Kluwer Arbitration Blog

# The Answer My Friend… Is Blowing In The Wind: ESG in EU-Related Supply Chains

Jonathan Barnett (Nivalion AG) · Tuesday, March 21st, 2023

On 17 and 24 February 2023, speakers from various jurisdictions convened webinars to address ESG, climate change and EU-related issues. Jonathan Barnett (Nivalion AG) reports.

**Keynote Speech: The Expanding Universe of Climate Change Disputes:** Annette Magnusson (Climate Change Counsel)

Annette Magnusson delivered the keynote speech on "The Expanding Universe of Climate Change Disputes" to examine the evolving intersection between climate change and arbitration and litigation. Geopolitics, the global economy, black swans like the pandemic, the climate crisis – and more – are becoming increasingly visible in disputes heard by courts and tribunals around the world, reflecting an "expanding universe" of climate change issues and disputes vis-à-vis an increase in the number of cases and the substantive issues raised.

**Arbitration**

Annette assessed climate change arbitration through the definition of the 2019 report of the International Chamber of Commerce on Resolving Climate Change Related Disputes through Arbitration and ADR, which identifies three categories of climate change disputes:

- Commercial projects with investors and other contracting parties acting in line with Paris Agreement commitments, a category of contracts that is likely to increase as Net Zero commitments both in the public and private sectors gain momentum;
- Disputes under general commercial contracts which may have no specific climate-change related purpose, but where the focus of the contract may be directly or indirectly impacted by the climate crisis; and
- When arbitration agreements are entered into after a dispute has arisen. The ICC report notes this may become more prevalent as concerns climate change disputes.

Due to the general principle of confidentiality in **international commercial arbitration**, there is no clear accessible data on cases with climate change elements. Nonetheless, in addition to the above ICC report, the 2019 and 2022 SCC Reports on "Green Technology Disputes" assess disputes relating to e.g. sustainable forestry, organic food, organic waste management, and carbon reduction technologies. The reports show a significant increase in such cases even between 2019 and 2022, with renewable energy cases as the most common examples of green technology disputes and an increase in parties with carbon reduction as their main business activity.

Given the proliferation of global trade and related increasing use of commercial arbitration over the past 30 years, ongoing societal transition will largely be governed by commercial contracts, many of which will include an arbitration clause and will increasingly include climate change elements. Substantial and increasing investments and technological developments in clean energy will form the foundation of achieving the 2050 target under the Paris Agreement of Net Zero. This will inevitably give rise to disputes; we are therefore likely to see the energy transition reflected also in the case load of international arbitration and impacting new areas of law and actors, e.g. the definition of fiduciary duties and the boundaries of proper financial risk management will likely evolve: As climate risks become a reality with flooding, degradation of coast lines and other physical effects, commercial disputes are likely to follow.

By contrast to the scarcity of information about commercial arbitration, **investment arbitration** generally provides more accessible information about climate disputes. From a comparative perspective, however, such disputes represent a small portion of all arbitration cases being filed in the world. Annette focused therefore on commercial arbitration as the likely leader to shape climate disputes via arbitration.

**Litigation**

When viewed through the definition of the Grantham Research Institute at the London School of Economics, climate change appears in litigation in the following scenarios:

- Cases that directly refer to climate change and climate law, for example the Paris Agreement;
- Cases where there is an explicit reference to climate change but parties rely on other – expanding – grounds for climate-related change, e.g. actions related to air pollution claim under emissions trading schemes, the protection of land and forests; and
- Cases that have practical implications for climate change mitigation and adaptation but do not make any specific reference to climate change, similar to the second category of cases in the ICC report.

Addressing climate change before the courts is a growing phenomenon: Since 2015, the total number of known climate change-related litigation cases has more than doubled to 2,000 with roughly one-quarter of such cases being filed between 2020 and 2022. The “expansion” of the universe of climate disputes applies to the number of cases and legal argumentation and actors involved, in particular corporate actors and claims of corporate inaction, a perceived lack of responsibility or insufficient or inappropriate communication on climate change. Greenwashing-cases has become a very visible trend in courts around the world, including e.g. by ClientEarth against the directors of Shell for its alleged flawed climate strategy.

Introducing more climate change-aligned arguments in litigation may also lead to an increasing use of scientific evidence in the courtroom and raises novel questions: How much contribution from one specific actor is enough to establish causality? How much power and control over a substantial amount of greenhouse gas emissions do individual actors have, and how are they using this position to prevent dangerous climate change? The outcome of climate litigation may also lead to new legal norms – and this is probably where we find the strongest link between climate litigation and climate change related elements in international arbitration.

### Should procedures be different in the expanding universe?

Annette argued that climate change elements in a dispute motivates a different procedure: Time is of the essence to conclude transactions and projects for climate change mitigation and adaptation and to maintain the goals of the Paris Agreement and the 1.5°C target. A time-consuming and costly dispute directly obstructs the dire need for fast societal transition. The flexibility and adaptability of international arbitration could provide a sustainable solution to resolving disputes efficiently, with mediation providing a strong potential to maintain good business relationships.

