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SUMMARY REPORT

OF THE THIRD SESSION

(3 - 5 June 2024)

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1. The third session of the Working Group on International Investment Contracts (the Working Group) was held in hybrid format from 3 to 5 June 2024 at the seat of UNIDROIT in Rome. The session was attended by 17 members and 19 observers, including representatives from international and regional organisations, as well as members of the UNIDROIT Secretariat and staff of the ICC Institute for World Business Law (the ICC Institute). The list of participants is available in Annexe I.

2. The session was chaired by UNIDROIT President Ms Maria Chiara Malaguti (the UNIDROIT Chair) and by the Chair of the ICC Institute Council, Mr Eduardo Silva Romero (the ICC Chair, together the Chairs).

Item 1: Opening of the session and welcome

3. *The Chairs* opened the session and welcomed all participants to the meeting. They extended an especially warm welcome to new participants in the Working Group.

4. *The UNIDROIT Chair* thanked all the participants who had contributed to the significant amount of work that had been done by the Subgroups during the intersessional period. She recalled that the first two Working Group sessions had mainly focused on the scope of the project, general matters, and preliminary discussions on selected substantive issues. Thanks to the dedicated work of the Subgroups, the documents for the third session contained concrete proposals on several subtopics.

Item 2: Adoption of the agenda and organisation of the session

5. *The UNIDROIT Chair* introduced the Annotated Draft Agenda and the organisation of the session. She proposed discussing the Subgroup Reports in the following order: Subgroup 2, Subgroup 4, Subgroup 3, Subgroup 1.

6. She noted that the Working Group had also received a Revised Issues Paper and a document with relevant ICC Model Clauses. Moreover, the Secretariat had shared, as background information, a memorandum from the research task force established under the Roma Tre-UNIDROIT Centre for Transnational Commercial Law and International Arbitration (Roma Tre-UNIDROIT research task force) on choice of law and dispute settlement clauses in international investment contracts (IICs).

7. *The Working Group agreed with the organisation of the session as proposed and adopted the Draft Agenda (UNIDROIT 2024 – Study L-IIC – W.G. 3 – Doc. 1, available in Annexe II).*

Item 3: Adoption of the Summary Report of the second session

8. *The UNIDROIT Chair* noted that the Secretariat had shared the draft Summary Report of the second Working Group session with all participants. *The Working Group adopted the Summary Report of the second session (UNIDROIT 2024 – Study L-IIC – W.G. 2 – Doc. 9).*

Item 4: Update on intersessional work and developments since the second Working Group session

9. *The UNIDROIT Chair* referred to the Revised Issues Paper, which contained a summary of the intersessional work that had been conducted since the second Working Group session.

10. She recalled that it had been suggested at the second session to start work on possible draft Principles with Commentary and Model Clauses. To this end, the Chairs had shared with the Working Group a template that followed such tripartite structure, to guide the intersessional work and help clarify the possible need for principles specific to IICs, taking into account the UNIDROIT Principles of International Commercial Contracts (UPICC) and other existing instruments.

11. Furthermore, the Secretariat had produced a preliminary draft structure of the future instrument (Annexe II to the Revised Issues Paper) based on the work of the Subgroups and considering possible additional matters that might merit being addressed in the instrument.

Item 5: Consideration of work in progress

12. Before turning to the Reports of the Subgroups, *the UNIDROIT Chair* welcomed any suggestions on the preliminary draft structure of the future instrument.

a) Matters identified by the Secretariat: Preliminary draft structure

13. *The ICC Chair* highlighted the need to provide practical advice to contracting parties of IICs. He cautioned against the production of a lengthy instrument and proposed including the future Model Clauses in a separate document or annexed to possible Principles with Commentary.

14. *A participant* asked whether the project would focus only on investment projects for which the State or a State entity awarded a concession to a private foreign investor – which he referred to as "private" or "ICSID-like projects" – or whether it would also cover public procurement contracts concerning projects that were financed by other parties (e.g., the State) – which he referred to as "public" projects.

15. In the ensuing discussion, it was noted that the International Centre for Settlement of Investment Disputes (ICSID) dealt with arbitration cases concerning a range of contracts (not only concession agreements). The future instrument should not be confined to ICSID arbitration, even if its case law might be useful for the interpretation of certain concepts.[1]

16. *The UNIDROIT Chair* asked whether the fact that financing was provided by a public party had an impact on the terms of the contract, i.e., whether this led to a different level of protection to the State and the investor. She also asked whether contracts concerning "public" projects were subject to an investment treaty in case of a challenge.

17. It was discussed that both concession agreements and construction contracts contained protection clauses for the contracting parties, although they were not necessarily the same. The source of the financing might affect the content of certain clauses. For instance, the State would generally be expected to have a stronger position in publicly-financed projects. For such projects, a construction contract was entered into by the State directly with a contractor, and the contract was usually awarded as the result of a competitive bidding process pursuant to the host State's procurement law. In that case, the State had already set out the features of the contract from the outset, and it would generally accept the best technical offer with the lowest price. This was different from the practice with "private" projects, whereby a concession agreement was concluded between a State and a private party, and the holder of the concession would, in turn, enter into a construction contract with a contractor. In case of public-private partnership agreements whereby a foreign investor contributed funding to the project, there might also be a bidding process, but the State would make its selection based on the anticipated revenue of the project.

18. *The UNIDROIT Chair* indicated that the Working Group would have to consider how to address these different contracts and the interplay between them.

19. *Several participants* expressed support for covering both types of contracts in the future instrument, irrespective of whether the project was financed by the State or by a private investor. It

[1] Reference was made to the findings of the ICSID Tribunal in respect of the existence of a protected "investment" in the case *Joy Mining Machinery Limited vs Arab Republic of Egypt*, which *inter alia* required that the project constitute a significant contribution to the host State's development.

was noted that a concession agreement typically mirrored the risk allocation provisions in the construction contract, so there would be merit in covering both (although some investment projects were limited to just a construction phase). It was also emphasised that the UPICC were suitable for contracts governing "public" projects, subject to the public policy of the host State. It was suggested to focus on general contractual clauses, irrespective of the type of contract, while leaving it to contracting parties to supplement those with contract-specific clauses.

20. The participants acknowledged that some contracts might be concluded following a public procurement process, but it was suggested to not focus on that unduly since it depended on domestic legislation, and in any case the future guidance could not deviate from mandatory rules.

21. A suggestion was made to clarify the scope of the instrument by referring to a non-exclusive list of categories of contracts: (i) concession agreements, (ii) product-sharing agreements, and (iii) build-operate-transfer agreements. These categories would cover the different types of contracts alluded to previously.

22. *Other participants* recalled that the Working Group had so far purposefully not defined "international investment contract" in order not to limit the scope to only certain contracts. It was also noted that developing a definition was challenging, as the work of UNCITRAL on Investor-State Dispute Settlement (ISDS) Reform had shown. Furthermore, if the aim was to develop Model Clauses, a definition did not seem needed since the clauses could be included in any type of contract. *One participant* cautioned against listing certain categories of contracts in the future instrument; he preferred a flexible approach that would ensure the instrument was future-proof.

23. *A participant* emphasised the need to clearly define the scope and objective of the project. He had understood that the aim was to contractualise the protections that had been developed for international investments. Such protections had traditionally been embedded in treaties but needed to be reflected in contracts due to the crisis in international investment law. This could be done by means of an umbrella investment contract that would protect underlying contracts or by clauses in individual contracts. In his view, this would include "stabilisation" clauses and the contractualisation of the Fair and Equitable Treatment (FET) standard. On the other hand, adapting the UPICC to any type of contract that involved a State or State entity would be a different and much broader exercise.

24. *The UNIDROIT Chair* confirmed that the intention was to contractualise, and where needed modernise, the protection offered in bilateral investment treaties (BITs). To do so, the suggested approach was to examine the types of clauses to be inserted in IICs, with the UPICC and other existing instruments as a starting point. For certain aspects, such as "stabilisation", a functional approach could be followed by also considering renegotiation and similar clauses to reach the same result. The idea was to consider the balance of interests in the contract as a whole. This explained why a range of subtopics was being considered. However, this did not mean that all the UPICC would need to be adapted; many were expected to be appropriate for IICs.

25. *The ICC Chair* agreed and added that investment protection essentially concerned the fair and equitable treatment of the investment. He suggested to identify the different corollaries of FET and examine how each of them could be addressed, by means of (an adaption of) the UPICC, new Principles, and/or Model Clauses.

26. *A participant* agreed that it would be helpful to contractualise the desirable FET protection but explained that divergent views had been expressed on the question of to what extent an IIC could specify or derogate from the FET standard under a treaty. This could be solved by clarifying in the treaty that its provisions might be specified in IICs and that the State could decide to derogate from those provisions, e.g., by means of a provision similar to Article 6 of the United Nations Convention on Contracts for the International Sale of Goods (CISG). The future instrument could thus also usefully provide guidance to negotiators of investment treaties. He underscored that the

instrument should provide explanations, either by means of Commentary to a set of Principles or in a Legal Guide.

27. *Another participant* suggested to consider the "bankability" of the investment project when developing the future guidance. He explained that financiers tended to be cautious about contracts with clauses that could affect the stability of the investment. Therefore, it was important that clauses that might lead to adaptations to the contract (e.g., price increases, time extension) contain clear criteria or trigger events.

28. *A participant* asked how the future instrument would relate to the UPICC. He noted that the preliminary draft structure only referred to some UPICC provisions, while it might be preferable to follow the same structure as the UPICC and cover all provisions in the future instrument (i.e., including the UPICC that already seemed to fit well for IICs), specifying any adaptations and/or providing additional guidance where appropriate.

29. *The UNIDROIT Chair* clarified that the suggestion was to refer in the instrument to the UPICC that were already suitable for IICs without needing to reproduce them, and to focus instead on aspects of the UPICC that might require adaptation or additional explanations for IICs. In addition, the instrument would provide guidance on aspects that were not covered in the UPICC since they were specific to IICs. Support was expressed for the suggested approach, which would be explained in the Introduction.

30. The UNIDROIT Chair then elaborated on the preliminary draft structure of the instrument chapter by chapter, and asked whether any additional contents should be included and/or any rearrangement of content was deemed necessary.

31. In the ensuing discussion, it was suggested to (i) add guidance on contract termination (addressing unilateral termination of an IIC by the host State); (ii) elaborate on the transfer of rights and obligations, considering that the contract often indicated that a transfer was not possible without the prior written consent of the host State; (iii) consider whether to include guidance on environmental, social and governance (ESG) aspects in a dedicated Chapter, and to cover corruption therein; and (iv) emphasise the concept of cooperation. However, it was suggested to focus on substantive matters first since the structure could be adapted as the work evolved.

b) Reports of the Subgroups

32. *The UNIDROIT Chair* drew the attention of the Working Group to the next item on the agenda and invited the Co-Chairs of the Subgroups to introduce the Subgroup Reports for the third session.

1. Report of Subgroup 2: Change of circumstances

33. *One of the Chairs of Subgroup 2* thanked the Subgroup members for their contributions during the intersessional period. Some of their input had been integrated into the main text of the Report of Subgroup 2, while other contributions had been included as Annexes. For hardship and force majeure, Subgroup 2 had followed the tripartite template as much as possible, while the Subgroup had not yet produced a draft Principle or Model Clause on "stabilisation" since divergent views had still been expressed on that subtopic. Finally, he noted that several issues for discussion by the Working Group had been highlighted in the footnotes.

