The choice for UNIDROIT Principles of International Commercial Contracts to fill the legitimacy gap in the arbitration of sustainability-related disputes

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1. UPICC as applicable law in investment contracts

The UNIDROIT Principles of International Commercial Contracts set forth general rules for international commercial contracts when the parties have agreed that their contract be governed by general principles of law, the *lex mercatoria* or express choice for the Principles. Nevertheless, the UPICC can be applied even when the parties have not chosen any law to govern their agreement – which is definitely not the classic approach. Also, according to their Preamble[2], they may be used to interpret or supplement international uniform law instruments and supplement domestic law.

The Principles were developed by renowned scholars and practitioners who, besides trying to convert the Common Law and Civil Law traditions, also took into consideration the general practice within international commercial transactions and included a set of best practices. The Principles are not aimed at resolving each and every matter present in the contract, especially because they are not of procedural nature, although they are traditionally used to support the interpretation of the substantive law. As emphasised by Bonell, they are 'a non-legislative codification or "restatement" of the law of international commercial contracts in general'[3].

As to their application to investment disputes, and therefore to investment contracts, there is outstanding controversy. From the arbitration point of view, the preferred method of solving international commercial and investment disputes[4], the Principles are mostly used to help interpret national law and to give arbitral tribunals a reference when assessing interest and damages. Considering that such cases involve a considerable presence of public international law aspects and guarantees, it is still rare that parties choose them as their sole

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[2] UNIDROIT. (2016). UNIDROIT Principles of International Commercial Contracts 2016. Retrieved from https://www.unidroit.org/instruments/commercial-contracts/unidroit-principles-2016/.

[3] Bonell, M. (2010). The UNIDROIT Principles of International Commercial Contracts: Achievements in Practice and Prospects for the Future. Australian International Law Journal, 17, 177.

[4] Queen Mary University of London; White & Case.. (2021). International Arbitration Survey: Adapting Arbitration to a Changing World. Retrieved from https://arbitration.qmul.ac.uk/research/2021-international-arbitration-survey/.

law applicable to the merits. However, as the majority of investment contracts are also commercial contracts, their use has gained more and more adherence throughout the years – particularly because of their rising credibility and worldwide recognition.

2. The legitimacy gap in investment arbitration

The withdrawal of several countries from the 1965 Washington Convention and the subsequent questioning of the legitimacy of investment arbitration, particularly evident in the stance of Latin American nations like Venezuela and Bolivia, stem from persistent complaints regarding the perceived lack of neutrality, impartiality, and transparency in investment arbitration awards.

This scepticism is underscored by allegations that investment arbitration is unduly influenced by a select group of arbitrators who consistently rule in favour of foreign investors, thereby establishing a precedent that tends to favour expansive interpretations of the law[5]. Such concerns are exacerbated by the subjective nature of arbitral decision-making, which lacks objective parameters.

However, as emphasised by the preparing documents of the UNIDROIT and ICC project on UPICC and international investment contracts[6], the Principles enjoy widespread recognition and are extensively utilized in international transactions. Recognizing the legitimacy gap confronting investment arbitration, initiatives such as the UNIDROIT and ICC project on UPICC and international investment contracts seek to enhance legal certainty, predictability, and transparency in arbitration proceedings. This is possible precisely because of the endorsed reputation of the UNIDROIT Principles. By opting for the UPICC, parties involved in international contracts can benefit from established and harmonized interpretations of each principle, thereby fostering greater clarity and consistency in contractual agreements.

Moreover, the utilization of UPICC can potentially mitigate risks associated with post-award challenges, as arbitral tribunals may encounter fewer uncertainties stemming from divergent interpretations of national law. This is particularly advantageous as parties will be precluded from relying on conflicting interpretations of national law provided by professionals lacking legal training in the relevant jurisdiction. In essence, the adoption of

[5] Sornarajah, M. (2017). The international law on foreign investment (4th ed.). Cambridge, United Kingdom; New York, USA: Cambridge University Press.