### Any More challenges ahead?

Providing regulatory clarity over ESG standards and reporting will likely create hurdles: Financial institutions may be exposed to claims of incorrect and misleading information regarding their ESG practices and products.

### Closing

The US physicist Stephen Hawking is quoted having said "*the universe is expanding at an ever-increasing pace. It will expand forever, getting emptier and darker*". In contrast, the expanding universe of climate change disputes will hopefully not be empty, but filled with innovation and motivation to achieve the 1.5°C target.

**The EU Corporate Sustainability Due Diligence Directive and the EU Corporate Sustainability Reporting Directive:** Jillian Kirn (Climate Change Counsel), Adolf Peter (Shanghai University of Political Science and Law; Wöss & Partners LLC)

### CSDDD & CSRD – What are they?

Jillian explained that the EU Corporate Sustainability Due Diligence Directive (**CSDDD**) will require in-scope companies to incorporate environmental and human rights due diligence throughout their supply chains. In-scope companies will be required to integrate due diligence into their corporate policies, identify potential and actual adverse human rights and environmental impacts from operations, prevent, mitigate, and remediate such adverse impacts, establish and maintain a complains procedure, monitor the efficacy of the due diligence policies, and communicate publicly on their due diligence efforts. The CSDDD builds on, and interacts with, other regulations that focus on supply chain environmental, social, and governance (**ESG**) such as the EU Sustainable Finance Disclosures Regulation (**SFDR**) and the EU Corporate Sustainability Reporting Directive (**CSRD**).

The CSRD will update and operationally replace the EU Non-Financial Reporting Directive and operate in tandem with the CSDDD. Companies will be required to disclose sustainability information in their management reports (meaning that financial and sustainability information will be published together) and it will be digitized making it more accessible and searchable. Disclosures will also be subject to limited third-party assurance. CSRD reporting will include a significant focus on Scope 3 emissions (indirect emissions from upstream and downstream sources in a company's value chain).

### Key elements of CSRD and CSDDD

- Double materiality: Assessing both financial materiality (impact of the outside world on a company) and impact materiality (company's impact on the outside world), plays an integral role in, in particular, CSRD reporting.
- Supply chain: Though the CSDDD does not include the same double materiality language, it does require management of social and environmental impacts along the entire value chain, including accountability for direct and indirect suppliers.
- Extraterritoriality: The CSDDD envisages enforcement by Member States with penalties for non-compliance and specific duties for company directors to adequately consider sustainability matters. However, the CSDDD enforcement mechanism is different from the CSRD and the SFDR and differs further from reporting rules that are being promulgated in other regions (e.g. the U.S. Securities and Exchange Commission's Climate-related Disclosures Proposed Rule). This lack of alignment can create reporting challenges for companies operating in, or with suppliers in, multiple regions.

**What to expect**

Although the CSDDD and CSRD both come from the EU, we can expect a ripple effect around the world since any company that operates in the EU will need to designate an authorized EU representative and comply with the CSDDD (even if they are not headquartered in the EU). Courts have been the fora for most ESG disputes to date and that trend is likely to accelerate. However, with the rise of ESG-related contract clauses and the inclusion of ESG provisions in international investment treaties, commercial and investor state arbitration may play a greater role in ESG disputes in the future. Companies would therefore benefit from building interdisciplinary internal and external teams now in order to develop a strategic approach, meet compliance deadlines, and stay up to date on evolving industry best practices and enforcement expectations.

**Impact outside the EU**

Adolf discussed the impact of the CSRD and the CSDDD on non-EU Entities in relation to Greenhouse Gas (**GHG**) emissions. Dr. Peter emphasized that the CSRD would require reporting entities to include in their management reports the plans to ensure that their business model and strategy are in line with the 1.5°C target of the Paris Agreement. Compliance with the CSRD's reporting requirements would have to be mandatorily verified by auditing firms or independent assurance service providers based on a limited assurance engagement.

In relation to the CSDDD, Adolf pointed out that non-EU entities would in particular be indirectly impacted by the CSDDD by being part of an EU-related supply chain. They would therefore be subjected to the mandatory sustainability-related due diligence of a supply chain leading company which is directly covered by the CSDDD. Not complying with the CSDDD's environmental and human rights-related standards could give rise to being eliminated (contractual termination) from the supply chain. However, on the basis of the CSDDD, adverse climate impacts would not have to be included into a company's supply chain-related due diligence policy and code of conduct. Still, in line with the CSRD, Adolf stressed the significance of Art. 15 of the CSDDD Proposal stipulating the adoption of a plan to ensure compliance with the climate-related targets in the Paris Agreement.