1.1 "Stabilisation" clauses

34. The Report of Subgroup 2 recalled the rationale for stabilisation clauses as a risk-mitigation tool for investors. The members of Subgroup 2 agreed that there was a need to protect the legitimate interests of the investor but recognised that the State had legitimate interests too (e.g., concerning

the environment, health, or human rights). It was proposed to cover three main components of "stabilisation" clauses in the future instrument: (i) a substantive provision on the scope of the clause, (ii) a procedural provision containing the "trigger events", and (iii) exceptions.

35. The Report distinguished three types of "stabilisation" clauses: (i) "freezing" clauses, which had been heavily criticised; (ii) "fiscal stabilisation" clauses; and (iii) "economic equilibrium", "stabilisation and renegotiating" or "modern stabilisation" clauses.

36. *A member of Subgroup 2* explained that the Working Group would need to agree on a conceptual approach to allow Subgroup 2 to produce a concrete proposal on "stabilisation". He considered that the two extremes – a broad stabilisation clause or no stabilisation clause – could be disregarded since they did not seem in the interest of any contracting party. Broad stabilisation clauses would also be contrary to the Principles for Responsible Contracts of the United Nations Office of the High Commissioner for Human Rights (UN Principles for Responsible Contracts).

37. Turning to the types of clauses outlined in the Report, he indicated that "freezing" clauses were out of fashion although they were still used in practice in a very limited manner. Subject-matter specific "stabilisation" clauses – with "fiscal stabilisation" clauses as the prominent example – might appear to be a good option, but he warned that States might still need some room for manoeuvre in the area of tax legislation. "Economic equilibrium" clauses required parties to renegotiate if there was a substantial financial loss. The question with those clauses was what should happen in case the State had a valid reason for changing its laws in the public interest. In his opinion, the preferable way forward was to produce a general protective clause with exceptions for regulatory freedom, namely for *bona fide*, non-discriminatory measures in the public interest.

38. *Another member of Subgroup 2* explained the rationale behind a note on non-automatic and limited fiscal stability (Annexe I to the Subgroup 2 Report). He noted that the experience and practices related to "stabilisation" clauses had been diverse and inconsistent. While predictability was a legitimate concern, "stabilisation" clauses could undermine compliance with domestic law and create legal "enclaves" that could lead to inconsistency and complicate regulation of the investment. Furthermore, such clauses prevented law reform and constrained legitimate government measures. This would also apply to "economic equilibrium" clauses, since the remedy of financial compensation could have a prohibitive effect similar to that of "freezing" clauses. In his view, the use of "stabilisation" clauses should be informed by existing instruments such as the UNIDROIT-IFAD Legal Guide on Agricultural Land Investment Contracts (ALIC Guide), the OECD Guiding Principles for Durable Extractive Contracts, and the UN Principles for Responsible Contracts. The future instrument should prioritise alternatives to "stabilisation", which could be regulatory or legislative in nature (e.g., designing the tax regime in a way that anticipated different market dynamics) or contractual (e.g., treating costs attributable to compliance with changes in the law as project costs and providing for renegotiation in good faith if the economic viability of the project was undermined by the changes). The note contained draft Principles on "stabilisation" clauses, suggesting that their use be minimal.

39. *Another member of Subgroup 2* introduced a second note on "stabilisation" clauses (Annexe II to the Subgroup 2 Report), which focused on (i) their scope of application and (ii) the distinction with hardship clauses. He considered that the scope of "stabilisation" clauses should be consistent with the concept of legitimate expectations for investors as established in ICSID case law, that it should be broader than merely fiscal legislation, and that it should also cover *bona fide* changes by the host State. His suggestion was to refer in the future instrument to "*any unilateral intervention (act) by the host State which may affect the economic equilibrium of the IIC*". In his opinion, the investor should be entitled to compensation even if the change was *bona fide*, while the threshold for contract termination should be high. The difference between "stabilisation" and hardship clauses would be that the former concerned a changing economic equilibrium due to a State's intervention while the latter concerned unforeseen circumstances that did not relate to an act of the host State.

40. The Working Group agreed that "freezing" clauses were undesirable since a State should not be constrained contractually from changing its laws. It was recalled that freezing clauses had been heavily criticised, rejected by international organisations, and judged unconstitutional or invalid by courts in some jurisdictions. Reference was also made to the ALIC Guide, which recognised that the enforceability of freezing clauses was dubious in some legal systems.

41. The participants favoured a balanced approach. The ALIC Guide and the ICC Model Clause on "new or changed laws" were deemed a useful starting point. *One participant* noted that the main question was how to mitigate the impact of the change in law for the investor while taking into account that it took some risk from the outset that the host State could change its laws. *Another participant* noted that the concept of "stabilisation" was closely connected to hardship and force majeure since they all addressed situations of changing circumstances in a long-term contract. It was also observed that several participants seemed to favour an approach similar to the *fait du prince* theory.

42. Some discussion took place on the concept of "legitimate expectations". *A participant* suggested avoiding this term in any operative Principle or Model Clause since it was subject to different interpretations and could create confusion. *Another participant* considered it beneficial to discuss the interpretation of legitimate expectations in the future instrument and find a contractual solution since some countries were no longer party to investment treaties and therefore relied solely on contracts. He reiterated that it would be useful to encourage treaty negotiators to include a provision similar to Article 6 of the CISG that would allow contracting parties to specify or opt out of the FET standard. *Another participant* agreed but warned that it might not be possible to opt out of principles of customary international law (e.g., on State responsibility). It was also noted that legitimate expectations had to be mutual, i.e., they concerned not only the investor but also the host State.

43. It was emphasised that, in addition to the legitimate expectations of the parties, the foreseeability of the change at the time of conclusion of the contract was important. Furthermore, the point was raised that events outside the field of influence of the State might constrain a State to change its laws. The question was whether this fell within the scope of a "stabilisation" clause. It was also suggested to consider situations whereby not the State itself but a State agency or other public body was party to an IIC. In such case, legislative changes were outside the scope of competence of the public contracting party.

44. Regarding the difference between "stabilisation" and hardship clauses, the point was made that the former related to changes in legislation – understood in a broad manner, e.g., including changes in regulations and agreed standards – while the latter related to changing economic circumstances that made the performance of the contract more burdensome for one of the parties. In case of a change in legislation, there was no alternative other than to comply with the revised rules, but the question was what relief was to be granted to the investor.

45. *Several participants* agreed that the investor should be entitled to compensation, at least in certain circumstances. However, *several participants* cautioned against treating *bona fide* measures the same as *mala fide* measures. They considered such approach outdated and pointed out that any contractual solution should contemplate the criticism of the ISDS system, including its perceived lack of balance between the interests of investors and States. Therefore, it was suggested to identify requirements for compensation. *One participant* added that an act that would be tantamount to force majeure and forced the State to change its laws should not trigger the compensation obligation.

46. *Some participants* wondered whether inspiration could be drawn from the balance in customary international law between expropriation and the "police powers" doctrine, according to which the *bona fide*, non-discriminatory exercise of certain regulatory powers by the government aimed at the protection of legitimate public welfare was not deemed expropriatory or compensable.

It was noted that the International Court of Justice had recently reaffirmed the doctrine but had also indicated that government powers were not unlimited.[2] *One participant* cautioned against drawing on principles of public international law and preferred alignment with the ALIC Guide.

47. *A member of the UNIDROIT Secretariat* asked whether the Working Group agreed to provide different options in the future instrument for contracting parties to consider, depending on the circumstances. *One participant* agreed and highlighted the need for flexibility. *Another participant* considered that different options for model contract language could be useful for nuances, but emphasised the need to agree on a general approach so that clear guidance could be provided. For instance, the Working Group would have to choose between an automatic or non-automatic approach to the inclusion of stabilisation clauses. On this point, *one participant* indicated that he agreed with the approach advocated in Annexe I to the Report of Subgroup 2, advocating against the automatic use of stabilisation clauses, which was also in line with the ALIC Guide. It was noted that it would in any case be for the parties to decide which of the future Model Clauses to insert into their contract.

48. *The ICC Chair* concluded the discussion by emphasising that the aim was to produce new guidance (i.e., to develop *lex ferenda* rather than *lex lata*) on how to convert protections that were traditionally included in BITs in contractual protections. While this should be done while considering developments and reality, he suggested to not overly focus on the existing practice.

1.2 Hardship

49. *One of the Chairs of Subgroup 2* explained that the discussions on hardship within the Subgroup had reached sufficient maturity to propose Principles and a Model Clause with different options. He invited the drafter to introduce the suggested approach and noted that the footnotes and Commentary to the draft Principles contained questions for consideration by the Working Group.

50. *A member of Subgroup 2* explained that, for the draft Model Clause, inspiration had been drawn from the UPICC, the ICC Model Clauses, and a memorandum of the Roma Tre-UNIDROIT research task force. Regarding the effects of hardship in IICs, a key question was whether the disadvantaged party should be able to withhold performance. In his view, in line with the UPICC, the answer should be in the negative. Withholding performance or unilateral termination of the IIC could mean interrupting an important service offered to the public or crucial to the State. For IICs, contract continuation was thus even more relevant than for commercial contracts. The draft Model Clause indicated that a court or arbitral tribunal may determine appropriate compensation for the loss suffered by the disadvantaged party during the period of hardship. It contained different options for the possible adaptation of the IIC by a court or arbitral tribunal in case the renegotiation process failed.

51. *Another member of Subgroup 2* introduced a note on relational contract theory (Annexe III to the Subgroup 2 Report), which he considered especially relevant for hardship and force majeure. He explained that relational contract theory sought to deal with inevitable "gaps" in contracts, i.e., clarifying what would happen in case circumstances changed and those changes had not been foreseeable. The theory was based on the assumption that parties would cooperate to keep the contract alive. This was in line with the UPICC, e.g., on co-operation between the parties and the principle of good faith. He considered that the UPICC provisions on hardship and force majeure were well-suited to IICs and only suggested to add an obligation for the State to give notice and engage in a renegotiation process. This might not require an adaptation of the Principles but could be clarified in the main text of the future instrument.

[2] *See* International Court of Justice, *Certain Iranian Assets (Islamic Republic of Iran v. United States of America)*, Judgment of 30 March 2023, paragraph 185.

52. *A participant* pointed out that relational contract theory was controversial, although some lessons could perhaps be drawn from it. *Another participant* wondered how relational contract theory dealt with clawback provisions (e.g., clawback taxation by the State if an investment was more profitable than anticipated).

53. *Another participant* suggested examining the relationship between hardship and force majeure, on the one hand, and applicable law, on the other hand. *The Deputy Secretary-General* indicated that the ALIC Guide already provided guidance on this point, which the Working Group might usefully consider. *Still another participant* noted that in many jurisdictions contractual clauses in principle prevailed over domestic law subject to mandatory rules. In several countries in the MENA region, the application of the hardship doctrine was a mandatory rule aimed at protecting the weaker contracting party and, therefore, no issues would arise.

54. The discussion then turned to the draft Principles on hardship. Following a question by the UNIDROIT Chair, *the drafter* clarified that the proposed Principles were largely in line with the UPICC, with only minor adaptations to account for the special nature of IICs.

55. As to the definition of hardship (draft Principle 2), *some participants* expressed doubts about the reference in paragraph 2(e) to the "temporary" nature of the fundamental alteration of the equilibrium of the contract. It was not fully clear to them why such reference was needed and, if so, whether it should be a cumulative requirement. *The drafter* of the proposed principle agreed that such reference might not be needed since it could be considered implied.

