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The Right to Regulate in Investor- State Arbitration: Slicing and Dicing Regulatory Carve-Outs

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The Right to Regulate in Investor–State Arbitration: Slicing and Dicing Regulatory Carve-Outs

Vera Korzun*

ABSTRACT

This Article examines the “right to regulate” as the power of a sovereign state to adopt and maintain government measures for public welfare objectives. It explores how claims by foreign investors in investor–state dispute settlement (ISDS) may interfere with the state’s ability to regulate, and how the state can protect its right in international investment agreements. The Article first explains the structure of modern international investment law and dispute resolution. It next turns to the right to regulate and explores why regulatory disputes represent a major challenge for ISDS. It continues by analyzing how exceptions, exclusions, and other safeguard provisions can be used in investment treaties to protect the right to regulate. It then critically examines the tobacco carve-out and other safeguard provisions of the Trans-Pacific Partnership (TPP) Agreement as to their ability to protect the right to regulate. Finally, the Article explores alternative solutions to the challenges of ISDS. It concludes by arguing that regulatory disputes are best resolved through a hybrid system of dispute resolution that is amenable to both private interests and public policy considerations.

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I. INTRODUCTION

The reputation of investor–state dispute settlement (ISDS) has suffered a heavy blow in recent years. Ever since Australia and Uruguay had to defend their tobacco plain-packaging legislation in investor–state arbitrations against multinational tobacco company Philip Morris International, Inc.,¹ it became clear that foreign

1. See, e.g., Philip Morris Asia Ltd. v. Austl., PCA Case No. 2012-12, Award on Jurisdiction and Admissibility (UNCITRAL 2015), http://www.italaw.com/sites/default/files/case-documents/italaw7303_0.pdf [<https://perma.cc/LGV7-X4X7>] (archived Jan. 20, 2017) [hereinafter *Philip Morris Asia*]. Although four years after the notice of arbitration was served, Australia won in this investor–state arbitration, the reputation of ISDS has been damaged. In large part, because this dispute showed how legitimate government measures can be challenged in investor–state arbitration through creative treaty- and

investors can use ISDS to challenge government measures adopted for legitimate public welfare objectives. Outraged over the dispute with Philip Morris, the Australian government vowed that it would no longer include ISDS in its international investment agreements (IIAs).² And with Australia present at the negotiating table of the Trans-Pacific Partnership (TPP)³ Agreement, the inclusion of ISDS in the TPP was first called into question.⁴ However, by February 2016, with a new federal government in power, Australia consented to ISDS and signed the TPP together with eleven other Asia-Pacific nations.⁵ Yet, outside of the Asia-Pacific Region, the debate about the costs and benefits of investor–state arbitration continued with renewed vigor as

forum-shopping. *See also* Philip Morris Brands Sàrl v. Uru., ICSID Case No. ARB/10/7, Award (July 8, 2016), <http://www.italaw.com/sites/default/files/case-documents/italaw7417.pdf> [<https://perma.cc/KX3J-TYCC>] (archived Jan. 21, 2017) [hereinafter *Philip Morris Brands Sàrl*] (describing a similar claim against Uruguay).

2. AUSTL. GOV'T, DEPT. OF FOREIGN AFFAIRS AND TRADE, GILLARD GOVERNMENT TRADE POLICY STATEMENT: TRADING OUR WAY TO MORE JOBS AND PROSPERITY 14 (2011), http://blogs.usyd.edu.au/japaneselaw/2011_Gillard%20Govt%20Trade%20Policy%20Statement.pdf [<https://perma.cc/P282-GZF4>] (archived Jan. 21, 2017) (“In the past, Australian Governments have sought the inclusion of investor–state dispute resolution procedures in trade agreements with developing countries at the behest of Australian businesses. The Gillard Government will discontinue this practice.”).

3. Trans-Pacific Partnership, Feb. 4, 2016, <https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text> [<https://perma.cc/Z59T-EHFT>] (archived Feb. 1, 2017) [hereinafter TPP].