According to Adolf, climate-washing/greenwashing may in particular occur if supply chain leading companies fail to implement an effective (climate) due diligence policy along the supply chain. The CSRD's reporting obligations and the CSDDD's requirement to set up a plan to ensure compliance with the targets of the Paris Agreement would contribute to the reduction of climate-washing because reporting false or insufficient information would certainly result in more stakeholder pressure, trigger additional climate litigation (in particular in light of the recent legal action brought by Greenpeace, Friends of Earth and other NGOs against the French oil and gas group TotalEnergies and the judgment of the Hague District Court against Shell forcing the latter to reduce its worldwide GHG emissions, including Scope 3 emissions, by 45% by 2030, compared to 2019 levels) and may even have criminal consequences in some jurisdictions. For this reason, Adolf mentioned that in order to avoid any potential greenwashing-related allegations, companies would be well-advised to include GHG emissions-related targets (including Scope 3 emissions encompassing indirect upstream and downstream emissions materializing in the reporting entity's value chain) in their supply chain-related codes of conduct and their due diligence policy.

Adolf in particular highlighted the danger for companies (including non-EU entities) not to control their suppliers. He mentioned the example of the Chinese electric car manufacturer NIO. Being listed on the New York Stock Exchange, NIO would have to fulfill extensive reporting requirements. Dr. Peter stressed that in NIO's publicly available annual report directed at investors (Form 20-F), NIO emphasized that:

> *We do not control our independent suppliers or their business practices. Accordingly, we cannot guarantee their compliance with ethical business practices, such as environmental responsibilities, fair wage practices, and compliance with child labor laws, among others. […] Violation of labor or other laws by our suppliers or the divergence of an independent supplier's labor or other practices from those generally accepted as ethical in the markets in which we do business could also attract negative publicity for us and our brand. This could diminish the value of our brand image and reduce demand for our electric vehicles if, as a result of such violation, we were to attract negative publicity. If we, or other players in our industry, encounter similar problems in the future, it could harm our brand image, business, prospects, results of operations and financial condition*.

In this context, Adolf noted that NIO had recently entered into an agreement with Shell to jointly construct and operate battery charging and swap stations across China and Europe. Taking into consideration the Hague District Court judgment, Adolf pointed out that Shell would be well-advised to urge NIO to control its suppliers regarding the generation of GHG emissions.

**Overview on the European Green Deal and the EU Climate Pact:** Carmen Marqués Ruiz (EU Climate Pact)

Carmen gave an overview of the European Green Deal and the European Climate Pact.

Carmen underlined that ESG issues are becoming increasingly more important for European companies and citizens. With the European Green Deal, the EU is developing a new policy and regulatory framework which aims at mobilising all the society, including companies, to achieve sustainability. The European Green Deal wants to transform an urgent challenge into a unique opportunity for the EU to reinvent itself and become more competitive in a sustainable way. The European Green Deal aims to transform the EU into a modern, resource-efficient and competitive economy, to ensure no net greenhouse gas emissions by 2050, economic growth is decoupled from the use of resources and no people and places are left behind.

As an Ambassador of the European Climate Pact, Carmen explained that this is an EU-wide initiative launched in 2020, which invites individuals, communities and organizations to participate in the fight against climate change and to build a greener Europe (see also here). The Pact is made up of some 772 ambassadors from all over Europe who are very active in social media, give lectures, write articles, take initiatives protecting the environment.

**The Sanctions Mechanism of the EU Corporate Sustainability Due Diligence Directive:** Markus P. Beham (University of Passau, Germany)

Markus spoke on the sanctions' mechanism of the proposed EU Corporate Sustainability Due Diligence Directive (**CSDDD**), providing an overview of envisioned consequences for companies in violation of future obligations along their supply chains. While the proposal foresees "*effective, proportionate and dissuasive*" penalties, "*including pecuniary penalties*", their exact form has not been specified yet. However, domestic legislation such as the German Supply Chain Act may help inform an educated guess on possible consequences such as the exclusion from public procurement or pecuniary penalties amounting to a maximum of EUR 8 million or 2% of annual global turnover, in addition to skimming off any economic advantage gained from the violation. Furthermore, the proposed CSDDD will introduce civil liability for violations into the domestic legal systems of EU Member States.

**GHG emissions reductions, The Hague district court decision and Shell – the environmental component of ESG:** Leonardo Sempertegui (OPEC)

Leonardo focused on environmental aspects of ESG and started by explaining that the "E" (Environmental) aspect has been regulated for decades by multiple international environmental and development legal instruments.

The landscape of ESG is nevertheless evolving. On 26 May 2021, the The Hague District Court delivered its ruling in the climate change case filed by a group of NGOs and private individuals against Royal Dutch Shell plc ("Shell"). In this case, the court applied an "*unwritten standard of care*" arising out of extensive sources including the Dutch civil code, political declarations, plans, Human Rights Conventions, scientific reports etc. The court's expansion of this legal theory to a private entity is unique. In doing so and by replacing the need for a causal link to adjudicate, the calculation of potential damages becomes almost "*speculative*".

This case also highlights corporations' environmental obligations. The Dutch court determined that Shell needs to reduce its carbon emissions by 45% by 2030. The judge assumed the role of a policymaker, traditionally limited to the executive branch since it requires high technical skills. To comply, Shell is selling assets which might be acquired by investors and corporations which may be not subject to the same stringent standards and scrutiny as global corporations. Shell will comply with the judgment but the emissions net total will not be reduced. The effectiveness of the court's decision therefore needs to be assessed as to whether it has achieved the investors' and climate activists' goals: If the goal was to reduce emissions, this is unlikely as the result has shifted emissions from an accountable party (Shell) to less unaccountable parties.