56. Several questions were raised regarding draft Principle 3 on the effects of hardship. First, in relation to renegotiation (draft Principle 3(1)(a) and paragraphs 25-27 of the Commentary), *a participant* asked how the "equilibrium intended by the parties" would be determined, considering that IICs were long-term contracts and that the contract might have changed since its conclusion.

57. Second, she noted that Principle 3(1)(b) on compensation seemed to shift the risk of hardship to the other party. She wondered whether this would be appropriate since renegotiation of a contract did not necessarily lead to compensation or a change in price. *Another participant* suggested to integrate possible compensation in the renegotiation process rather than as an independent course of action. *The drafter* answered that shifting the burden to the other party was the intention of the *théorie de l'imprévision*, which had inspired the draft Principle. The assumption was that a State would prefer continued performance of an IIC given the general interest served by it, and would, in return, accept the shift in burden. He indicated that compensation was a principle in French doctrine but might not need to be included as a principle here.

58. Third, *a participant* asked why it seemed from the draft Commentary that only the investor could claim compensation. *The drafter* clarified that the request for compensation might not need to be limited to the investor only. Furthermore, a suggestion was made to provide guidance on the extent of compensation, i.e., whether compensation should be provided for (i) the "past" losses caused by the hardship, (ii) the "future" losses, or (iii) both. It was noted that disregarding past losses could create an incentive to prolong the renegotiation process. At the same time, the parties in practice focused on finding agreement on a fair solution; the discussion on past and future losses might then move to the background.

59. Fourth, *several participants* in principle agreed with draft Principle 3(3), according to which hardship did not entitle the disadvantaged party to withhold performance. However, it was suggested to make the provision less absolute and explain how this related to paragraphs 21 through 24 of the draft Commentary on termination in case of non-performance.

60. *The drafter* explained that the principle of continuity provided the rationale for advocating against withholding performance. *A member of the UNIDROIT Secretariat* recalled that the Working

Group had emphasised the relevance of that principle in previous Working Group sessions, noting that termination of the contract would result in withdrawal costs. *Another participant* added that the concept of *continuité de service* was an administrative law concept but had also been used in private contracts.

61. *The Deputy Secretary-General* agreed with the proposed approach on not withholding performance, which was in line with the UPICC. At the same time, the UPICC recognised in the commentary that there might be extraordinary circumstances in which withholding performance would be justified. In the ensuing discussion, it was suggested to indicate in the Commentary that parties were advised to regulate in their IIC whether withholding performance would be possible, referring to the principle of continuity but explaining that there might be circumstances in which withholding performance might be justified.

62. Fifth, regarding draft Principle 3(5), *the Deputy Secretary-General* wondered whether the reasonable requirement was appropriate. Furthermore, *a participant* suggested clarifying the prioritisation of the remedies and not starting with termination under (a). *Another participant* asked whether contract adaptation by a court or arbitral tribunal under (b) was supported by empirical analysis since contracting parties generally did not favour this. *The drafter* indicated that he was not aware of an empirical study on this topic. *Still another participant* added that contract adaptation by a court or tribunal might be preferable to unilateral termination of the IIC and that including it as an option in the contract could be an important incentive for parties to agree on a solution during the renegotiation process.

63. Some discussion took place on the general approach to hardship and its effects. *One of the Chairs of Subgroup 3* noted that renegotiation and contract adaptation were also being considered in the context of breach of ESG obligations. Therefore, if a general model clause were to be provided in the future instrument, it might be preferable to refer to it as a "renegotiation/adaptation clause" rather than as a "hardship" clause.

64. *A participant* observed that the draft Principle on hardship seemed almost akin to an insurance clause since it required the parties to renegotiate the contract or provide compensation in case of any loss caused by hardship. He wondered whether the criteria for hardship were formulated too broadly. He observed that the definition consisted of two parts: (i) events that fundamentally altered the equilibrium of the contract, which seemed a high threshold, (ii) "*either because the cost of a party's performance has increased or because the value of the performance of a party receives had diminished*", which seemed to point towards a lower threshold. For instance, he doubted whether it would be justified for a host State to pay compensation in case of a major change in interest rates that would affect the investment project but was beyond the control of the host State.

65. *The Deputy Secretary-General* explained that hardship was an exceptional situation with a high threshold under the UPICC. The second part of the definition meant to clarify that the alteration of the equilibrium may manifest itself in two ways, but the high threshold of a "fundamental" alteration of the equilibrium still had to be met, as also followed from the UPICC commentary. Hardship should therefore be distinguished from a renegotiation clause that would be triggered based on different circumstances (e.g., those under examination by Subgroup 3), even if the consequences might be similar. It was noted that the case law confirmed that hardship only covered exceptional circumstances.

66. *The drafter* added that it had not been the intention to provide an insurance-type clause. Renegotiation and compensation were envisaged but if instead the contract would be terminated due to hardship, the State would need to find a new contractor with similar financial consequences. *A participant* responded that a new contractor might not necessarily be equally or more expensive.

67. *One participant* suggested to consider the option of an extension of time in case a party was temporarily prevented from performance of its obligations under the contract. Such extension of time clause was common in construction contracts. Moreover, he suggested to clarify that there should be no double recovery if clauses might overlap in scope (e.g., it should not be possible to obtain compensation both under a hardship and a force majeure clause).

68. *Another participant* suggested clarifying the intended approach in paragraphs 8 and 9 of the draft Model Clause. On paragraph 8, he wondered whether the proposed "cooling-off period" – which required parties to renegotiate for a specific period of time before referring the matter to the court or arbitration – should only apply in case of hardship or also in other circumstances. On paragraph 9, he suggested not to limit the scope of the available remedies in arbitration procedures to compensation and contract termination, since in practice other remedies might be sought. He also wondered whether an arbitral tribunal would be able to adapt the contract in an enforceable way. He suggested that Subgroup 4 should deal with these aspects since they were concerned with dispute resolution.

69. *The drafter* answered that a cooling-off period in a hardship clause did not exclude its inclusion in a dispute resolution clause. Instead, if it were included in a dispute resolution clause only, its applicability in case of hardship might be unclear, depending on the interpretation of the concept "dispute". *Another participant* suggested to continue working in parallel in the Subgroups, noting that possible overlaps could be addressed at a later stage of the project.

1.3 Force majeure

70. *A member of Subgroup 2* explained that the draft Principle and Commentary on force majeure were based on the relevant UPICC provisions as a starting point. For the draft Model Clause, regard had also been given to existing (model) contracts. Considering the specificities of IICs – which often concerned long-term projects with substantial investment sums and projects that might not be easily dismantled or moved – the draft guidance encouraged the parties to keep the contract alive and to consider termination only in case of a prolonged force majeure event. The difference with hardship was that force majeure led to non-performance. Notice of the impediment should be given to the other party, and performance should continue as soon as possible in case the impediment was temporary. The draft Principle also envisaged a dispute resolution mechanism for possible disagreements about whether the right to suspend performance or terminate the contract was properly exercised. The draft Model Clause contained a non-exhaustive list of force majeure events.

71. *One of the Chairs of Subgroup 2* suggested to also address the risk allocation between a State and a contractor in case an investment facility was partially or fully destroyed due to a force majeure event. The general principle was that the risk of loss or damage to the investment facility passed to the State at the time of takeover, and the State could then normally benefit from business interruption insurance. The situation was less clear if the force majeure event happened *before* the takeover. While the risk would then in principle be on the investor, the latter might not be able to bear such risk if the event was not insurable. This situation was usually not regulated in the force majeure clause of an IIC but in a section on risk transfer or accepted risks. The question was how to address this topic in the future instrument and which Subgroup should handle it. *Another participant* agreed to cover this and suggested to also address risk allocation *after* takeover, or after the construction phase ended but before the investor recovered its costs or started to make a profit.

72. *A member of Subgroup 2* introduced a note on force majeure (Annexe IV to the Subgroup 2 Report), which recalled the relevant UPICC provisions and ICC Model Clauses, and suggested draft contract language. The note advocated the view that (i) force majeure assumed that performance was absolutely impossible, (ii) the event had to be unpreventable and unforeseeable, (iii) there was no causal link between the breach and the damage and hence no grounds for compensation.

73. *A participant* suggested specifying in the Model Clause what would happen if the party affected by the force majeure event did not notify the other party as soon as reasonably practicable. He noted that the clauses of the International Federation of Consulting Engineers (FIDIC) provided that the affected party was not entitled to relief as long as it did not give notice. He also mentioned that the force majeure clause in concession agreements often mirrored the force majeure clause in construction contracts. On the relationship between "impossibility" of performance and force majeure, he noted that the FIDIC provided, in addition to a force majeure clause (sub-clause 18.1 on "exceptional events") a separate clause on "release from performance under the law" (sub-clause 18.6). *Another participant* referred to the relevant provisions of the UPICC: article 7.1.1 on the definition of non-performance and 7.1.7 on force majeure.

74. *The Deputy Secretary-General* observed that the Commentary to the draft Principle indicated that termination should be authorised only, if at all, in the event of a prolonged force majeure event, while the draft Principle stipulated that nothing prevented a party from exercising a right to terminate. She suggested strengthening the wording of the draft Principle to clarify that termination was meant to be a last-resort measure. Secondly, she asked whether the Model Clause purposefully referred both to "written notice" and "notify". She also wondered whether additional notices might be necessary during the process, apart from the notice on the resumption of performance. Thirdly, she suggested to present paragraph 2(b) of the Model Clause separately since it did not seem connected to the notice. Finally, she suggested referring in the Commentary to the UPICC on the need to mitigate the consequences of the non-performance.

75. *A participant* doubted whether amendments to the UPICC provisions on hardship and force majeure were needed. He considered them already appropriately, as was demonstrated by their use in practice. He suggested that, if helpful, examples of case law on IICs could be offered in the text of the future instrument. *Another participant* agreed in principle but noted that precautions on termination should be advocated for IICs, given their special characteristics. *A member of the UNIDROIT Secretariat* added that the memorandum of the Roma Tre-UNIDROIT research task force contained examples of clauses that limited termination to force majeure events that lasted more than two years.

76. *The UNIDROIT Chair* thanked everyone for their input. For the next intersessional period, she asked all the Subgroups to carefully consider whether adaptations to the UPICC were necessary due to the characteristics of IICs, particularly the fact that one of the contracting parties was a State and that the investment often concerned a public service or utility. If adaptations or additions were deemed necessary, then this should be clearly explained in the draft Commentary.

2. Report of Subgroup 4: Choice of law and dispute settlement clauses

77. *One of the Chairs of Subgroup 4* introduced the Report, explaining that the Subgroup had met virtually and that it had benefited from input on both topics from the perspective of contract-based ICSID arbitration. Subgroup 4 recognised that there were existing instruments in this area and that reform efforts were ongoing; the aim was to complement that work from the unique perspective of IICs. Subgroup 4 intended to start with the development of draft Model Clauses in the next intersessional period and welcomed input from Working Group participants on existing contract clauses and relevant case law. It was recognised that close coordination with the other Subgroups was needed given the overlap of some issues.

2.1 Choice of law clauses

78. *One of the Chairs of Subgroup 4* introduced the section on choice of law, which contained six questions for discussion by the Working Group. Examples were whether the future instrument should provide different options of choice of law Model Clauses, which sources of law should be referenced and, if there were multiple sources, whether there should be a hierarchy.

79. *A participant* asked whether the intention was to develop a choice of law clause for the contract as such or for dispute resolution. *The Chair of Subgroup 4* clarified that the work on choice of law was limited to the law applicable to the contract; the law applicable to dispute settlement would be addressed as part of the work on dispute settlement clauses.