[6] UNIDROIT. Investment Contracts & UPICC. Retrieved from https://www.unidroit.org/work-in-progress/investment-contracts-upicc/.

UPICC holds the promise of enhancing the efficacy and credibility of investment arbitration processes by providing a robust framework grounded in internationally recognized principles.

3. Environmental clauses in international investment contracts

The integration of Environment, Social, and Governance (ESG) considerations into dispute resolution and corporate practices represents a burgeoning trend within contemporary legal discourse. This paradigmatic shift finds its origins in the formal designation of the term "ESG", which emerged with the publication of the United Nations Global Compact Initiative's seminal report titled "Who Cares Wins" in 2004. Subsequently, the salience of ESG principles was further emphasised by the adoption of the 2030 Agenda for Sustainable Development by all United Nations member states in 2015. This comprehensive framework delineates 17 Sustainable Development Goals (SDGs) across diverse sectors, thus amplifying the imperative for ESG integration.

Given the profound implications of ESG considerations on corporate reputation and the broader domain of corporate social responsibility, legal practitioners are increasingly advising their clients to incorporate ESG-related clauses into contractual agreements. This reflects a strategic response to both external pressures exerted by UN member states and internal demands from conscientious citizens. In response to these dynamics, numerous jurisdictions have enacted legislation aimed at promoting ESG objectives, particularly concerning environmental protection and climate change mitigation.

Empirical evidence corroborates the burgeoning significance of ESG-related disputes, particularly within the realm of climate change litigation. Notably, research conducted by the London School of Economics Grantham Institute for Climate Change[7] reveals a substantial volume of ongoing or concluded climate change litigation cases globally, numbering 2,002 as of the study's findings in 2022[8]. Moreover, data compiled by the Sabin Center's Climate Change Litigation database illustrates the proliferation of climate-related

[7] Setzer, J., & Higham, C. (2022). Global trends in climate change litigation: 2022 snapshot. Grantham Research Institute on Climate Change and the Environment. https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2022/08/Global-trends-in-climate-change-litigation-2022-snapshot.pdf

[8] Vannieuwenhuyse, G. (2023). Exploring the Suitability of Arbitration for Settling ESG and Human Rights Disputes. In M. Scherer (Ed.), Journal of International Arbitration, 40(1), 1–28. Kluwer Law International.

legal actions, with 2,180 cases documented across 65 jurisdictions[9] and various adjudicatory bodies as of December 31, 2022. These statistics underscore the growing role of legal mechanisms in addressing ESG-related concerns and reflect the evolving landscape of dispute resolution in response to pressing environmental and social imperatives.

Despite the prevailing preference for litigation as the primary means of resolving disputes, it is foreseeable that this trend may undergo transformation in the coming years. This shift is primarily attributed to the procedural expediency offered by arbitration mechanisms and is further influenced by the proliferation of international investment contracts and the incorporation of ESG clauses into commercial contracts featuring arbitration provisions. Consequently, arbitration proceedings addressing ESG concerns, particularly those pertaining to environmental issues, are experiencing a notable ascendancy.

However, it is imperative to acknowledge the persistent critiques leveled against investment arbitration, as delineated earlier. Within the context of this investigation, environmental disputes encompass interstate or mixed conflicts arising under diverse legal frameworks, including but not limited to multilateral treaties such as the 1982 UN Convention on the Law of the Sea, bilateral and multilateral investment treaties, contracts, and other instruments featuring international investment provisions. Notably, the Permanent Court of Arbitration (PCA)[10] has presided over numerous disputes characterized by legal complexities arising out of domestic environmental regulatory frameworks and the host State's obligations under international environmental law.