Leonardo explained that the intersecting energy "trilemma" between green & clean vs. secure & reliable vs. affordable & available must be resolved, and that a future source of conflict will be the disparity of energy use in the world.

For climate change obligations, the guiding star is the Paris Agreement; this is also the starting point for OPEC countries. The Agreement was signed by all member countries and ratified by all but one of the OPEC member states. The fact is, however, that according to energy consumption projections, nuclear energy, hydro, gas and renewables will increase in the next decades because there will be economic growth and there is a global unmet demand. OECD countries will reduce their consumption, but other countries are starting or well underway on their development path, which is necessarily energy intensive. There are conflicting needs and rights that are difficult to reconcile, so although we need to try and achieve these goals, our expectations need to remain realistic and based on scientific findings.

Leonardo elaborated on the various understandings of ESG and the need or at least desire for a universal standard, e.g. does ESG include anti-corruption (it depends)? What is the difference between "ESG" and "legal compliance" ("E" (environmental), if these obligations are already codified in multiple instruments and conventions which facilitates compliance)? Measurement and accountability are key, including limiting the use of ESG discourse as a PR exercise.

**Supply chain-related due diligence and third-party verifications:** Els van Poucke (Deloitte Legal, Belgium)

Els discussed supply chain-related due diligence and third-party verifications. According to the CSDD, companies are required to integrate due diligence into their corporate policies and to establish and annually update a due diligence policy describing:

- the company's approach to due diligence;
- a code of conduct describing the rules and principles of the company (large companies mostly already have such codes); and
- the processes put in place to implement due diligence.

Such due diligence is required as related to a company's own operations as well as the operations of its subsidiaries and business partners in an 'established business relationship' in its supply chain.

Companies should provide audit clauses in their contracts and make sure that there is contract-cascading in the supply chain. Furthermore it is advisable to put in place third-party risk management. Checks related to third parties should be carried out in the pre-contractual phase and during the execution of the agreement (monitoring) in order to verify compliance with codes of conduct, applicable laws and conventions related to human rights and fundamental freedoms and the environment.

**Contractually binding ESG-related supplier codes of conduct, contractual cascading and ESG-related contractual clauses:** Harald Sippel (Skrine, Malaysia)

Harald spoke from his practice in Malaysia where in some industries, foreign workers sometimes find themselves in precarious circumstances: among others, this regards situations where employers keep the foreign workers' passports and thereby restrict foreign workers' movement. There are also serious concerns about foreign workers having to pay excessive commission fees in order to be able to come to Malaysia, thereby often resulting in a state of dependence. Both situations are very strong indicators of modern slavery.

Harald warned the audience that appropriate measures must be taken at this point already, not only in the future. In light of claims before courts, as explored by the previous speakers, but also legislation in several Western countries, purchasers must protect themselves from potential exposure. Harald highlighted the German Supply Chain Responsibility Act as the law that stands out internationally at the moment. This is, above all, because the maximum fines purchasers face are 2% of their global annual turnover. Harald put this seemingly small number into perspective by highlighting that on the days prior to the event, he had been in meetings with a German client and determined that this client's exposure was EUR 320 million (at an annual turnover of EUR 16 billion). It was at this moment that his client fully understood that its ESG-related obligations were not to be taken lightly and that legal advice was money well-spent.

Harald also highlighted that in light of the potential exposure and the difficulty to fully control the risks of supplier & sub-supplier due diligence, some companies were already considering not taking on more projects in riskier markets. For those who want to explore lucrative business opportunities, risk management is necessary. One of the – if not *the* – most important ways to manage the significant exposure that purchasers face is through contractual provisions, which provide them with the necessary protection. Building on his practice of advising many European businesses who are active in Malaysia, Dr. Sippel explored the most typical clauses seen in international contracts. In their most simple form, these concern the adaptation of the purchaser's code of conduct (which one would expect to be in compliance with the purchaser's local laws). Ideally, this relates not only the purchaser's direct suppliers, but also includes any sub-suppliers (and their respective sub-suppliers). This way, purchasers can ensure that – at least from a contractual perspective – they have taken the necessary steps to reach compliance along the supply chain.

Harald also emphasized that in an ideal world, purchasers should insist on provisions beyond merely the adaptation of codes of conduct. He reminded the audience repeatedly that each contract would ideally take an individualistic approach, taking into account:

- the specific country risk (i.e., the ESG-related risks in China are different from those in Malaysia);
- the specific industry risks (i.e., labour-intensive industries with low-skilled, often foreign workers are more prone to risks); and
- the specific company risk (i.e., a supplier which has already undergone several certifications and audits will on average have a lower risk than a supplier who is new to ESG audits).