80. The participants generally agreed that the choice of law clause tended to be less important for investors than the dispute settlement clause. While they tended to accept the host State's law as applicable law, they preferred a neutral approach in dispute settlement. *The Deputy Secretary-General* indicated that the UPICC could be chosen as the law applicable to the contract but also at the moment a dispute arose, as was highlighted in the Model Clauses for the Use of the UPICC.

81. The Working Group agreed on promoting the use of the UPICC as applicable law and discussed that the Model Clauses for the Use of the UPICC, which offered various alternatives, provided a useful starting point. Support was particularly expressed for recommending the use of the UPICC or the future instrument as a tool to interpret and supplement a chosen domestic law, which already was the most common use of the UPICC. The need for broad promotion was mentioned, preferably also through other international bodies or organisations such as the envisaged Advisory Centre on International Investment Law and Investor-State Dispute Settlement.

82. The discussion then turned to the interaction between possible different sources of law. *One participant* cautioned against an approach whereby the supplementing "transnational law", which might be vague, was given priority over the chosen domestic law. *Other participants* emphasised that the perhaps vague concept of "transnational law" as used in the 1950s/60s had evolved over time and that the UPICC were concrete and beneficial to use for contracting parties. Furthermore, using the UPICC as a secondary source of law could favour the bankability of the investment project and international arbitrators would likely welcome a solution such as the UPICC, while respecting the governing law clause.

83. Different views were expressed on *dépeçage*, according to which different parts of the contract would be subject to different sources of law. *One participant* favoured this approach, while *another participant* expressed caution given the complexity in practice. He emphasised that the future guidance should be concrete and operational. *Other participants* noted that the ICC Model Clauses could be used for inspiration, and that there were existing IICs that contained a clear hierarchy of sources of law.

84. The participants discussed that it would be important to explain in the future instrument why the UPICC as choice of law would be beneficial not only for investors but also for host States, which tended to favour their own domestic law. Reference was made to neutrality and to the UPICC as a means towards unification. Furthermore, it would be easier for States to familiarise themselves with internationally recognised principles than with the domestic law of other States. It was discussed that the instrument should not present the UPICC as "superior" to domestic law.

85. *A member of the UNIDROIT Secretariat* added that the aim was to seek an appropriate balance between the interests of investors and States in the instrument as a whole. For instance, while an element of "stabilisation" and neutrality in the applicable law might primarily benefit the investor, the host State would benefit from clear contractual commitments from the investor on policy goals.

86. *A participant* mentioned that it was not always sufficiently clear what a reference to "international law" in the choice of law clause meant, e.g., whether it also included soft law. It was discussed that the UPICC provided a concrete set of rules that could well be chosen as governing law, even if it was soft law, while international standards on policy goals could not be applied to the entire contract, but might be relevant for specific aspects of the IIC.

87. The Working Group discussed that it would be important to clarify the scope of the choice of law clause. While it had traditionally been drafted broadly as applicable to all issues arising out of the contract, this had changed over time, also considering that the context in which IICs operated had changed. *One participant* expressed the view that a choice for a certain domestic law covered all legislation in that jurisdiction and not only a subset thereof. *Another participant* raised the point that for countries with a federal system, the clause should clarify whether federal or State law applied.

88. Some discussion took place on whether to expressly exclude conflict of laws rules from the scope of choice of law clauses. *Several participants* were in favour of this, noting that it was common practice and accepted in both common and civil law jurisdictions. Such exclusion of *renvoi* was provided, *inter alia*, in the Rome I Regulation and in the Inter-American Convention on the Law Applicable to International Contracts, and it was the approach in the Principles on Choice of Law in International Commercial Contracts of the Hague Conference on Private International Law. *Two participants* expressed hesitance about expressly fully excluding the application of conflict of laws rules. They noted that this might be redundant since it was sufficiently clear that the choice of a certain applicable law concerned substantive law, and that such exclusion might lead to uncertainties in case issues arose that were not covered by the law applicable to the contract.

2.2 Dispute settlement clauses

89. *One of the Chairs of Subgroup 4* introduced the section of the Subgroup 4 Report on dispute settlement. He noted that effective dispute resolution consisted of three elements: dispute prevention, dispute mitigation, and dispute management. He indicated that the Working Group could benefit from the lessons learned about the issues that had led to the crisis in investment arbitration. Well-drafted contractual dispute settlement clauses could help States and investors preserve their contractual relationship, provide opportunities for resolving grievances before they became disputes, give parties an alternative to direct recourse to investment arbitration, and create a more durable and legitimate dispute resolution process.

90. The Working Group was invited to provide input on the aspects outlined in the Report: (i) the content of possible Model Clauses, e.g., whether they should provide for litigation or different alternative dispute resolution (ADR) mechanisms, and whether any distinctions needed to be made depending on the type of contract or sector; (ii) means of avoiding parallel proceedings, e.g., "fork-in-the-road"/"no U-turn" provisions and waivers of treaty arbitration; and (iii) transparency and conflicts of interest, with due regard to existing instruments.

91. As a general matter, the participants agreed with the importance of the three elements for effective dispute resolution mentioned by the Chair of Subgroup 4, and the important potential of the future instrument in this context.

92. On point (i) of the Report, the participants agreed on the need to contain and settle disputes at an early stage by providing options for ADR mechanisms before recourse to judicial proceedings or arbitration. Such options could include a cooling-off period for negotiations and mediation. *One participant* advocated a multitiered approach whereby the parties that were directly involved in the dispute first had to attempt amicable settlement for a fixed period of time, followed by referral to senior executives, before turning to arbitration. *Another participant* agreed to encourage ADR, even if there might be impediments to the use of such mechanisms in the context of IICs.

93. With regard to negotiation, *one participant* raised the point that diverging interpretations had been given as to whether non-compliance with a cooling-off period had procedural or jurisdictional consequences, i.e., it was not clear whether the arbitral tribunal was prevented from hearing the case in such circumstances. He suggested addressing this in the future instrument.

94. Broad support was expressed for mediation as an efficient and cost-effective ADR mechanism. Reference was made to the importance of the United Nations Convention on International Settlement Agreements resulting from Mediation (Singapore Convention), which ensured that a settlement reached by the parties became binding and enforceable. It was noted that several countries already applied the principle of *res judicata* to settlement agreements resulting from mediation to prevent subsequent recourse to arbitration or judicial proceedings concerning the same subject matter. *One participant* cautioned that mediation did not seem as effective in international disputes as in a domestic context.

95. The participants generally favoured the inclusion of mediation in a dispute settlement clause as an optional step prior to arbitration. This way, contracting parties would have contractual legitimacy to use mediation (which was particularly important for State officials) while avoiding the possible drawbacks of compulsory mediation (e.g., a "tick-the-box" approach). *One participant* agreed on the importance of a contractual basis for State officials to engage in mediation but warned that they might still face issues at the settlement stage.

96. *Several participants* considered that mediation should remain an option throughout the dispute resolution process, including at the arbitration phase. It was suggested to consider "mediation windows" as a tool, i.e., providing mediation as an option in specific stages of the process.

97. The Working Group also discussed the potential use of dispute boards. *A participant* explained that these were commonly used in the context of construction contracts. Traditionally, dispute boards had issued recommendations, but decisions had become binding under FIDIC contracts because States considered such practice preferable in light of rules on the accountability of public officials and anti-corruption laws. Dispute boards seemed less apt for concession agreements, although *ad hoc* dispute boards (to be established only if a dispute arose) could perhaps be considered. *Another participant* preferred not to discuss dispute boards at all in the future instrument.

98. With regard to arbitration, reference was made to the complexities that might arise in case the investor was a joint venture comprising both local and foreign companies. It was noted that unanimity might be required to initiate arbitration proceedings, while the local investor might refuse it. Possible solutions were to allow a foreign investor to commence arbitration for its own share of the joint venture or to consider the joint venture partners joint and several creditors under the IIC.

99. Some discussion took place on claims concerning corruption. *One participant* considered that such claims were not arbitrable because corruption constituted a criminal offence in many jurisdictions. *Another participant* clarified that this had changed over time; arbitrators nowadays did have jurisdiction with regard to allegations of corruption. Reference was made to the ICC Task Force Addressing Issues of Corruption in International Arbitration. He considered that the future Model Clauses should provide for anti-corruption obligations for both parties, which could be the subject of arbitration proceedings if arbitration was the chosen dispute settlement mechanism.

100. *A participant* presented the main findings of research on contract-based ICSID arbitration. This research had shown that there was no clear trend in dispute resolution clauses – some were generic while others were very detailed – although an ADR mechanism was usually considered. The steps seemed to depend on the type of contract, the parties, and the region. Generally, three different ADR mechanisms were envisaged by the contracting parties in addition to and before arbitration: (i) recourse to a joint committee of the parties, (ii) amicable settlement (i.e., a generic provision indicating that the parties would seek to settle disputes within a certain period of time), and (iii) mediation and conciliation. Some dispute resolution clauses referred to all three steps, while others mentioned only one or two options. Since there was no "one-size-fits-all solution", she suggested that it might be challenging to develop model clauses. *Another participant* agreed and noted that diverging views existed on cooling-off periods and on mechanisms to prevent and mitigate

disputes. The Working Group would need to decide whether to set out all options or recommend specific solutions.

101. The discussion then turned to the possible participation of third parties in a dispute settlement process. *A participant* suggested to address the possible extension of an arbitration clause to non-signatories (e.g., subcontractors). *The UNIDROIT Chair* wondered to what extent third-party participation could be arranged contractually, considering the procedural rules of courts and arbitration tribunals.

102. In the ensuing discussion, it was noted that the extent of possible "contractualisation" in this area depended on the type of third party and whether it concerned judicial or arbitral proceedings. For instance, *amici curiae* were comprehensively covered by the rules of courts and arbitration tribunals, while domestic laws differed as to the participation of third-party beneficiaries of the contract. Furthermore, civil procedural rules often allowed the involvement of third parties in judicial procedures (and could even oblige them to participate) while arbitration was normally limited to the parties that signed the arbitration agreement. The extent to which a contract could arrange third-party participation also depended on the law applicable to the arbitration agreement; it might be less challenging if the arbitration agreement was not linked to a choice of domestic law. Furthermore, it was noted that the rules of some arbitration tribunals allowed *amici curiae* participation and the consolidation of arbitrations. To enable this, it was important to include the same arbitration clause in all contracts that governed an investment project. Finally, it was noted that third parties affected by the investment could in any case not be prevented by a contractual clause to exercise their rights.

103. On avoiding parallel proceedings (point (ii) of the Report), *one participant* preferred not to discuss the details of *res judicata* since it was complex and also related to substantive issues. *Another participant* noted that waiver provisions invoked by States were rarely accepted by tribunals but he considered it useful to work on a possible contractual model clause. Furthermore, it was discussed that there may be situations of sequential, rather than parallel, proceedings (e.g., commercial arbitration followed by investment treaty arbitration). Given the focus of the project on contracts, it was suggested to address in the future instrument only multiple parallel or sequential proceedings by the contracting parties and not, for instance, shareholder claims or parallel proceedings by different investors vis-à-vis the same State concerning the same subject-matter.

104. The Working Group also discussed the concept of counterclaims. It was noted that both States and investors could submit claims based on an IIC since it contained obligations for both parties. There might be little to add in a contract with regard to counterclaims since such claims were normally regulated in arbitration tribunals' procedural rules. According to those rules, the counterclaim had to be based on the same or closely connected legal basis. A contractual clause could perhaps merely indicate that the State could raise a counterclaim that was not based on the IIC as such.