4. The TPP was negotiated behind the closed door, leaving the public largely in the dark as to the details of negotiation process. In March 2012, Australian Trade Minister Craig Emerson was quoted as saying that “[w]e do not and will not support investor–state dispute settlement provisions. This is government policy.” *See* Adam Gartrell, *Labor Standing Firm on Pacific Trade Deal*, SYDNEY MORNING HERALD (Mar. 5, 2012), <http://www.smh.com.au/breaking-news-national/labor-standing-firm-on-pacific-trade-deal-20120305-1ue2b.html> [<https://perma.cc/E2SR-UFXZ>] (archived Mar. 19, 2017). In spring 2015, the Australian government was still reluctant to agree on ISDS in the TPP. Noticeably, a draft TPP’s investment chapter published by WikiLeaks in March 2015 contained footnote 29, which excluded application of the ISDS provisions with respect to Australia and investors from Australia. *See* Trans-Pacific Partnership Treaty: Advanced Investment Chapter working document for all 12 nations (Jan. 20, 2015 draft), WikiLeaks release: March 25, 2015, n. 29, <https://wikileaks.org/tpp-investment/> [<https://perma.cc/86K4-YER4>] (archived Mar. 6, 2017) (“Section B [“Investor–State Dispute Settlement”] does not apply to Australia or an investor of Australia. Notwithstanding any provision of this Agreement, Australia does not consent to the submission of a claim to arbitration under this Section.”).

5. The TPP was signed on February 4, 2016 by Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. The future of the TPP is currently unclear as the United States under the new administration has begun withdrawing from the TPP. *See* Peter Baker, *Trump Abandons Trans-Pacific Partnership, Obama’s Signature Trade Deal*, N.Y. TIMES (Jan. 23, 2017), <https://www.nytimes.com/2017/01/23/us/politics/tpp-trump-trade-nafta.html> [<https://perma.cc/A7XU-23E8>] (archived Mar. 6, 2017). It remains to be seen whether the TPP will survive the United States’ withdrawal.

part of the Transatlantic Trade and Investment Partnership (TTIP)⁶ negotiations. This time ISDS threatened to undermine the treaty as a whole, as partners across the Atlantic are sharply divided on the merits of the ISDS regime.⁷

The critics of ISDS have long pointed to the lack of transparency, consistency, and overall legitimacy in the ISDS process, where private arbitrators are called upon to decide multi-million dollar claims against sovereign states. The opponents of investment treaty arbitration further allege that, through ISDS, foreign investors—most commonly multinational corporations—interfere with a government’s ability to regulate in the public interest.⁸ This includes protection of public health, public policy, safety, and the environment. The crusade against ISDS is now supported by evidence from recent investor–state arbitrations challenging government regulation, notably, in the nuclear energy sector in Germany, as part of the nuclear power phase-out program,⁹ and in the renewable energy sector in Bulgaria, the

6. *EU Negotiating Texts in TTIP*, EUROPEAN COMMISSION (July 14, 2016) <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1230> [<https://perma.cc/37HG-EPEK>] (archived Jan. 21, 2017) [hereinafter TTIP].

7. See, e.g., *ISDS: Important Questions and Answers*, TRADEWINDS (Mar. 26, 2015), <https://ustr.gov/about-us/policy-offices/press-office/blog/2015/march/isds-important-questions-and-answers-0> [<https://perma.cc/K9QV-7E7Z>] (archived Jan. 20, 2017) (discussing the U.S. position (from the Office of the U.S. Trade Representative) on ISDS, approving the current system of investor–state arbitration); see also Cecilia Malmström, *Proposing an Investment Court System*, EUROPEAN COMMISSION (Sept. 16, 2015), http://ec.europa.eu/commission/2014-2019/malmstrom/blog/proposing-investment-court-system_en [<https://perma.cc/4CMW-RLPF>] (archived Jan. 20, 2017) (discussing the EU position expressing dissatisfaction with modern ISDS and suggesting to replace it with an investment court system); Krista Hughes & Philip Blenkinsop, *U.S. Wary of EU Proposal for Investment Court in Trade Pact*, REUTERS (Oct. 29, 2015, 3:00 PM EDT), <http://www.reuters.com/article/us-trade-ttip-idUSKCN0SN2LH20151029> [<https://perma.cc/V9TS-T8AP>] (archived Jan. 21, 2017) (noting the U.S. reaction to the EU proposal).

8. See OECD, “*Indirect Expropriation*” and the “*Right to Regulate*” in *International Investment Law 2* (OECD Working Papers on Int’l Inv., Paper No. 2004/04, 2004) (“[T]here is increasing concern that concepts such as indirect expropriation may be applicable to regulatory measures aimed at protecting the environment, health and other welfare interests of society.”).