However, there are some terms that Harald strongly recommends having in contracts no matter what. This includes mandatory audits upon the purchaser's request, detailed remedies in case of a breach of the code of conduct including the suspension and termination of the contract, if necessary, and indemnity provisions in case the purchaser must pay a fine because of ESG-related incidents with a (sub-)supplier. That said, Harald acknowledged that there is no "bulletproof" contract and that each needs to be negotiated with an understanding and recording of the obligations and risks involved.

**ESG claims from a funder's perspective,** Simon Knupfer (Nivalion AG): Lucas Macedo (Nivalion AG)

Simon and Lucas discussed ESG claims from a funder's perspective. They began by identifying claims that likely encourage long-term shifts in public and corporate policy due to previous, current and future ESG violations including damages and deterrents for future breaches.

Common hurdles to such claims include obtaining and substantiating suitable information and costs to pursue such claims. Litigation finance can be a suitable solution in supporting meritorious ESG claims, but this is weighed against the current novelty and lack of predictability of some ESG cases, such as the growing wave of climate-related litigation. Such unknowns may be overcome by a clear causal link, e.g. with the help of the so-called attribution sciences. For the "funding stars to align", other issues are determinative including that financial compensation should at least be indirectly pursued in the claim (without, of course, impeding simultaneous injunctive relief), with the expected funder's investment ideally observing a minimum 10:1 ratio vis-à-vis quantum: legal budget. This seeks to ensure the funded party receives the majority of proceeds.

Finally, Simon and Lucas reinforced that the expected duration of cases is highly important as funders project their investments in relation to invested capital over time. Although some defendants may seek to quickly settle ESG claims, e.g. to avoid reputational risk (typically a good solution for all parties involved), others may intend to fight to the very end either to postpone a financial impact or to try to avoid setting precedents. Simon and Lucas recommended also considering other available options to pursue claims including NGOs, pro bono legal support initiatives and even State-sponsored legal assistance funds.

**ESG-related damages claims in international commercial – applicable law:** Herfried Wöss (Wöss & Partners)

In his presentation on ESG-related damages claims, Dr. Wöss started with a reference to recent court cases where the OECD Guidelines for Multilateral Enterprises and the United Nations Guiding Principles on Business and Human Rights were considered as duty of care standards under the applicable tort law, citing *Milieudfensie et al. vs. Royal Dutch Shell* and other cases where soft law is being converted into hard law through judicial procedures. He underlined that ESG-related damages claims appear in two different contexts:

- the tort law aspect under different applicable laws; and
- the contractual damages aspect.

With respect to the former, there are different tort law approaches under different applicable laws. Jurisdiction and standing play an important role in this respect. The modifications made by the Council of the European Union to the CSDDD on 30 November 2022 clarify the Directive's tort law and imperative law approach, referring to damage caused to a natural or legal person, a breach of a duty, the causal link between the damages and the breach of the duty, and fault. The measure of damages under the Directive is "full compensation", which does not allow for punitive damages.

Herfried mentioned that there is a lack of clarity with respect to precise obligations owed under the CSDDD. If it is only the due diligence obligation, then the question to ask under the differential hypothesis or but-for premise is “what would be the situation of the injured subject if the due diligence obligation had been performed?” If the result would be the same, then there would be no causality or liability.

With respect to contractual damages, Herfried referred to the Contractual Clauses Project for human rights due diligence of the American Bar Association which recommends clauses worded under US law and CISG which are to be inserted in supply contracts, purchase orders or similar documents for the sale of goods, and future guidance of the European Commission of voluntary model contract clauses to achieve compliance with the CSDDD. He emphasised the need to apply CISG to mirror-image supply contracts throughout the supply chain in order to allow a pass-through of risks and obligations based on the same applicable law. He mentioned that contractual disputes will centre upon the interpretation of due diligence clauses, the effects of CSDDD as mandatory law to arbitrations governed by different applicable laws, the lack of standardisation and conflicting norms, the significant transaction cost of complying with ESG obligations, the role of third-party conduct, evidentiary issues and causality. Herfried underlined that companies throughout the supply chain should start today with the preparation of their new supply contracts and the respective ESG-clauses.

**ESG-related supply chain arbitrations – Consolidations and joinders:** Adolf Peter (Shanghai University of Political Science and Law; Wöss & Partners LLC), Alice Fremuth-Wolf (Nivalion AG)

Adolf emphasized the ever-increasing interrelatedness between ESG (in particular climate-related issues) and international commercial arbitrations involving multiple parties of multiple tiers (e.g. employer, contractor, subcontractors, lower-tier subcontractors, etc) along international supply chains (supply chain arbitrations). Dr. Peter addressed some specifics in terms of construction (build-only model and design-build model) and automotive supply chains before explaining that breaches of material ESG-relates provisions would have the potential to give rise to damage claims based on:

- a severe loss of reputation causing pecuniary losses (loss of profits) by losing customers and the termination of significant business relations/projects; and
- delays in connection with the removal of defaulting subcontractors, the temporary halt of projects, retenders and ongoing investigations.