As pointed out by Felipe Nazar *et al*[11] "ESG language is becoming prevalent in modern IIAs. These clauses are not just symbolic. By embedding these principles in IIAs, States are creating a legal foundation that can balance investor rights with the urgent need for environmental protection and social equity". These clauses typically articulate the respective rights, responsibilities, and obligations of contracting parties concerning

[9] United Nations Environment Programme. (2023). Global climate litigation report: 2023 status review. Retrieved from https://wedocs.unep.org/bitstream/handle/20.500.11822/43008/global_climate_litigation_report_2023.pdf?sequence=3.

[10] Permanent Court of Arbitration. Environmental dispute resolution. Retrieved from https://pca-cpa.org/en/services/arbitration-services/environmental-dispute-resolution/.

[11] Nazar, F., de Paz, S., de Arcos, M., & Peréz Llorca. (2024). ISDS and ESG: Friends or Foes? Asociación Latinoamericana de Arbitraje (ALARB). Retrieved from ISDS and ESG: Friends or Foes? - Kluwer Arbitration Blog.

environmental protection, conservation, and sustainable development within the context of investment ventures. Notably, the integration of environmental provisions into investment contracts signifies a departure from conventional approaches centred solely on economic considerations, underscoring a broader commitment to ESG principles.

The emergence of environmental clauses in international investment contracts may engender a symbiotic relationship with arbitration, wherein arbitration assets, such as procedural flexibility, provide a vital avenue for resolving disputes arising from the implementation and interpretation of these clauses, thereby promoting the effective enforcement of environmental standards and fostering sustainable investment practices on a global scale.

4. The UNIDROIT and ICC joint project on UPICC and international investment contracts

Despite being largely used as a tool to support the interpretation of the law applicable to the merits of investment disputes, the UNIDROIT Principles of International Commercial Contracts may also be used as substantive law by itself. Although investment contracts are not within the Principles' scope of application, it is uncontested that many investment contracts also are, in nature, commercial contracts. This is precisely the understanding of the partnership between UNIDROIT and ICC's Institute of World Business Law.

The initiative started in 2022 when the UNIDROIT Secretariat received a proposal from the ICC Institute to be concluded in the 2023-2025 timeframe. The proposal, added to UNIDROIT's 2023-2025 Work Programme aims at investigating how international investment contracts can be modernised, harmonised, and standardised.

4.1. Case law on the application of the UPICC in investment arbitration

The main ways for adjudicating investment arbitration disputes typically entail adherence to established procedural frameworks, notably the Arbitration Rules of the International Centre for Settlement of Investment Disputes (ICSID), or the auspices of prominent international arbitration institutions such as the Permanent Court of Arbitration (PCA) and the International Chamber of Commerce (ICC). Alternatively, parties may elect to pursue ad hoc arbitration proceedings governed by the United Nations Commission on International Trade Law (UNCITRAL) Rules, although this approach has historically garnered less favour within the realm of investment arbitration.

It is general knowledge that the classic way of resolving investment disputes is through ICSID arbitration. As such, the provision referring to applicable law is Article 42(1) where it is stated that, in the absence of an agreement between the parties, the arbitral tribunal shall apply the law of the Contracting State party and such rules of international law as may be applicable[12].

According to Cordero-Moss[13], this provision grants the parties "the power to choose from a wider scope of sources", including soft law instruments such as the UPICC. Furthermore, "they are the product of a dialogue between various sources – national, international and non-state"[14]. The Principles are widely used in international commercial arbitration, especially since "contractual parties are free to opt for non-state rules [...] as their contractual statute"[15].

There are two classic cases on the matter: Gemplus & Talsud v. Mexico and Charles Lemire v. Ukraine.

In Gemplus & Talsud v. Mexico[16], the Tribunal invoked a provision of the International Law Commission to hold the State liable for expropriation within the scope of the concession contract signed between investors from Argentina and France with Mexico. The Tribunal made use of Article 7.4.3(1) of the Principles and stated that "it would be possible to illustrate these general principles by means of various other national legal systems (both common law and civil law), but it is unnecessary to do so here because [...] these principles are amply reaffirmed in the UNIDROIT Principles [...]".