9. See, e.g., *Vattenfall AB v. Federal Republic of Ger.*, ICSID Case No. ARB/12/12, <http://www.italaw.com/cases/1654> [<https://perma.cc/29UQ-YDAV>] (archived Feb. 11, 2017) [hereinafter *Vattenfall*] (a pending investor–state arbitration under the Energy Charter Treaty (ECT) and the ICSID Convention and Arbitration Rules, where Vattenfall, state-owned Swedish energy company, is reportedly seeking compensation for its investments lost due to the shutdown by Germany of two reactors in Krümmel and Brunsbüttel, in line with the country’s energy phase-out plan). See also Nathalie Bernasconi-Osterwalder & Martin Dietrich Brauch, *The State of Play in Vattenfall v. Germany II: Leaving the German Public in the Dark*, INT’L INST. FOR SUSTAINABLE DEV. (2014), <http://www.iisd.org/sites/default/files/publications/state-of-play-vattenfall-vs-germany-ii-leaving-german-public-dark-en.pdf> [<https://perma.cc/84VY-PBZ3>] (archived Jan. 21, 2017) (providing background information on the case).

Czech Republic, Italy, and Spain as a response to regulatory changes in their solar energy incentive programs.¹⁰

The supporters of ISDS defend the system by arguing that the ability to submit a claim directly to investor–state arbitration under an investment treaty remains an important factor for private investors seeking to invest abroad.¹¹ And so, while the debate on the future of investor–state arbitration continues, it is clear that, for ISDS to survive, it has to respond to the most vocal objections regarding the lack of transparency, legitimacy, public accountability, and consistency in investment arbitration awards.

Regulatory disputes bring an additional layer to the discussion of the long-overdue reform of ISDS. Disputes of this type involve challenges by foreign investors to government measures of general application, such as laws, regulations, or executive acts.¹² Regulatory disputes are particularly controversial because they allow foreign

10. See, e.g., ENERGO-PRO a.s. v. Republic of Bulg., ICSID Case No. ARB/15/19, <http://investmentpolicyhub.unctad.org/ISDS/Details/630> [<https://perma.cc/VR38-N5JT>] (archived Jan. 19, 2017); EVN AG v. Republic of Bulg., ICSID Case No. ARB/13/17, <http://www.italaw.com/cases/2171> [<https://perma.cc/KF9R-7TYE>] (archived Jan. 21, 2017); Antaris Solar GmbH v. Czech, PCA Case No. 2014-01 (UNCITRAL 2013), <https://pcacases.com/web/view/24> [<https://perma.cc/FCD6-FVSZ>] (archived Jan. 21, 2017); Belenergia S.A. v. Italian Republic, ICSID Case No. ARB/15/40, <http://investmentpolicyhub.unctad.org/ISDS/CountryCases/103?partyRole=2> [<https://perma.cc/GZ6P-JZCY>] (archived Feb. 1, 2017) (one of the six solar energy ICSID arbitration cases pending against Italy at the time of publication); Cordoba Beheer B.V. v. Spain, ICSID Case No. ARB/16/27, <http://investmentpolicyhub.unctad.org/ISDS/Details/731> [<https://perma.cc/FA3X-RZFF>] (archived Jan. 21, 2017) (the latest of over 30 ICSID arbitrations commenced against Spain in the renewable energy sector); Luke Eric Peterson, *Solar Investors File Arbitration against Czech Republic; Intra-EU BITs and Energy Charter Treaty at Center of Dispute*, INV. ARB. REP. (May 15, 2013), <https://www.iareporter.com/articles/solar-investors-file-arbitration-against-czech-republic-intra-eu-bits-and-energy-charter-treaty-at-center-of-dispute/> [<https://perma.cc/K732-9MHQ>] (archived Feb. 11, 2017) (describing arbitration filed against the Czech Republic by claimants objecting to the country’s recent treatment of investments in photovoltaic energy production); see Charles A. Patrizia et al., *Investment Disputes Involving the Renewable Energy Industry Under the Energy Charter Treaty*, GLOBAL ARB. REV. (Oct. 2, 2015), <http://globalarbitrationreview.com/chapter/1036076/investment-disputes-involving-the-renewable-energy-industry-under-the-energy-charter-treaty> [<https://perma.cc/3PWB-N27A>] (archived Jan. 20, 2017) (providing an overview of regulatory changes in the renewable energy sector in these countries and the resultant investor–state arbitrations).