Moreover, goods may be deemed defective based on contractually agreed criteria related to certain ESG standards. For this reason, Dr. Peter stressed the significance of including contractually binding ESG-related clauses or expressly referencing codes of conduct in supply chain-related contracts (including remedies and the contractual termination as a last resort). Adolf went on to underline the importance of contractual cascading (passing on of legal obligations) to oblige all tiers of a supply chain to adhere to the ESG standards/policy of the supply chain leading entity. In particular, Dr. Peter drew attention to a recent ESG-related Borealis construction project halt in Belgium leading to the retender of the majority of the project and potential major damage claims based on the ESG-related delay of the project.

Adolf predicted that ESG-related violations by a supply chain member would certainly lead to more and more complex disputes involving multiple parties. Due to the internationality of the parties, ESG-related disputes would best be solved by means of international commercial arbitration. In the context of multi-party arbitrations, Adolf outlined the advantages (in particular preventing the rendering of contradictory arbitral awards) of consolidations (combination of several pending arbitrations into a single arbitration heard by the same arbitral tribunal) and joinders of additional/third parties in one pending arbitration. As consolidations or joinders may not be in the interest of all parties, some parties may object. As specified by Adolf, an advance consent (overriding a later objection during the proceedings) could be implied from the parties' consent to apply institutional arbitration rules containing specific criteria which would have to be fulfilled in order to achieve a consolidation or joinder without the parties' express consent.

In connection with supply chain-related disputes in construction and automotive supply chains involving multiple and different parties and contracts, consolidations (even against the objection of a party) would most likely be granted if the applicable institutional arbitration rules in a case refer to a series of related transactions and compatible arbitration agreements. In this context, Adolf highlighted the arbitration rules of the Hong Kong International Arbitration Center (HKIAC), the Singapore International Arbitration Center (SIAC) and the China Maritime Arbitration Commission (CMAC).

In order to avoid disputes about consolidations and joinders, Adolf recommended the inclusion of the following clause into the arbitration agreement explicitly agreeing on consolidations and joinders along the supply chain:

"The Parties irrevocably consent to the consolidation of two or more pending arbitrations in relation to [insert defined Subject Matter/Project/Transaction/Related Contracts] in accordance with Art. [insert the consolidation provision of the applicable institutional arbitration rules] (effective as from [insert date on which the applicable institutional arbitration rules entered into force]). The Parties irrevocably consent to join [insert defined Related Parties eligible to be joined] as an additional party in relation to [insert defined Subject Matter/Project/Transaction/Related Contracts] in accordance with Art. [insert the joinder provision of the applicable institutional arbitration rules] (effective as from [insert date on which the applicable institutional arbitration rules entered into force]). Each of the parties to this Arbitration Agreement shall enter into an identical form of this Arbitration Agreement with [insert defined Related Party] with whom they contract for [insert defined Subject Matter] in relation to the [insert defined Project/ Transaction]."

Besides supply chain arbitrations, Adolf discussed the necessity for European parties to adapt model clauses of Chinese arbitration institutions. In particular, Adolf recommended to expressly agree in the arbitration agreement on the number of arbitrators, the language of arbitration, the applicable rules of evidence (e.g. the IBA Rules on the Taking of Evidence, the CIETAC Guidelines on Evidence or the Prague Rules), the law of the arbitration agreement and to expressly stipulate that the presiding arbitrator should not have the nationality of one of the parties. Moreover, Adolf stressed that parties would be well-advised also to tackle the question of multi-party arbitrations (consolidations and joinders) in the arbitration agreement (in particular in supply chain-related scenarios).

Alice then went on to present the broad joinder provisions and the concise consolidation rules contained in Article 14 and Article 15 of the VIAC Rules 2021 comparing them with the much more detailed provisions in the ICC Arbitration Rules 2021 (Articles 7-9). The VIAC model allows different kinds of joinders to proceedings without regard to national legal concepts like the German/Austrian "Nebenintervention", the French "intervention forcée/volontaire" or the common law concept of vouching in. Even an amicus curiae brief, not known under civil law tradition, is possible. It is up to the arbitral tribunal to assess and decide a joinder request taking into account all relevant circumstances such as the arbitration agreement, the will of the parties, the underlying legal relationship between the parties, confidentiality interests, the interest for a speedy, cost-efficient and final resolution of a dispute and the avoidance of contradictory decisions. She then provided examples from her former practice as VIAC Secretary General of joinder scenarios in supply chain disputes and the challenges involved including the appointment of arbitrators (see also VIAC [ed.], Handbook on the Vienna Rules and the Vienna Mediation Rules 2018).

Alice concluded by analyzing why the SIAC Cross Institutional Consolidation Protocol 2017 ultimately was not a success in practice.

**Specifics regarding arbitration agreements involving Chinese parties (including sino-foreign joint venture companies and wholly foreign-owned companies incorporated in China) in EU-related supply chains:** Xu Guojian (Shanghai University of Political Science and Law, SGLA Law Firm, China), Adolf Peter ( Shanghai University of Political Science and Law; Wöss & Partners LLC), Alice Meissner (Meissner & Passin Attorneys, Austria)

International supply chain disputes have taken up a large proportion of today's cross-border disputes. In light of the applicable and upcoming European ESG Directives, any contractual party within a supply chain involving European supply chain partners is confronted with the question of ESG liability. Thus, the question of how best to structure dispute resolution clauses of supply chain contracts in order to optimize the enforcement of rights in the event of breach of ESG representations and warranties is essential.