105. On transparency and conflicts of interest (point (iii) of the Report), support was expressed for the reference to the UNCITRAL Code of Conduct for Arbitrators in International Investment Dispute Resolution. It was noted that the UNICTRAL Rules on Transparency in Treaty-based Investor-State Arbitration could be usefully considered too, adapted as appropriate to investment contracts.

106. *The UNIDROIT Chair* suggested to discuss the issue of ADR in general and whether there were matters that could not be addressed by the arbitration clause for reasons of public policy. She also reminded that Subgroup 0 work might impact on waivers. Subgroup 0 was tasked with the drafting of the Introduction to the future instrument and thus there was a need for coordination, including on whether a State could waive immunity rights by contract in the execution phase.

107. *Most of the participants* agreed that waiver of arbitration under a treaty, when multiple options for arbitration were available, fell within the scope of Subgroup 4 rather than Subgroup 0.

Some participants mentioned that, since IICs were commercial contracts and not administrative agreements, when the parties signed an arbitration agreement, they agreed to resort to arbitration without any limitation, the State consenting to waive any restrictions relating to State immunity, both as regards jurisdiction and execution of awards.

108. *Other participants* recalled the peculiarity of State immunity claims (i.e., divergent domestic laws on the matter, limitations of ICSID and the New York Convention) and warned that any possible stipulation under the future instrument would run the risk of being neglected by courts or not being accepted by States. As to immunity from jurisdiction and enforcement there might exist more acceptable practice, based on those jurisdictions that accepted relative immunity and States' practice of enforcing and executing arbitral awards for reputational issues, but many States continued to object to immunity from execution on procedural grounds and property distinctions. They suggested that the Working Group should consider State immunity as a side issue.

109. *Still other participants* objected that investors would expect State immunity to be addressed in the future instrument. Waiver of sovereign immunity was a fundamental issue and had already been tackled in ICC model contracts for both major projects and joint ventures. It might be not an easy task, but a model clause was necessary.

110. *One of the Co-Chairs* of Subgroup 4 noted that when a State entered into an arbitration clause, it was considered as waiving its immunity from jurisdiction. A typical defence from the State was that who signed the contract had not been authorised to do so and that the contract was therefore null and void, or no jurisdiction might be found.[3] Under the ICSID Convention, States agreed to enforce awards through an automatic system, but still subject to the provisions on immunity from execution that continued to apply, so in principle there would not be room to limit those immunities.

111. It was mentioned that an ICSID model clause was available on State waiver of immunity as to its property, though its validity and scope would depend on the applicable law, as was often resorted to contract practice. The Convention contained different regulations with regard to the three stages (immunity from jurisdiction, enforcement, execution) but immunity from execution issues were left to domestic law. It was mentioned that also the New York Convention did not regulate the issue of execution and national courts came to different interpretations as to what was meant by enforcement and/or execution.

3. Report of Subgroup 3: Addressing policy goals in IICs

112. *The Co-Chair of Subgroup 3* listed eight issues flagged in the Report, namely: (i) if a definition of "investor" was needed and if it would include the signatory or all the subjects of the value chain; (ii) if the focus was on the host State's or also the home State's law; (iii) if policy goals should be defined by reference to ESG in relation to the need to shape a future-proof document; (iv) how an international standard on policy goals should be construed; (v) if the investment should be assessed against a test of single materiality (inside the corporation) or double materiality (also outside the corporation); (vi) if the future instrument would govern States' and investors' activity also in the post-investment period and until when; (vii) how a duty of cooperation and good faith in this area would be formulated and how it would match with more general clauses in the instrument; (viii) if due diligence should be covered, taking into account the differences between the OECD and the UN documents in this area, as well as the new EU Directive on Corporate Sustainability Due Diligence (CSDD Directive).

[3] It was noted that Swiss law on arbitration contained a provision that precisely aimed at fighting this kind of defence on the part of the State.

113. *One participant* suggested to consider the World Bank's conditions on environmental and social requirements that were added to contracts (such as FIDIC construction contracts) for projects financed by the World Bank. *The UNIDROIT Deputy Secretary-General* indicated that UNIDROIT had started exploratory work on a possible project on corporate sustainability due diligence that might have some issues in common with the IICs Project. Mutual feedback would be beneficial in this regard, but also a clear definition of the scope of the two projects, which would mainly depend on the definition of value chain.

114. *Several participants* considered it important to place ESG in both the preamble, as a basis for interpretation, and in the main text of an IIC, to create rights or obligations. *Other participants* cautioned that there were different views on the single and double materiality standard worldwide. The EU had opted for the double materiality standard, which was seen as a higher standard of protection[4], while the International Auditing and Assurance Standards Board (IAASB) advocated a single materiality standard, viewed as having a better chance of being adopted worldwide (and adopted by e.g., China). It was suggested that the Working Group consider these approaches and sensitivities.

115. *The UNIDROIT Chair* mentioned that any position taken by the Working Group would need to be explained in the commentary. *A member of the UNIDROIT Secretariat* added that the instrument could also provide different options, leaving it to negotiators to strike a balanced solution in their contracts depending on the specific circumstances of the case.

116. *The Co-Chairs of Subgroup 3* noted that the investment should be in line with the highest standard and that the work should be aligned and coordinated with UNIDROIT'S envisaged new project, including a coherent notion of value chain. An option could be to consider the value chain in an IIC to include any operator or actor that the investor was using in order to implement the investment (actors that were identifiable for the investor). It was emphasised that the concepts of investor and value chain should be sufficiently broad to capture multinationals' responsibility for subcontractors, i.e., multinationals could no longer claim that they were unaware of subcontractors' activities.

117. *The UNIDROIT Chair* summarised that an investor, as a party to an IIC, would undertake the contractual obligation vis-à-vis the contracting State (or State entity) to ensure that all subcontractors respected international standards on ESG, including due diligence obligations and/or contractual responsibility for the acts of their partners, be they suppliers, co-workers, and so forth. *The Co-Chairs of Subgroup 3* agreed that this core issue could be dealt with in different ways, either by using the principle of "comply or explain" or by detailing the liability of the investor and the host State in the contract based on a range of standards to respect (human rights, social and environmental commitments), with different possible approaches as regards liability, including in some cases a delegation of responsibility from the investor to some of its subcontractors or clients.

118. *One participant* considered that the future instrument should limit itself to providing guidance on issues concerning policy goals, since these were constantly evolving and involved public international law. The wide endorsement of the UPICC in the international arena, including by UNCITRAL, would ensure the acceptance of UPICC-derived Principles concerning IICs. *Another participant* noted the importance of adjusting ESG in some contexts, clarifying if the contractualisation of ESG obligations would provide a legal basis for additional contractual claims against States, and what the consequences would be in case of violations by investors (e.g., whether this would affect their standing to raise a claim or their claims to compensation).

119. *Further participants* suggested to explore issues of investors' accountability based on the law of its home State as a means to level the playing field between States and investors, and the possible

[4] The double materiality standard required companies to look at the input and the output version of sustainability, the former meaning what was the impact of the sustainability constraints on the company, the latter to what extent the company's activities were impacting the social and economic environment in sustainability terms.

role of the home State as a third party in disputes between the investor and the host State. It was also proposed to further investigate on which ground corporate sustainability due diligence or ESG standards would become binding on the parties (home or host State law; international law; the law applicable to the contract).

120. *The Co-Chairs of Subgroup 3* agreed with previous interventions and mentioned that the reference in the Subgroup 3 Report to the deprivation of investment protection as a consequence of violating ESG standards was in line with recent discussions at the OECD. She agreed that guidance should be provided but suggested to go beyond that, by also providing model clauses.

121. *The UNIDROIT Chair* asked what would be specific to IICs in the area of ESG obligations. For instance, for States, the kind of obligation that would apply to them and whether violations could lead to a contractual claim; and for investors, the issue of single/double materiality and the relevance of host/home State legislation. Other aspects, such as the concept of ESG or the standard to be respected seemed to be of general nature (i.e., not limited to IICs specifically).

122. *The Co-Chairs of Subgroup 3* mentioned that a typicality of IICs was their long-term nature, which caused a greater potential for impact on the host State compared to contracts for the trade of goods and services. For instance, IICs concerning natural resources and infrastructures might last for decades and bring about hefty damage to the environment at the investment site in case of poor management. While a due diligence supply obligation in trade would mean, e.g., to ensure that chain operators were not using child labour, in IICs it would imply for the investor continuous monitoring of all stages of operations along the whole life of the investment, which bore on all sections of the future instrument (applicable law, mitigation duties, and so forth).

123. *Other participants* considered that, in addition, IICs often implied a contribution to economic development in the host State (e.g., spending a proportion of the investment on engaging local suppliers or subcontractors), which increased the necessity of considering ESG due diligence in the investment value chain. Furthermore, OECD statistics on procedures reporting violations of the OECD Guidelines[5] before National Contact Points (NCP) showed that the same industries or economic sectors normally present in investment projects were also the most likely to be the subject of complaints: thus, investment projects were probably more exposed to the risk of ESG violations than other sectors. Moreover, when dealing with extending due diligence obligations throughout the value chain, there was the issue of whether this was an obligation of result or means, i.e., if the investor was to deploy its best efforts with subcontractors and suppliers to disseminate ESG standards, or if it was bound to be liable for the conduct of its partners, essentially providing a warranty that none of its suppliers and subcontractors will violate ESG standards.

124. *The UNIDROIT Chair* indicated that there were recommendations of OECD NPCs that might be deemed IICs-specific, i.e., concerning the need for transparency and stakeholder involvement in the investment project, that. For instance, a specific obligation for investors to inform and dialogue with local stakeholders might be something special to IICs and, by this methodology, other investment-specific standards could be inferred by importation from strands of decisions taken by NCPs, different from those that were in place in the financial or trade sector.

125. *One of the Co-Chairs of Subgroup 3* noted that a group of students in the context of a Trade Lab Clinic had explored contract-based investments complaints before OECD NCPs, and frustration of transparency commitments was found to be prevalent in OECD NCPs reports. It was also found that prior consultations with indigenous communities and other affected vulnerable groups would have avoided conflicts. Providing guidance and suitable procedural mechanisms for cooperation along the entire life of contract could possibly avoid disputes. A finding was clear that many ESG standards did not find proper consideration at a judicial level, with the OECD system being mainly voluntary and thus not totally satisfactory. Therefore, there was an opportunity for the Project to tackle this

[5] The OECD Guidelines for Multinational Enterprises on Responsible Business Conduct.

uncertainty and the flaws of the existing system, integrating ESG concerns into the dispute settlement system by informal consultation, mediation or conciliation.

126. *The UNIDROIT Chair* also noted that NCPs' procedures referred to home State standards to guide companies' behaviour in the host State but were not proper dispute settlement procedures based on law adjudication. Therefore, it was still to be seen whether strands of decisions with their underlying principles could be reasonably transferred into contract law since ESG coverage might be easier in a context where there were no sanctions and no liability, but rather a reputational incentive to change or adjust behaviour.

127. It was mentioned that some of the world's largest companies supported the EU CSDD Directive. The alignment of IICs with CSDD legislation would ensure consistency in ESG practice and compliance across jurisdictions, including in the interest of investors. It was also proposed to include capacity-building clauses in IICs that would impose on the leading investor the obligation to enhance its subcontractors' and suppliers' capabilities in areas such as environmental management, social responsibility, and governance practices. It was also discussed that a combined approach was emerging between due diligence obligations and codes of conduct, whereby due diligence was more preventive while codes were still annexed to the contract and provided a legal basis for remedies (e.g., justifying terminating or suspending the supplier contract). With reference to OECD NCPs, the reputational damage which stemmed from those procedures was pointed out and the trend of companies to apply a risk strategy to buy in local communities before the commencement of the investment, to avoid that an injunction be sought by an NGO to suspend or terminate the project. Furthermore, it was noted that local communities' involvement should be a bilateral (State and investor) obligation, based on a joint interest, and an end-term should be provided for legal suits to provide certainty and know from which moment an investment could be considered closed and completed, with no obligations or open liabilities further stemming therefrom.

