state companies participate –with public funds– any of the parties can request the arbitral tribunal to issue orders on the confidentiality of the proceeding and on any matter related to the arbitration (e.g. article 22 of the ICC Rules of Arbitration, see also article 1(4) of Appendix II – Internal Rules of the International Court of Arbitration). In practice, a request is generally presented by the private parties in these proceedings, causing that the information on the existence and the reasoning behind such proceedings are confidential and, therefore, unknown to the general public. This means that only the parties to the dispute may access documents and evidence filed during the arbitration, thus limiting access to other users to these precedents

[25] Herbert Smith Freehills, The Rising Importance of ESG and its Impact on International Arbitration, July 27, 2021, available at https://www.herbertsmithfreehills.com/latest-thinking/the-rising-importance-of-esg-and-is-impact-on-international-arbitration, accessed on 1 July, 2022.

[26] For example, although the most recent Note to Parties and Arbitral Tribunal on the Conduct of Arbitration Under the ICC Rules of Arbitration, published in January 2021, recognizes the right of the parties to object to the publication of decisions, documents or awards at any time prior to their publication, and to access information on the composition of the tribunal, it now contains a default rule of publication and dissemination of information, unless the parties object (see paragraphs 50 to