In Joseph Charles Lemire v. Ukraine[17], on the basis of an investment agreement between the United States and Ukraine, the US investor established broadcasting stations in Ukraine, but they could not be sufficiently run under the terms of the contract – which triggered the proceedings before the ICSID. In its decision, the Tribunal cited the Principles as "a

[12] International Centre for Settlement of Investment Disputes (ICSID). ICSID Convention (English). Retrieved from https://icsid.worldbank.org/sites/default/files/ICSID%20Convention%20English.pdf

[13] Cordero-Moss, G., & Behn, D. (2014, September 1). The Relevance of the UNIDROIT Principles in Investment Arbitration. Uniform Law Review, 19(4), 570. Retrieved from SSRN: https://ssrn.com/abstract=2704308

[14] Gama Jr., L. (2006). Contratos internacionais à luz dos princípios do UNIDROIT 2004: soft law, arbitragem e jurisdição. Rio de Janeiro: Renovar.

[15] Schilf, S. (2015). Os princípios UNIDROIT, o conceito do direito e a arbitragem internacional. São Paulo: Marcial Pons; CAM-CCBC.

[16] ITALAW. (n.d.). Gemplus S.A., SLP S.A., Gemplus Industrial S.A. de C.V. v. The United Mexican States, Award. Retrieved from https://www.italaw.com/cases/documents/481.

[17] UNILEX. Joseph Charles Lemire v Ukraine. Retrieved from http://www.unilex.info/principles/case/1533

manifestation of transnational law" and quoted their preamble as to their relevance and application.

4.1.2. Dunor Energía, S.A.P.I. de C.V. v. Comisión federal de electricidad (Mexico)

The case is the result a tender realised in 2015 when the parties concluded a public works contract financed at a fixed price for the installation of power plants in Mexico. The dispute is based on discrepancies and additional expenses allegedly provoked by the State. Accordingly, the UNIDROIT Principles were used to reinforce a conception of general principle of law:

> It adds that, under the own acts doctrine, "one should not be able to go against one's own acts", this doctrine being known as "[o]ne of the general principles of Law" also recognized in the UNIDROIT Principles on International Commercial Contracts (2016)[18].

The arbitral tribunal also made use of such Principles, even though the applicable substantive law was solely Mexican:

> The UNIDROIT Principles on International Commercial Contracts also refer to this principle in Article 1.8, which states "A Party may not act in contradiction to an understanding that it has raised in its counterpart and in accordance with which the latter has acted reasonably accordingly and to their disadvantage" (emphasis added)[19].

4.1.3. Republic of Yemen and Yemen Ministry of Oil and Minerals v. Canadian Nexen Petroleum (China National Offshore Oil Corp), Consolidated Contractors (Oil & Gas) Company S.A.L., Occidental Peninsula, LLC and Occidental Peninsula II, Inc.

The parties concluded an Agreement for Petroleum Exploration and Production (PSA) in 1986 and, in 2011, Respondent 1 sent a letter to Claimant asserting that, *inter alia*, the strike provoked by the Masila Labor Union (MLU) constituted a force majeure event under the PSA – which was not accepted by Claimant. Consequently, Claimant decided not to extend the PSA. In short terms, in the arbitration, Claimant argues numerous breaches of contractual obligations, such as the ones related to the wells, waste management facilities and other items that were handed over in a substandard condition.

[18] Dunor Energía, S.A.P.I. de C.V. v. Comisión federal de electricidad (Mexico). (2022, December 15). LCIA Case No. 204865. Retrieved from https://www.italaw.com/sites/default/files/case-documents/italaw170821.pdf

[19] Dunor Energía, S.A.P.I. de C.V. v. Comisión federal de electricidad (Mexico). (2022, December 15). LCIA Case No. 204865. Retrieved from https://www.italaw.com/sites/default/files/case-documents/italaw170821.pdf

The parties also had a thorough discussion on the applicable substantive law, where the tribunal decided for, among other things, the application of the UNIDROIT Principles:

> (iv) The Arbitral Tribunal unanimously decides that the UNIDROIT Principles are applicable in respect of Respondents' time-bar defence;
>
> (v) The majority of the Arbitral Tribunal decides that the following claims of Claimant are time barred in accordance with the limitation periods under Article 10.2 of the UNIDROIT Principles[20].