128. *One participant* noted that the Working Group should strive for a cautious, balanced approach. He mentioned that there would be a practical problem in identifying the home State of intrinsically multinational corporations, and importing home State standards or further raising the ESG threshold increased costs, possibly resulting in certain types of investments becoming unviable, at odds with the aims of making profit and contributing to economic development in the host State.

129. *The UNIDROIT Chair* agreed that importing a too-wide set of standards from the home State could cause competition issues and might overly penalise the foreign investor vis-à-vis national investors in the host State. *The UNIDROIT Deputy Secretary-General* noted that the lines of discussion were similar to those in the envisaged CSDD project, one being what the UNIDROIT Principles might add to ESG obligations, and another shifting from a conflictual or "all-or-nothing" approach to a collaborative approach.

130. It was finally mentioned that ESG raised issues of choice of law. While the EU Directive had its own liability clauses, other legislation (such as the "Transparency Act" in Norway) did not provide any rule on liability, meaning that any liability for a breach of an ESG best effort or obligation clause would likely be adjudicated under the law of the site of harm. This might not be the best-suited law to decide the case, and thus one should consider the emerging rule to adjudicate liability for environmental damages – that more and more often allowed the injured party to choose between local law and the law of the damaging party. There might be issues in choosing the applicable law before the damage had materialised, but these were all circumstances that should be investigated in further depth.

4. Report of Subgroup 1: Pre-contractual issues in IICs and validity

4.1 Pre-contractual issues

131. *One of the Chairs of Subgroup 1* introduced the section of the Subgroup 1 Report on pre-contractual issues, which consisted of proposals – including commentary to existing UPICC provisions and draft Model Clauses – on five subtopics. She preliminarily noted that it was doubtful if some aspects could be regulated by contract, as they were issues of mandatory law or public policy. The Report therefore contained a caveat and a suggestion that institutional endorsement of the future Model Clauses might be helpful.

132. The first draft Model Clause on "risk for its own assumption" tackled the main issue of creating more predictability to avoid that the principle of good faith and fair dealing in UPICC art. 1.7 be used by courts or arbitral tribunals – as currently occurred – to disregard the contract terms parties had agreed upon. Based on the contractual practice of carrying out commercial due diligence in the pre-contractual phase,[6] it could be assumed there was a duty on the investor to assess all publicly-available information having an impact on the future contract. The question was how much information, based on the principle of good faith, the State should make available to the investor which was not publicly available (e.g., details of the project). The draft Model Clause indicated that each party could not be blamed by the other party for not having disclosed something that was publicly available, and that a party had the duty to disclose only the information that was requested by the other, unless it was confidential.[7] In terms of procedure, the request of information should be specific and accompanied by a brief explanation of the reasons why the information was relevant; expert adjudication would be provided to settle any disagreement on the admissibility of any request for information (including on grounds of confidentiality).

133. *The other Co-Chair of Subgroup 1* noted that the principle of good faith and fair dealing under UPICC art. 1.7 might not only relate to information but be broader. For instance, it might entail a duty to act in good faith towards the conclusion of the contract, requiring the parties to act in good faith at each step (MOUs, letters of intent) that contributed to the progressive formation of a complete agreement. He suggested also covering such duty in the Commentary and a Model Clause. Another participant agreed and wondered whether it would be helpful to refer to different stages for entering into an IIC (e.g., invitation to tender, initial due diligence, bidding, negotiations).

134. *Some participants* stated that good faith and fair dealing in UPICC art. 1.7 referred to international trade and the whole duration of contract, and not only the pre-contractual phase. As to the proposal that a party might not be held to have acted in breach of a duty of good faith if it did not disclose information that was not requested by the other party, it was mentioned that certain information in the hands of the host State might be of a special nature that the investor could not access or could not even know the existence of through proper due diligence. In this case, there should be a reversal of burden, such as in certain common law jurisdictions, and the investor should not be found at fault for not having asked for that information. It was suggested that the future instrument formulate a standard regarding the amount of information that parties were bound to disclose as such as sufficient to decide on the concerned issue. The principle in UPICC art. 1.7 should be formulated in the future instrument as a general principle applying throughout the duration of the contract, while UPICC art. 2.1.15 on negotiations in bad faith might suffice to tackle pre-contractual issues.

135. The opinion was expressed that State contracts and public tender contracts should be dealt with separately, as the latter's regime also included competition law. It was also reminded that the

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[6] Commercial due diligence can be understood as the analysis of all the legal, technical, financial and commercial aspects of the deal that create the basis for the investor's business decision, the determination of price or costs, etc.

[7] It was held that contracts usually include a definition of what is confidential information.

relational contract theory addressed how to operationalise and give concrete meaning to good faith and that since IICs were established a long-term relationship during which circumstances changed and adjustments were needed, guidance criteria should be identified on how to run the process by which the parties meet, establish values and objectives, and adjust the contract. In the context of dispute prevention, mitigation and grievance mechanisms, States' obligation to share information was a key aspect, but States proved reluctant to disclose.

136. The procedural steps envisaged in the Model Clause (obligation to request information, to disclose information unless inappropriate, third expert's determination if the information was to be disclosed) were deemed useful and acceptable. *One participant* noted that in the pre-contractual practice of construction contracts, while the investor had a due diligence duty, the State held information stemming from its special knowledge of the local environment that was not always publicly available. The potential contractor might not be in the condition to bear the costs of on-site investigation before the conclusion of the procedure, as it did not know if it would be assigned the contract. He considered that this information should be disclosed by the State in the tender. The obligation to disclose should be bilateral, as the investor's due diligence duty had limitations.

137. It was noted that the pre-contractual phase also covered ESG due diligence and this, as a continuing obligation, would cover the whole duration of contract. In this regard, *the UNIDROIT Chair* asked if the future instrument should include an autonomous principle or section on ESG due diligence and third parties' involvement. In response, it was suggested to limit this discussion to the parties who would conclude the future contract, while ESG obligations towards third parties would be addressed separately.

138. *The Co-Chair of Subgroup 1* illustrated the next draft Model Clause on each party's freedom to evaluate its own interests. The clause was formulated considering UPICC art. 1.8 on inconsistent behaviour[8] and the general principle of good faith in UPICC art. 1.7 with a view to address changes in business strategy by investors or in policy by States during the negotiations, which could last for years, with investors losing interest in the operation (e.g., for changes in fiscal policy or regulation). The idea would be to ensure that throughout the negotiations or possibly the tender process, and until a binding contract is entered into, each party would be entitled to change its negotiation position, including breaking off the negotiations or the tender process, subject to such restrictions as expressly agreed upon by the parties and in the tender documents. In substance, the party might not be held to have acted in breach of a duty of good faith or the prohibition of inconsistent behaviour if it has informed the other party that its negotiating position was subject to contract.

139. *The UNIDROIT Chair* noted that the clause was clear from a commercial law standpoint, but it should be considered whether it was still viable in the context of investment law, where a party to the contract was the State and public law was involved. *One participant* confirmed that the reference to "not to disappoint expectations" in section 1.2(B), para. 4 of the Report might entail very different concepts for investment lawyers, compared to commercial law or international trade. He added that section 1.2(C), which stated that the party was acting in good faith if it made clear to the other party that its negotiation position was subject to contract, would give the impression that a party had the duty at any moment to clarify that, unless something was agreed, it would not be bound by it. However, UPICC art. 2.1.13, which was presumably the point of departure for this clause, would apply only in a particular situation where very specific matters were of such an importance that a party would not intend to enter into a binding agreement unless those matters were settled in a satisfactory manner. This would be a higher standard of agreement which would not fit within the pre-contractual phase, as it would make it difficult to formulate a principle that an agreement was always necessary on all matters. *Other participants* reminded that IICs might be subject to approval

[8] "A party cannot act inconsistently with an understanding it has caused the other party to have and upon which that other party reasonably has acted in reliance to its detriment."

after the signature of the contract, particularly by the State. Consistency of behaviour and good faith in the approval procedure should be part of the pre-contractual obligations of the State.

140. *The Co-Chair of Subgroup 1* illustrated draft Model Clause 1.3, which confirmed that if the parties had been negotiating but no contract was concluded, the contract could not be seen as concluded and there was no specific performance obligation to conclude the contract. While clause 1.2 already pointed to this (together with UPICC art. 2.1.13, which provided the basis), this clause effectively prevented the negotiating parties from falling under UPICC art. 2.1.15 on negotiations in bad faith, if a party entered into or continued negotiations when not intending to reach an agreement with the other party. It happened that one party might enter into negotiations without being sure it would sign the contract, this depending on the concrete developments of the negotiation in relation to that party's business strategy. Such a text, to be included in pre-contractual documents, would clarify that no bad faith and subsequent liability was to be found with a change in a party's negotiation position, except as was specifically agreed by the parties.

141. *The UNIDROIT Chair* raised a doubt as to whether these principles would apply to tender procedures. It was clarified that clause 1.3 in particular would hardly apply to public tenders. The tender would regulate in detail the negotiating phase and provide for a security to prevent withdrawal of the offer by the private negotiator, which would not have an incentive to change strategy. Generally, individually negotiated IICs and IICs under public tenders might be treated separately.

142. *Some participants* held the opposing view that, if the Working Group was going to take on special types of IICs, it could not embrace all the specificities of the multitude of forms an investment relationship might take. It was suggested to take a general approach to the formulation of these clauses so that no IICs were left out, while it was up to the parties to apply the general principles to specific types of IICs.

143. *One participant* noted that, according to Australian law, the expression "subject to contract" might take different meanings such as the intention to be bound, expressing the desire to draw up a formal document at a later stage, or to postpone the creation of an obligation until a formal contract was drafted.[9] *Another participant* added that in practice the clause "subject to board approval" clause was often employed. This raised concerns since it might be seen as a "*condition potestative*" where a party inserted a condition depending on the will of only that party. The "subject to board approval" clause might be used to exit the contract. It was noted that the clause meant that it would not amount to a breach of the duty of good faith for a project to be submitted to the board without knowing whether it would be approved or not.

144. *The UNIDROIT Chair* recalled how crucial it was to consider public party involvement in IICs. She asked how this would apply when a State (and not a public company with a board) was party to the negotiations, i.e., when the approval should come from a Ministry or other authority, such as Parliament, and how issues of liability would apply in such a context.

145. *The Co-Chair of Subgroup 1* replied that the clause would fulfil the same function as it would be difficult to say that simply because a State entity had negotiated certain conditions, the State needed to approve them. It was considered the case of a change in government where a government was elected with the mandate to change policy in a sector related to the negotiation of an IIC. Translating the "subject to board approval" clause to a State dimension, it would seem that the clause worked in most change of government/policy situations, as what mattered was the initial intention of the first government triggering negotiations, but it could be difficult to require the government to disclose different concurring projects or different options.

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9 *See* High Court of Australia, "Masters and Cameron" (1954).

146. *The UNIDROIT Deputy Secretary-General* flagged that the UPICC included rules on public permission requirements, as they had a bearing on the validity of contract; it should be examined how they applied in the pre-contractual phase.

