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In Praise and Criticism of Arbitration as a Means of Resolving ESG Disputes

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The term environmental, social and governance (ESG) was coined almost 20 years ago in a landmark report entitled 'Who Cares Wins,' which was the result of a joint initiative of financial institutions invited by the then United Nations Secretary-General Kofi Annan to develop guidelines and recommendations on how to better integrate ESG issues in asset management, securities brokerage services and associated research functions. Today, ESG has become a prominent feature of the business and regulatory landscapes.

Not surprisingly, this has led to a corresponding increase in the number of ESG-related disputes. ESG disputes may be settled by litigation, arbitration, or other forms of alternative dispute resolution. Arbitration is especially well-suited to resolving ESG disputes, considering that it offers several advantages as a means of resolving ESG disputes.

These include: (1) neutrality of forum and flexibility as to where an arbitration is hosted; (2) specialist expertise of the arbitral tribunal; (3) flexibility of procedure and availability of specialized procedural rules; (4) worldwide coverage of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) enabling cross-border recognition (ICC Commission Report, Resolving Climate Change Related Disputes through Arbitration and ADR); and (5) accessibility by a broad range of actors such as states, private parties and intergovernmental organizations (IBA Climate Change Justice and Human Rights Task Force report, Achieving Justice and Human Rights in an Era of Climate Disruption).

Nonetheless, notwithstanding the advantages offered by arbitration as a means of resolving ESG disputes, arbitration remains the subject of various criticisms. In this post, I briefly review some of these purported criticisms and posit that rather than pointing to weaknesses they underscore arbitration's strengths in resolving ESG disputes.

Arbitration Depends on Party Consent

Arbitration has been dismissed as a means of resolving ESG disputes on the basis that ultimately it depends on party consent (See e.g., Report of the European Law Institute, "Business and Human Rights: Access to Justice and Effective Remedies", page 65 (positing that "any consensual system of dispute resolution such as mediation or arbitration is open to capture by the stronger party unless

effectively and externally controlled")). While this has been the case, the issue of consent does not limit the potential usefulness of arbitration as may be supposed.

Any stakeholders can submit a dispute to arbitration if they are a party to an agreement or other instrument that includes an arbitration agreement. These can include a wide range of instruments such as contracts, rules, decisions, resolutions, treaties and constituent instruments.

Many such instruments may identify further stakeholders that can submit claims, even if they are not parties to the instrument (The Hague Rules on Business and Human Rights Arbitration: Questions & Answers, page 7). For example, there is an increasing use of contracts to oblige a principal company to enforce due diligence in its supply chain and enable it to be held responsible for any non-compliance. In keeping with the UN Guiding Principles on Business and Human Rights, businesses can demand that their own suppliers and business partners accept arbitration to mitigate and address human rights risks throughout their operations (Questions & Answers, page 4). This role of model cascading contract clauses to facilitate companies' compliance with their due diligence requirements through their supply chain also features in the Proposal for an EU Directive on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 (COM/2022/71 final).

In addition to the foregoing, multi-stakeholder industry arrangements and global framework agreements between individual businesses and global unions may also stipulate arbitration to settle disputes arising thereunder so as to ensure coherent application of their terms when disputes do arise. Binding contractual commitments between a business and the stakeholders affected by its operations to arbitrate and to respect the outcome and pay any damages awarded sends a strong signal of a business's commitment to ESG helps foster a corporate culture of respect for ESG and may have positive reputational ramifications for business (In the context of human rights, see Questions & Answers, page 3).

And the use of these kinds of ESG-related clauses is not limited to supply chain contracts, considering the broad scope of contexts in which ESG issues arise. ESG-related clauses are also increasingly common, for example, in corporate transactions, including warranties and indemnities relating to a range of ESG issues, as well as in long-term investment contracts, for example, in the extractive and energy sectors.

Arbitration Is Incapable of Providing Effective Remedies

Another criticism of arbitration is that it lacks the necessary coercive powers that national courts possess (See e.g., Report of the European Law Institute, "Business and Human Rights: Access to Justice and Effective Remedies, page 65). This criticism is misplaced. For workers, communities and others who might be adversely harmed by a business's operations, recourse to arbitration will be appealing if there is a serious risk that for any reason domestic courts or other national institutions cannot provide a timely and meaningful remedy for violations (In the context of human rights, see Questions & Answers, page 4).

Courts cannot be counted on to provide victims with a timely and meaningful remedy for violations wherever there is inaccessibility, lack of independence, corruption, lack of capacity and underdeveloped legal frameworks (Questions & Answers, page 4). In addition, for claims against multinational businesses, courts in a business's home state may refuse to accept such cases based

on jurisdictional, corporate-law and other legal doctrines (Questions & Answers, page 4). Moreover, domestic litigation might entail significant costs or delay for the parties. And finally, even where a court issues relief to a victim(s), enforcement of the judgment in other countries might face various barriers (even when issued by a reputable court according to international standards).

On the other hand, the flexibility of arbitral procedures for parties and the finality of an arbitration award, may make for a more rapid and effective resolution of the dispute than domestic courts (Questions & Answers, page 4).

Arbitration Is Unsuited To Resolving Questions of Public Interest

The criticism that arbitration is not apt for resolving questions of public interest is also misplaced. There, in fact, have been cases where corporations used arbitration for resolving public interest disputes with third parties (ICC Commission Report, Resolving Climate Change Related Disputes through Arbitration and ADR, paragraph 5.82). Several advantages for doing so are as follows:

(a) limitation of multiple proceedings by providing for a one-stop, neutral and efficient forum and better management of excessive litigation risk in multiple fora;

(b) improved reputation by offering effective means for the adjudication of ESG claims, such as environmental claims, to the various stakeholders affected by their business activities; and

(c) companies may offer an arbitral forum for claims by potentially affected stakeholders as a means to address local or political opposition to a project or to satisfy certain legal requirements in order to allow the project to move forward

(See ICC Commission Report, page 45 (the Report also notes, “For many of the same reasons, arbitration mechanisms involving third-party participation are also being discussed in the context of investor-State arbitration and the UN Guiding Principles on Business and Human Rights.”)).

Indeed, it is the public interest nature of such disputes – which often involve socially driven, rather than purely “legal”, issues (e.g., activist challenges and potential media crises) – that make arbitration well-suited to resolving such disputes and thus help free up the court system.

Conclusion

This article is not intended to suggest that arbitration is a panacea for the resolution of all ESG disputes, or a substitute for national courts in all cases. However, for the reasons outlined above, it would be just as misconceived to believe that national courts should be the exclusive forum for the resolution of ESG disputes to the exclusion of arbitration.

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