11. Ted Bromund, James M. Roberts & Riddhi Dasgupta, *The Proposed Investor–State Dispute Settlement (ISDS) Mechanism: U.S. Should Oppose EU Demand to Abandon It*, HERITAGE FOUND. (Jan. 31, 2017, 5:40 PM), <http://www.heritage.org/research/reports/2015/07/the-proposed-investor-state-dispute-settlement-isds-mechanism-us-should-oppose-eu-demand-to-abandon-it> [<https://perma.cc/U3JD-6J4M>] (archived Feb. 1, 2017).

12. See, e.g., U.S. DEP’T OF STATE, 2012 U.S. MODEL BILATERAL INVESTMENT TREATY art. 1, <http://www.state.gov/documents/organization/188371.pdf> (last visited Jan. 20, 2017) [<https://perma.cc/89YJ-VM7P>] (archived Jan. 20, 2017) (providing that a “measure” includes any law, regulation, procedure, requirement, or practice”) [hereinafter 2012 U.S. Model BIT].

investors to challenge legitimate government measures in front of international arbitral tribunals.¹³ The concern is that international investment agreements and the ISDS regime have empowered foreign corporations to interfere with a state's ability to regulate for the benefit of the public at large.¹⁴ In doing so, they have also placed the defending state at the mercy of private arbitral tribunals that are often too far removed from such states to properly consider the public policy implications of the challenged government measure.¹⁵ Furthermore, regulatory disputes may have a chilling effect on regulation worldwide, as the fear of ISDS may prompt governments to refrain from adopting a regulatory measure.¹⁶ This growing dissatisfaction with ISDS has led some countries to cancel or revise their bilateral investment treaties

13. See, e.g., Gus Van Harten & Martin Loughlin, *Investment Treaty Arbitration as a Species of Global Administrative Law*, 17 EUR. J. INT'L L. 121, 124 (2006) ("This growth [of investment treaty arbitration] suggests that multinational enterprises are increasingly prepared to use investment arbitration to resolve disputes with states, indicating that investment arbitration has become an important method for foreign investors to resist state regulation and seek compensation for the costs that flow from the exercise of public authority.").

14. See, e.g., TPP "Worst Trade Deal Ever," Says Nobel-Winning Economist Joseph Stiglitz, CBC NEWS (Mar. 31, 2016), <http://www.cbc.ca/news/business/joseph-stiglitz-tp-1.3515452> [<https://perma.cc/VKW6-GP5Q>] (archived Feb. 1, 2017) [hereinafter "Worst Trade Deal Ever"] ("Stiglitz takes issue with the TPP's investment-protection provisions, which he says could interfere with the ability of governments to regulate business or to move toward a low-carbon economy."). See also Van Harten & Loughlin, *supra* note 13, at 130 (observing that "a wide range of regulatory disputes between investors and the state has become subject to control through international arbitration at the instance of investors").

15. See Van Harten & Loughlin, *supra* note 13, at 126 ("A key aspect of the investment treaty arbitration is that it transplants this private adjudicative model from the commercial sphere into the realm of government, thereby giving privately-contracted arbitrators the authority to make what are in essence governmental decisions.").

16. Concerns over the chilling effect are frequently raised in scholarly and public policy debates on ISDS. See, e.g., Kyla Tienhaara, *Regulatory Chill and the Threat of Arbitration: A View from Political Science*, in EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION 606, 606 (Chester Brown & Kate Miles eds., 2011) (arguing that the issue of regulatory chill has been "inadequately addressed and often prematurely dismissed by legal scholars"). Indeed, the Uruguayan government was reportedly considering whether to relax its tobacco control measures to prevent an impending claim by Philip Morris. See Alison Ross, *Uruguay Urged to Fight on in Cigarette Claim*, GLOBAL ARB. REV. (Aug. 13, 2010), <http://globalarbitrationreview.com/article/1029513/uruguay-urged-to-fight-on-in-cigarette-claim> [<https://perma.cc/4HYV-X2A7>] (archived Mar. 6, 2017) (noting that in the summer of 2010 "Uruguayan ministers indicated the government may be prepared to reverse some of the legislation to stave off a potentially costly claim [by Philip Morris].") However, there are no persuasive empirical data showing that investor-state arbitrations have a chilling effect on regulation. See Christine Côté, *A Chilling Effect? The Impact of International Investment Agreements on National Regulatory Autonomy in the Areas of Health, Safety and the Environment 2014* (unpublished Ph.D. thesis, London School of Economics), etheses.lse.ac.uk/897/8/Cote_A_Chilling_%20Effect.pdf [<https://perma.cc/XAC5-ADEC>] (archived Jan. 21, 2017) (concluding that empirical data do not support the hypothesis of regulatory chill).