147. *The Co-Chair of Subgroup 1* illustrated the subsequent draft clause, which was derived from UPICC art. 1.4 on mandatory rules. It was suggested to provide specific contract language here with regard to IICs, considering the special treatment that the public party usually offered to foreign investors (e.g., tax breaks, exemption from regulatory obligations for a time), that might seem out of line with the mandatory law generally applicable in the country and needed to be specifically approved by the host State authority (e.g., the Parliament) ensuring their validity and enforceability. The proposed contract language would clarify that any such specially agreed terms would prevail over mandatory rules generally applicable in the host State.

148. It was noted that, in principle, this rule should be tested and applied by international arbitrators, but where the contract was found out of line with host State mandatory laws, competing bidders would seize local courts to have the bidding process reversed in their favour. UPICC art. 1.4 was reconnected to the doctrine of illegality and the investor's compliance with mandatory host State law, from which the investor could not opt out (except certain special treatment). *Some participants* mentioned that, if this was true, the principle needed to be broken into several levels, one dealing with national mandatory law (including the principle stemming from the Vienna Convention on the Law of Treaties that when entering into treaties States could not derogate from the essentials of their legal systems), and another with international law, where peremptory norms of public international law were considered, along with other norms that might not be peremptory, but still important.

149. *The UNIDROIT Deputy Secretary-General* clarified that the formulation in the UPICC from national to international and supranational simply wished to be as comprehensive as possible. *The Co-Chair of Subgroup 1* clarified that private international law rules would point to a certain set of rules as applicable to the IIC concerned, which could include international law and international (or transnational) public policy rules. It was acknowledged that this doctrinal issue was highly debated in literature and also tackled in the OAS Guide on the Law Applicable to International Investment Arbitration.

150. *Some participants* opined that the border between public and private international law was blurring. In a famous case, the French Court of Cassation had found, in relation to an ICC award and the rules for appointment of arbitrators in a multiparty contract and dispute, that it is a matter of "international public policy" to maintain a fair and equal opportunity for each disputing party to be represented at the arbitral tribunal. In other cases, the Court had found money laundering and corruption against French public policy and international public policy as well.[10] *Other participants* considered the principle well written and noted that in major investment projects, the investor would seek the opinion of the State legal counsel and then ask a private lawyer if this corresponded to the state of the art and complied with the host State Constitution.

151. Concerns were raised about the clause's wording that any such specific contract terms would prevail over mandatory rules generally applicable in the host State and suggested to refer to mere approval of the investment terms by the competent authorities. *Some participants* referred to the impact of this approach on stabilisation and on its ability to create legitimate expectations, since any clause in this sense would exactly mean that the investor legitimately expected that to be the term of the investment. Continued use of private law language might bring about the risk that IICs, which involved by their very nature a public law aspect, were challenged for contradicting the Constitution, or the basic structure of the legal order, or mandatory laws. It was also raised that, differently from stabilisation clauses, the clause would be a representation that there was treatment granted by the

[10] *See also* the "Sulaiman" case in UK in 1999 and the more recent "Shishkin" case in 2023.

public party which was valid and approved by authority, not to be deemed contrary to local mandatory law (with no commitment, though, for the future).

152. *The Co-Chair of Subgroup 1* illustrated the proposed "entire agreement" clause that could be included in the final contract, which defined the meaning of the pre-contractual phase for the interpretation of the contract. It was derived from UPICC art. 2.1.17 on merger clauses, in combination with UPICC art. 4.3 on relevant circumstances (referring to parties' negotiations as an element to be taken into consideration in the interpretation of a contract), UPICC art. 4.8 on supplying omitted terms (referring to the intention of the parties and good faith and fair dealing to complement the contract), and UPICC art. 5.1.2 on implied obligations (referring to good faith and fair dealing as elements to consider). The draft clause tackled the possibility that under an approach closer to civil law there might be a difference between what the parties expected by reading the terms of contract and after contract interpretation; the entire agreement clause would limit as much as possible the intervention by the interpreter since it would make sure that no obligation for either party could be implied on the basis of the party's conduct or exchange of documents in the pre-contractual phase, or based on a duty of good faith, unless they were necessary to give business efficacy to the contract or were obvious and did not expressly contradict the terms of the contract. She noted that the Working Group might opt for a different approach, but the one proposed would limit the risk for the parties to be bound by what they had not really agreed to but was rather derived from interpretation.

153. *One participant* argued that, from his experience in FIDIC and construction contracts before courts and arbitral tribunals, an entire agreement clause would not be strictly necessary. The existing UPICC would suffice since they included all the elements and circumstances that courts, both in civil and common law countries, would consider before taking a decision, including evidence from preliminary negotiations.

4.2 Validity

154. *The other Co-Chair of Subgroup 1* illustrated the subsequent part of the Subgroup 1 Report concerning validity. As to the form of an IIC, he mentioned that, unlike in the UPICC, the draft Principle required IICs to be in written form since this was a requirement that most legal orders established, with some flexibility as regards technological evolution to encompass electronic communications. The next draft Principle was drawn from UPICC art. 3.1.2, and indicated that an IIC was to be concluded, modified or terminated by the mere agreement of the parties without any further requirement, so to set aside any additional requirements, such as consideration or cause, which might exist under the applicable law, affecting the validity of the agreement, in line with what the UPICC provided for international commercial contracts. The assumption was that validity issues would not be subject to a choice of law, but rather governed by the domestic law of the host State.

155. *One participant* expressed doubts about whether a principle on validity of mere agreement was necessary. *Some participants* wished to propose some correction to language concerning bidding processes in tenders that appeared too strict and suggested to refer to situations where "bidders cannot substantially depart" from the tender conditions and, in the same vein, documentation "prepared by the State substantially not subject to negotiations". It was also pointed out that, in the context of tenders, the relevant law concerning written form (including on electronic support) would be the law of the tender, i.e., the law of the host State. This would be a preliminary phase that was still strictly governed by public procurement law, before the signature of contract and the choice of the law applicable to the final contract.

156. It was stressed that this was a very crucial point since the UPICC – or their adaptation to IICs – would give a common ground different from national laws, to govern the contract. The domestic law of the host State would still apply, but in case of dispute the UPICC (or adapted UPICC) would complement domestic law, as non-State law would become more widely eligible in an

arbitration context, and provide solutions to the controversy without indefinite discussions on consideration, relevance of precontractual negotiations, and so forth.

157. *The Co-Chair of Subgroup 1* illustrated the next draft Principle on initial impossibility, which was drawn from UPICC art. 3.1.3, in order to establish that initial impossibility should not determine the invalidity of the contract, but rather be dealt with under the rules of non-performance. Similarly, the mere fact that at the time of the conclusion of the contract, a party was not entitled to dispose of the assets to which the contract related should not affect its validity. Consequences would be, if goods to be delivered or used were not available any longer or a misrepresentation was made, infringement of the contract rules and damages. As to grounds of avoidance, he proposed that, as regarded the principles on mistake, which were rarely invoked in international commercial contracts and set a very high threshold to be triggered, some guidance might be provided in the commentary of the final instrument, instead of generally excluding their application.

158. *A member of the UNIDROIT Secretariat* recalled the PRICL methodology, and particularly a general provision that remitted to the UPICC that applied as they were, where they did not need adjustments to international reinsurance contracts. She noted that a similar provision might be included in the future instrument when the substantive content of the principle did not need textual adaptation, and/or some notes could be included in the Commentary explaining how the non-adapted UPICC would apply to IICs. *Another member of the Secretariat* noted that it would also be important to consider the amount of adaptation deemed necessary to adjust single UPICC articles to IICs, since small adaptations might not be worthwhile, as they would dilute the meaning of the UPICC and create confusion for prospective users. *A participant* held that all the work on the future instrument would remain in general contract law and should not go into the specificities of single types of IICs.

159. *The Co-Chair of Subgroup 1* illustrated the section on fraud, which referred to UPICC art. 3.2.5. He noted there might be overlap with representations and warranties, and perhaps differentiated application if it concerned individually negotiated IICs or public procurement contracts. He finally hinted at distinguishing between fraud and mistake, and the necessity of having specific provisions on fraud by the investor, fraud by the State, or improper influence.

160. *The UNIDROIT Chair* asked how this would connect to corruption issues and if the latter would deserve an autonomous principle for IICs, taking into consideration the clean hands doctrine and the possible consequence of the investment not being protected.

161. Reference was made to the interrelation between fraud and corruption, the significant role of public international law in this regard (including guidance by international organisations), and the need for coordination with Subgroup 3. *Some participants* drew attention to a different scenario where the fraudulent representation or non-disclosure was made by a third party, whose conduct could not be attributable to one of the parties (e.g., the employee of a State party), or when the misrepresentation by a third party was beneficial to one of the parties to the contract. In this regard reference was made to UPICC art. 3.2.8 on third parties. *One participant* considered that all the acts of any public servant with governmental status might perhaps be attributed to the State, even if there was no formal empowerment to act, and that Subgroup 0 might provide directions on that.

162. *One of the Co-Chairs of Subgroup 1* raised, in relation to the argument that the State could not raise as defence its internal distribution of competences, the question if this rule could raise tension with the due diligence rule, by which the private party should know the rules on State representation and that the representative was abiding by all regulations in force. *The UNIDROIT Chair* considered that issues of identity of the parties (and legal effects) – as regarded both the foreign private investor (supply chain or not) and the State party (nature and identity), as well as issues of responsibility – were to be considered part of the work of Subgroups 3 and 1.

163. *The Co-Chair of Subgroup 1* considered that corruption issues were better addressed by the legality provisions in the UPICC. He also clarified that fraud was about information included in the contract which fraudulently led the other party to believe in something that was not true. As to the

next Principle on threat and duress, drawn from UPICC art 3.2.6, he noted that in the field of investment, it might consist of economic duress, i.e., situations where the stronger party used its position of strength in a manner to pressure the other party to sign the contract. *The UNIDROIT Deputy Secretary-General* recalled that in the UPICC the term "duress" had purposely not been used, but if the Working Group considered that other terminology was needed in the context of IICs, it might decide to do so. *The UNIDROIT Chair* added that UPICC terminology should be maintained to the greatest extent possible, apart from specific, justified reasons to amend it.

164. *One participant* asked if, vis-à-vis the great array of tools the State could use to exert an intangible threat or duress on the private investor, the future instrument should use a higher or lower threshold to trigger the application of the principle compared to commercial contracts. *Another participant* considered that the threshold in the UPICC was already quite high. He also added that there was no reason to limit consideration to intangible threats or economic duress, as there were cases where physical pressure was exerted on negotiators (to the point of their freedom being limited). It was also mentioned that threat and duress might occur more frequently in amendments or addenda to contracts rather than the principal contract itself.

165. *The Co-Chair of Subgroup 1* moved to the next draft Principle on gross disparity, which was drawn from UPICC art. 3.2.7. It was mentioned that this principle might not be adequate "telle quelle" for IICs that are complex contracts negotiated between experienced professionals. The main adaptation to the UPICC provision was to provide for renegotiation rather than avoidance, while the grounds would in principle remain the same. The draft Principle indicated that the request for renegotiation should be made without undue delay and should indicate the grounds therefor, while not entitling the disadvantaged party to withhold performance. Upon failure to reach agreement within a reasonable time, either party may resort to the court or to arbitration. If gross disparity was found, the court or arbitral tribunal could either declare the avoidance of the IIC at a date and on terms to be fixed, or adapt the IIC with a view to restoring its equilibrium.