According to statistics of WTO, PR China (**China**) exported goods in the amount of USD 3.6 billion in 2021. Chinese companies represent, therefore, major players in today's international supply chains. Dr. Meissner pointed out the importance of a general understanding of provisions applicable to enforcement of arbitration awards in China.

**Differentiation of Arbitral Awards**

In the course of any "health check" of supply chain contracts involving Chinese parties, there is a distinction in China between enforcement procedures in China between domestic, foreign-related awards and foreign awards. In comparison to foreign-related arbitral awards, foreign awards are in general understood as those rendered in a foreign country.

The second sentence of Art. I(1) New York Convention provides that the Convention "*shall also apply to arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought.*" Hence, this may lead to the assumption that also foreign-related arbitral awards fall under the governance of the New York Convention. However the reciprocity reservation made by China clarified that foreign-related awards do not fall within the scope of the New York Convention.

Whereas international arbitration law upholds the territorial principle determining the regime of enforcement, the current Art. 269 Civil Procedure Law of China still refers to an award made by a foreign arbitration institution as a foreign award, even though the arbitration may have been administered by a sub-commission of a foreign arbitration institution established in China, such establishments being permitted under certain requirements in the Free Trade Zone of Beijing, Shanghai and other places. In light of these discrepancies, it has been decided in the Meeting Minutes on the Trial of Foreign-Related Maritime and Commercial Cases published by the Supreme People's Court in 2021 that such awards shall be deemed as "foreign-related" awards.

In anticipation of the implementation of the Draft Revised Arbitration Law issued by the Ministry of Justice on 30 July 2021, such discrepancies shall, however, be resolved, since the new Arbitration Law will allow the concept of ad-hoc arbitration in China, which is a significant breakthrough to harmonize the applicable provisions in China with the territorial principle in international arbitration law. Hence, the question of whether an award is foreign or not shall no longer be decided by the origins of the arbitration institution administrating the arbitration proceeding.

**The Prior Reporting System**

Most notably, the Supreme People's Court implemented a "Prior Reporting System" with its Notice on the Handling of Issues Concerning Foreign-related Arbitration and Foreign Arbitration. Such "Prior Reporting System" applies to foreign and foreign-related arbitral awards. As set out in the Notice: "*the people's court must report to the high people's court of the jurisdiction concerned for examination before making a ruling of non-execution or refusal of recognition and execution. If the high people's court agrees to non-execution or refusal of recognition and execution, it shall report its examination opinions to the Supreme People's Court. Only after the Supreme People's Court gives its reply can the ruling of non-execution or refusal of recognition and execution be made.*"

The "Prior Reporting System" imposed an obligation to report to a higher instance prior to any decision of non-enforcement of an arbitral award. Such reporting efforts required the competent judge to report to the intermediate people's court and the high people's court, which led at times to delay of the final decision on non-enforcement. This process does however address the fear of foreign investors that local protectionism may hinder effective enforcement proceedings. Hence, a negative decision confirming a non-enforcement of a foreign and foreign-related arbitral award may only be issued by the Supreme People' Court, whereas positive decisions may be issued directly by the intermediate people's court.

**The Trade and Sustainable Development Chapter of the EU/New Zealand Trade Agreement dated 30 June 2022:** Adolf Peter (Shanghai University of Political Science and Law; Wöss & Partners LLC)

Adolf talked about the importance of the EU/New Zealand Free Trade Agreement (**EU/NZ-FTA**) for the enforcement of climate-related targets contained in the Paris Agreement. Adolf focused on the climate change-related provisions (effective implementation of the Paris Agreement including commitments concerning Nationally Determined Contributions) being part of the sustainability chapter.

Unlike other free trade agreements concluded by the EU, the EU/NZ-FTA seeks to include a unique dispute settlement mechanism for sustainability-related issues with the possibility of sanctions confirmed by a Panel composed of three persons selected from official lists and sub-lists. A selection panel established by the European Commission found Dr. Peter suitable for appointment for the position of arbitrator and trade and sustainable development expert (**TSD Expert**) in bilateral disputes under the EU's trade agreements with third countries.

Adolf pointed out that violations which seriously jeopardize the achievement of the Paris Agreement's targets could possibly trigger compensation payments or, more realistically, a party's suspension of the application of other obligations contained in the EU/NZ-FTA. Finally, Adolf pointed out that the EU/NZ-FTA could be a trendsetting agreement for bilateral free trade agreements concluded by the EU with other nations. This could result in a more effective implementation of the Paris Agreement's targets.