(BITs);¹⁷ Bolivia, Ecuador, and Venezuela even went so far as to denounce the Convention on the Settlement of Investment Disputes between States and Nationals of Other States¹⁸ that established the International Centre for Settlement of Investment Disputes (ICSID).

Responding to these concerns, governments and the international legal community introduced several procedural and structural changes to ISDS. In the last five years, through the United Nations Commission on International Trade Law (UNCITRAL), they developed the Rules on Transparency,¹⁹ amended the UNCITRAL Arbitration Rules,²⁰ and adopted the United Nations Convention on Transparency²¹—all for treaty-based investor–state arbitration. In their IIAs, states also began incorporating provisions regarding arbitrators’ qualifications and

17. See, e.g., Natasha Mellersh, *No Longer a Fair Game?*, AFR. L. & BUS. (Sept. 30, 2015), <https://www.africanlawbusiness.com/news/5864-no-longer-a-fair-game> [https://perma.cc/VL5Z-LP6A] (archived Jan. 20, 2017) (observing that South Africa, for example, has terminated BITs with several EU countries, including Belgium, Germany, Italy, Luxembourg, the Netherlands, Spain, and the United Kingdom); see also Ben Bland & Shawn Donnan, *Indonesia to Terminate More than 60 Bilateral Investment Treaties*, FIN. TIMES (Mar. 26, 2014), <https://www.ft.com/content/3755c1b2-b4e2-11e3-af92-00144feabdc0> [https://perma.cc/A9GU-6NCS] (archived Feb. 1, 2017) (noting Indonesia seeks to cancel or renegotiate its more than 60 BITs); Marta Waldoch & Maciej Onoszko, *Poland Plans to Cancel Bilateral Investment Treaties with EU*, BLOOMBERG (Feb. 25, 2016), <https://www.bloomberg.com/news/articles/2016-02-25/poland-seeks-to-end-bilateral-investment-deals-with-eu-members> [https://perma.cc/23BA-HNPM] (archived Jan. 20, 2017) (explaining Poland has stated that it considers terminating its intra-EU BITs); Luke Eric Peterson, *Italy Follows Russia in Withdrawing from Energy Charter Treaty, but for Surprising Reason*, INV. ARB. REP. (Apr. 17, 2015), <https://www.iareporter.com/articles/italy-follows-russia-in-withdrawing-from-energy-charter-treaty-but-for-surprising-reason/> [https://perma.cc/C4JU-J9S3] (archived Feb. 1, 2017) (noting that in January 2015, Italy announced its withdrawal from a multilateral agreement—the ECT).

18. Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the Washington Convention), Mar. 18, 1965, 575 U.N.T.S. 159 [hereinafter ICSID Convention]; Sergey Ripinsky, *Venezuela’s Withdrawal from ICSID: What it Does and Does Not Achieve*, INT’L INST. FOR SUSTAINABLE DEV. (Apr. 13, 2012), <https://www.iisd.org/itn/2012/04/13/venezuelas-withdrawal-from-icsid-what-it-does-and-does-not-achieve/> [https://perma.cc/7NLA-JDBF] (archived Jan. 20, 2017).

19. UNCITRAL Rules on Transparency in Treaty-based Investor–State Arbitration, U.N. Doc. A/RES/68/109 (Apr. 1, 2014), <http://www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/Rules-on-Transparency-E.pdf> [https://perma.cc/5KHH-YXVB] (archived Jan. 21, 2017) [hereinafter UNCITRAL Rules on Transparency].

20. See UNCITRAL Arbitration Rules, U.N. Doc. A/RES/65/22, art. 1(4) (Jan. 10, 2011), <https://www.uncitral.org/pdf/english/texts/arbitration/arb-rules-revised/arb-rules-revised-2010-e.pdf> [https://perma.cc/8ZQQ-V27C] (archived Jan. 21, 2017) (“[F]or investor–State arbitration initiated pursuant to a treaty providing for the protection of investments or investors, these Rules include the UNCITRAL Rules on Transparency in Treaty-based Investor–State Arbitration . . . subject to article 1 of the Rules on Transparency.”).