166. *Some participants* expressed discontentment with this provision and noted that a similar provision in the future instrument would expose any IIC to the risk of being overridden, as most State legal affairs offices were understaffed; State lawyers had to sign long documents without being able to read everything and therefore might invoke ignorance. Too-extended specific renegotiation rights with a third-party entitlement (court or arbitral tribunal) to amend the IIC was critical in the investment field and would open the door to unpredictability for the parties while giving the Working Group the difficult task of examining and identifying the circumstances that allowed for renegotiation and amendment. A general clause on contract amendment by parties' common agreement might serve as a residual regime to cover cases which were not assigned specific renegotiation rights.

167. *A participant* cast doubts about whether the gross disparity principle should be left out in the context of IICs, as it had been subject to continued and deep reflection over the years in the process of elaboration and revision of the UPICC. He doubted whether there was a mandate to change the principle as it stood now, and he stressed that the threshold to trigger it was very high, implying an objective element of disproportion. Even if some misunderstanding occurred in courts, it had an educational value and could not be set aside without significant examination and analysis.

168. *The Deputy Secretary-General* replied that the gross disparity provision in the UPICC had been heatedly discussed in the process and that the fear had been that such a provision would destabilise the relationship. She also mentioned that disparity did not mean that there were a high number of provisions in favour of a certain party, but rather that there was an imbalance that shocked the conscience of a reasonable person. The threshold was therefore quite high and did not provide an easy escape from the contract. *One participant* warned against creating confusion by restating all the UPICC when the original UPICC might result applicable with few explanations and without amendments. He mentioned that the UPICC should be adapted only by exception when it was clearly felt that there was a need to modify the ordinary regime of general contract law provided for commercial contracts in the realm of investment contracts.

169. *A representative of the ICC* noted that the UPICC provision on gross disparity might be a reason why parties of IICs did not often use the UPICC directly as applicable law. Although the threshold was high, the parties preferred not to refer to the UPICC generally but to draw from specific Principles. Even if the ICC supported the application of the UPICC in their model clauses, the market had not always followed proposed indications.

170. *The UNIDROIT Chair* thanked the participants for their observations and anticipated that the Co-Chairs would provide guidance for the Working Group on the proposed format and structure of the future instrument (a self-standing instrument adjusted to the specific needs of IICs, while preserving the UPICC for commercial contracts). She recalled the observation that one participant had made, that it would be difficult to make acceptable to a host State to not apply its own domestic law to IICs, and pointed to the fact that a "matching solution" like the UPICC offered a means of complementary solutions to the applicable domestic law, might be acceptable and thus work.

171. *The Co-Chair of Subgroup 1* introduced the next draft Principle on threat, fraud or gross disparity imputable to a third party for whose conduct the other party was responsible – which was drawn from UPICC art. 3.2.8. In this case, he mentioned that the contract might be avoided under the same conditions as if the behaviour or knowledge had been that of the party itself. Where fraud, threat or gross disparity was imputable to a third person for whose acts the other party is not responsible, then the contract might be avoided only if that party knew or ought to have known of the fraud, threat or disparity, or had not at the time of avoidance reasonably acted in reliance of the contract (presumption of knowledge). He mentioned that this situation was different from the case of *"ultra vires"* and that it might need adaptation in relation to cases where State agencies or firms were involved with a high number of employees whose conduct might or might not be considered imputable to the State or the State entity.

172. *One participant* referred to State entities, particularly State companies, and considered that their status was usually private and deemed to be different from that of the State, but it should be considered whether in this context their employees would be considered connected to the State. There was also the case of State agencies or authorities that fully negotiated IICs but then submitted the agreement for approval by State organs.

173. *The Co-Chair of Subgroup 1* then moved to a proposed Principle on damages and clarified that it was framed as a general principle that, regardless of whether the IIC had been avoided, the party who knew or ought to have known of the grounds of avoidance was liable for damages so as to put the other party in the condition it would have been in if it had not concluded the contract. As for the theory of avoidance of contract, the right to damages of the aggrieved party would only cover negative interests. He clarified that this general rule would only refer to cases where a contract had just been concluded and thus implicated costs for the negotiations and conclusion of the contract. It was also made clear that the rule on damages and restitution in this context was specific to avoidance and that general rules and criteria for the calculation of compensation and damages as well as restitution would be covered at a later stage by Subgroup 1.

174. *Many participants* agreed that any position in regard to situations covered by damages and form of the damages should take into account the discussions at UNCITRAL, the outcome of which would be available in the following months. Once this was ascertained, the discussion in the Working Group should consider which situations arose in relation to IICs that deserved restitution and damages, the conceptual distinction between restitution (as "specific performance") and damages, and the specific rationales for one and/or the other – including what this implied when the rule of restitution required the involvement of the use of public power by a State or State entity and the difference with purely monetary restitution.

175. *The UNIDROIT Chair* asked to what extent damages might be regulated by the parties in a contract and how this might be viable in a list of Principles meant for application to contracts without falling into the classical logic of investment arbitration (full recovery). In particular, she sought to

know to what extent the future instrument should be coordinated with UNCITRAL's work, taking into account the different logic underpinning contract- and treaty-based arbitration.

176. *A participant* considered that the work of other international organisations should be taken into account while also considering the differences, and that a section on contractual damages, as distinct from public international law violations, might form a significant part of the final instrument. *The UNIDROIT Chair* agreed that there was a need to follow UNCITRAL's work. She invited the participants to reflect, according to the established methodology for the project, on possible differences in damages for a contractual breach and a treaty breach, how transnational principles and particularly the UPICC addressed this, possible differences between IICs and commercial contracts in this context, and to what extent this topic could be addressed in a Model Clause.

177. *The Co-Chair of Subgroup 1* then discussed a draft Principle on illegality as grounds for avoidance, which was drawn from UPICC art. 3.3.1 and could cover all concerns raised regarding illegalities that might surround the contract (active or passive corruption, money laundering, collusive bidding, etc). He mentioned that on one level, where a contract infringed a mandatory rule, the effects of that infringement upon the contract were those expressly prescribed by that mandatory rule; on another level, where the mandatory rule did not expressly prescribe the effects of infringement upon the contract, the parties had the right to exercise such remedies under the contract as reasonable in the circumstances; on a third level, a series of circumstances were provided to help the adjudicator to determine whether the right to remedies was or was not reasonable.

178. *Some participants* stressed that the doctrine of illegality was currently being widely debated, and there was a strong argument that when a private investor wished to achieve protection he first needed to be found to have gained access to the market in compliance with local laws and international standards, if applicable, and to have continued to comply with local laws and international standards throughout the life of the contract. Arbitral tribunals also held that illegality should be rather important, not a minor deviation. It was also raised that the reference to mandatory laws extended the scope and reach of the principle to a wider area than that covered by the legality doctrine in investment treaty arbitration, which would create the problem of possible abuses of the principle, if included in the future instrument. He finally proposed to have a general principle on compliance with mandatory laws and a related rule on consequences and remedies, while providing corruption with an independent and separate principle, that would cover the current discussion.

179. *The Subgroup Co-Chair* replied that the draft Principle, as formulated, did not refer to mandatory law as "international public order" or norms that should necessarily be applied under private international law systems, but rather mandatory rules of domestic, supranational and international origin that could not be eluded and were few (e.g., the UN Convention against Corruption and the Brazilian law on corruption where a public party was involved).

180. *Some participants* joined the view that a different and separate provision was necessary for corruption. One mentioned that the draft Principle was too broad, from major (criminal law) to minor (public procurement rules) violations, and a specific principle – including sanctions and penalties for corruption (as had been frequent in Iranian contracts some decades ago) – would be more adequate. It was recalled that an ICC model clause on anti-corruption, providing sanctions and a compliance programme (including procedural steps to be taken to monitor and avoid corruption in ordinary processes, as a sort of due diligence process), had been available since 2012 and was included in the document with relevant ICC model clauses. The clause was currently under revision.

181. *Other participants* also agreed that adequate focus on corruption was necessary because anti-corruption provisions worked in practice as warnings, providing for processes, procedural rules and auditing rights to create an environment inconducive to illegalities, whereas financial sanctions might work better than termination to preserve the investment, including in the interest of the State.

182. *The UNIDROIT Chair* closed the discussion, summarising that the Working Group had agreed that a separate Principle and anti-corruption clause was deemed necessary, while the draft Principle

on mandatory rules should be reconsidered from the angle of public international law, including the principle that they should apply only to States and not to private entities.

Item 6: Organisation of future work

183. *The UNIDROIT Chair* summarised the methodological indications that had surfaced during the discussion, as well as considerations on the structure of the future instrument, and ensured that issues of structure of the document, specificity of IICs, language, and so forth would be incorporated into a document of guidance for future work. The aim would be to make the exercise and the very structure of the "work in progress" document more consistent and solidified around clearly identifiable pillars of relevance to IICs.

184. She explained that the suggestion for Subgroup 0 (which had not prepared a Subgroup Report for this session) was to produce a draft Introduction to the instrument, defining its conceptual background, as well as proposals for some aspects in the envisaged Chapter with general provisions. Furthermore, she explained that the Consultative Committee would be updated on the progress made so far, and be asked to provide input on specific issues under consideration by the Working Group. The feedback received from the Consultative Committee would be considered during the next Working Group session. Following that session, it was envisaged that sufficiently developed documents would be shared with the Consultative Committee.

185. *A member of the UNIDROIT Secretariat* took the floor and illustrated the works of the Roma Tre-UNIDROIT research task force. He informed the participants that the task force had produced an interim version of a memorandum on choice of law and dispute settlement clauses in IICs, in addition to the previous interim memoranda covering policy goals and changes of circumstances. He also explained that further work had been done to integrate the sample of IICs, to make it more balanced in terms of represented geographical areas, the time period of the relevant contracts, and the economic sectors considered. He expressed his gratitude to the members of the task force for their dedication and excellent work, and gave them the floor for a few considerations on the contents of the latest memorandum. The final version of the three memoranda would be discussed during a virtual intersessional workshop on 3 October 2024, during which the ICC would present relevant ICC model clauses.

186. *Another member of the Secretariat* reminded the Working Group that the fourth session was scheduled for 25-27 November 2024 in Rome, while the fifth session would tentatively be held in Paris on 2-4 April 2025 (this was confirmed by the Secretariat following the third session).

Items 7, 8: Any other business. Closing of the session

187. In the absence of any other business, *the UNIDROIT Chair* thanked the Working Group participants for their valuable contributions and closed the session.

ANNEXE I

LIST OF PARTICIPANTS

MEMBERS

Ms Maria Chiara MALAGUTI *Chair*	President UNIDROIT
Mr Eduardo SILVA ROMERO *Chair*	Chair ICC Institute Council
Mr José Antonio MORENO RODRIGUEZ *Chair of the Consultative Committee*	Professor Founding Partner, Altra Legal
Mr Lauro GAMA	Professor Pontifical Catholic University of Rio de Janeiro
Ms Jean HO *remotely*	Professor National University of Singapore
Ms Margie-Lys JAIME *remotely*	Professor University of Panama Of Counsel, Infante & Pérez Almillano
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Ms Anna VENEZIANO	Deputy Secretary-General
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ANNEXE II

AGENDA

1. Opening of the session and welcome
2. Adoption of the agenda and organisation of the session
3. Adoption of the Summary Report of the second session (Study L-IIC – W.G. 2 – Doc. 9)
4. Update on intersessional work and developments since the second Working Group session
5. Consideration of work in progress
   a) Reports of the Subgroups
   b) Other matters identified by the Secretariat
6. Organisation of future work
7. Any other business
8. Closing of the session