**Investment arbitration: ESG-related damages claims, the relationship between ESG and investment protection and the role of climate change-related obligations (Paris Agreement) in investment arbitration:** Herfried Wöss (Wöss & Partners), Nikos Lavranos (Wöss & Partners LLC; EFILA)

In his presentation on Climate Change and Investment Protection, Dr. Wöss analysed:

- the role of the Paris Agreement in investment arbitrations against countries that deliberately destroy renewable energy production; and
- the relationship between the Paris Agreement and the Fair and Equitable Treatment standard (**FET**) for the determination of the so-called "illegality threshold", which is the starting point for the determination of damages under the differential hypothesis or but-for premise.

Herfried started with a reference to the *Vattenfall v. Germany* investment arbitration and the German Federal Court judgment on the phase-out of nuclear energy production in Germany as proof that the current investment protection regime meets the standards of modern state law for compensation, as well as to the joint expert comments (Wöss/San Román/Marboe) on the UNCITRAL Secretariat's note on damages to the UNCITRAL Working Group III on ISDS reform, which provides an overview of the hot topic of damages in investment arbitration. He then underlined the role of the Paris Agreement in the USMCA Consultations between the US and Mexico as regards the Mexican Energy Policy, a trade case with a USD 31 billon price ticket, that is likely to trigger a wave of investment arbitrations against Mexico for the deliberate destruction of renewable energy production and a series of State measures likely to violate the FET standard under USMCA and other IIAs.

As regards the relationship of the Paris Agreement and FET, Herfried referred to Article 31(3) of the Vienna Convention on the Law of Treaties, which provides that when interpreting a treaty any relevant rules of international law applicable to the relations between the parties shall be taken into account (*Philipp Morris v. Uruguay*, para. 290). This means that when interpreting the FET, the Paris Agreement should be taken into consideration. This may affect the so-called illegality threshold and damages under the differential hypothesis or "but-for"-premise which sets the limit to regulatory freedom and fixes the point where the measure becomes illegal due to its intensity and with respect to the time aspect, as shown in *Murphy v. Ecuador* (50% tax legal, 99% tax illegal), *Eiser v. Spain* (temporary restrictions) and *AES v. Hungary* (where the illegality threshold was not crossed). The higher the illegality threshold, the lower the damages. The Paris Agreement may bar legitimate expectations and investment arbitration with respect to carbon intensive energy production.

Prof. Dr. Nikos Lavranos stated that as regards the level of greening of the revised Energy Charter Treaty (**ECT**), it should be noted that as in CETA and other recent investment agreements, the ECT now contains an explicit provision on the 'right to regulate' of states, to achieve legitimate policy objectives such as the protection of the environment, including climate change mitigation and adaptation, protection of public health, safety or public morals. This is further backed up by the introduction of several specific provisions reaffirming states' obligations to implement the Paris Agreement regarding climate change and labour rights under International Labour Organisation conventions. Essentially, this means that measures adopted to achieve these aims are to be considered compatible with the ECT and thus excluding any ISDS claims from the outset.

Moreover, the revised ECT introduces a new level of flexibility by allowing contracting parties to selectively exempt themselves from certain important provisions of the ECT.

The EU, its member states and – interestingly – the United Kingdom have opted to carve-out fossil fuel-related investments from investment protection under the revised ECT. This applies to existing investments after 10 years from the entry into force of the relevant provisions and for new investments made after 15 August 2023. In short, a balanced and realistic solution has been found by – on the one hand – phasing out fossil fuels in due course, while on the other hand, maintaining them until de-coupling from Russian gas has been accomplished. So neither the incompatibility argument nor the lack of greening argument brought forward by the likes of Poland or the Netherlands is convincing.

**Challenges and financing of administrative (public) claims relating to ESG/sustainability matters:** Michaela Krömer (Krömer Law Firm, Austria), Alice Fremuth-Wolf (Nivalion AG)

Michaela and Alice Fremuth-Wolf discussed the **challenges and financing of administrative (public) claims relating to ESG/sustainability matters**. Michaela sketched out the public and private enforcement mechanism of the CSDD based on the draft of the European Commission. Whilst no final conclusion can yet be drawn, she pointed that out that, based on the present draft, climate protection does not play an important role as it does not constitute an enforcement due diligence duty.

The CSDD therefore should not serve as a gateway for climate litigation. Nonetheless, an increase of climate litigation can be expected within the European Union which – if successful – will effect companies' obligations. Michaela pointed out that, besides greenwashing and competition law claims, public claims concerning climate targets, use of land and natural resources and intergenerational justice can be expected. She concluded by briefly sharing a climate case she filed on behalf of 12 minors challenging the Austrian Climate Act based on the constitutional rights of the child and the principle of equality. The case received priority treatment by the constitutional court a few days after filing.

Alice concluded by providing insights into the challenges that funding of such public claims pose because they usually lack proceeds that could be shared with a funder. These claims are important and private capital is needed to solve public problems. Guidance could be taken from the Collective Redress Directive where three funding options for collective redress claims by qualified entities (**QE**) are proposed: third-party-funding, sector-specific initiates such as claim vehicles that are funded by special interest groups or NGOs with philanthropic backing. It is clear that crowd-funding and pro bono legal support will play an important role but also commercial funders will think hard how to be able to support this cause.

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