4.1.4. Gente Oil Ecuador PTE. LTD. v. Republic of Ecuador

Following a tender process, in 2012 the parties concluded a contract for the exploration and/or exploitation of Hydrocarbons. The relief sought is twofold: firstly, claimant argued for the declaration that respondent breached the contract and, as such, it should be terminated and, secondly, demands for damages.

The UPICC were firstly brought by respondent to argue for their use to interpret the arbitration agreement and later, by claimant, to address arguments related to the merits:

> La Demandada señala que, de conformidad con la cláusula 4.1 del Contrato, sus disposiciones se interpretarán de acuerdo al derecho ecuatoriano, en particular, conforme a las reglas contenidas en el Título XIII del Libro IV del Código Civil, que (i) se establecen en los mismos términos en el Código Civil de Chile; y (ii) son congruentes con los Principios de UNIDROIT para la interpretación de Contratos Comerciales Internacionales (los "Principios UNIDROIT")
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> Adicionalmente, la Demandante indica que el remedio resolutorio está habilitado cuando existen claros indicios de que la otra parte no cumplirá sus obligaciones, lo cual, afirma, ha sido aceptado por la jurisprudencia y la doctrina bajo la noción de incumplimiento previsible. En este sentido, la Demandante se refiere a los Principios Latinoamericanos del Derecho de los Contratos, la CISG y los Principios UNIDROIT[21].

Conclusion

In conclusion, the integration of environmental clauses into investment contracts reflects a growing recognition of the imperative to harmonize the arbitration practice with environmental sustainability goals. This paradigm shift necessitates a re-evaluation of traditional dispute resolution frameworks, with arbitration emerging as a preferred forum for adjudicating complex legal issues arising from the implementation and interpretation of

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[20] Republic of Yemen and Yemen Ministry of Oil and Minerals v. Canadian Nexen Petroleum (China National Offshore Oil Corp), Consolidated Contractors (Oil & Gas) Company S.A.L., Occidental Peninsula, LLC and Occidental Peninsula II, Inc. ICC Case No. 19869/MCP/DDA. (2020, February 4). Retrieved from https://jusmundi.com/en/document/decision/pdf/en-republic-of-yemen-and-yemen-ministry-of-oil-and-minerals-v-canadian-nexen-petroleum-china-national-offshore-oil-corp-consolidated-contractors-oil-gas-company-s-a-l-occidental-peninsula-llc-and-occidental-peninsula-ii-inc-final-award-tuesday-4th-february-2020

[21] Gente Oil Ecuador PTE. LTD. v. Republic of Ecuador. PCA Case No.2018-12. (2022, May 24). Retrieved from https://jusmundi.com/en/document/decision/pdf/es-gente-oil-ecuador-pte-ltd-v-republic-of-ecuador-laudo-final-tuesday-24th-may-2022

environmental clauses. Moreover, initiatives such as the UNIDROIT and ICC project play a pivotal role in enhancing legal certainty and transparency in arbitration proceedings by providing a standardized framework grounded in universally recognized principles.

The utilization of the UNIDROIT Principles within the context of the described disputes highlights their pivotal role in supplementing and enriching the legal framework governing international transactions. By invoking these principles, parties endeavour to build their contractual relationships with a robust foundation grounded in universally recognized norms and standards. Thus, the integration of the UNIDROIT Principles serves as a testament to their enduring relevance and utility in facilitating the resolution of complex international disputes, thereby fostering greater legal certainty and predictability in the realm of cross-border commercial and investment relations.

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