21. See United Nations Convention on Transparency in Treaty-based Investor–State Arbitration, *opened for signature* Mar. 17, 2015, <http://www.uncitral.org/pdf/english/texts/arbitration/transparency-convention/Transparency-Convention-e.pdf> [https://perma.cc/HK2M-KHY4] (archived Jan. 20, 2017) [hereinafter Mauritius Convention on Transparency].

experience,²² ethics rules,²³ and codes of conduct for arbitrators.²⁴ On a broader scale, to address the apparent legitimacy crisis in investment treaty arbitration,²⁵ the European Commission took the lead in proposing structural changes to ISDS. Most radically, it now proposes to replace ISDS with a permanent two-tier system of international investment courts.²⁶ The free trade agreements (FTAs) of the European Union with Canada²⁷ and Vietnam²⁸ are the first examples of treaties that contain provisions for such an investment court system instead of traditional ISDS.

In addition, to protect their regulatory space and limit exposure to regulatory disputes in ISDS, states have turned to more careful treaty drafting. First, they seek to limit potential ISDS claims by revoking or clarifying the scope of investor protection obligations under IIAs. Second, they seek to secure for themselves in the IIA regime the regulatory space for domestic policymaking. To do so, state parties

22. See, e.g., Free Trade Agreement, China-Austl., art. 9.15, ¶ 8, June 17, 2015, <http://dfat.gov.au/trade/agreements/chafta/official-documents/Documents/chafta-chapter-9-investment.pdf> [<https://perma.cc/MHC5-6XNE>] (archived Jan. 22, 2017) (“All arbitrators appointed pursuant to this Section shall have expertise or experience in public international law, international trade or international investment rules, or the resolution of disputes arising under international trade or international investment agreements.”) [hereinafter ChAFTA].

23. See, e.g., Free Trade Agreement, EU-Viet., ch. 8, ch. 2, §3, art. 14 (Agreed text as of Jan. 2016), http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154210.pdf [<https://perma.cc/P6JF-PAEC>] (archived Jan. 22, 2017) [hereinafter EU-Vietnam FTA].

24. See, e.g., ChAFTA, *supra* note 22, ch. 9, Annex 9-A (containing a code of conduct for arbitrators appointed pursuant to the investment chapter of ChAFTA). See also Free Trade Agreement, EU-Sing., Annex 9-F (Agreed text as of Feb. 2016), http://trade.ec.europa.eu/doclib/docs/2015/june/tradoc_153580.pdf [<https://perma.cc/E9BY-Z9AM>] (archived Jan. 22, 2017) (providing a Code of Conduct for Arbitrators and Mediators) [hereinafter EUSFTA].

25. See Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 *FORDHAM L. REV.* 1521, 1568 (2005) (suggesting that contradictory awards in ISDS undermine “the legitimacy of investment arbitration, particularly where public international law rights are at stake and the legitimate expectations of investors and Sovereigns are mismanaged”).

26. See Press Release, Eur. Comm’n, Commission Proposes New Investment Court System for TTIP and Other EU Trade and Investment Negotiations (Sept. 16, 2015), http://europa.eu/rapid/press-release_IP-15-5651_en.htm [<https://perma.cc/YY4P-M4EH>] (archived Feb. 1, 2017); see also Press Release, Eur. Comm’n, EU Finalises Proposal for Investment Protection and Court System for TTIP (Nov. 12, 2015), http://europa.eu/rapid/press-release_IP-15-6059_en.htm [<https://perma.cc/9U6L-MXKY>] (archived Feb. 11, 2017); Transatlantic Trade and Investment Partnership, Trade in Services, Investment and E-Commerce, Ch. II, http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf [<https://perma.cc/Z4V9-PPL5>] (archived Jan. 20, 2017) (for text of the EU’s Proposal for Investment Protection and Resolution of Investment Disputes).

27. Comprehensive Economic and Trade Agreement, Can.-EU, arts. 8.27-28 (Final text, Feb. 2016), http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154329.pdf [<https://perma.cc/8NXY-Q5PH>] (archived Jan. 22, 2017) [hereinafter CETA].

28. EU-Vietnam FTA, *supra* note 23, arts. 12–13.

increasingly incorporate into the treaty text a reference to the *right to regulate* as a rationale for various exceptions and exclusions, non-precluded measures, and deviations from investor protection obligations. In ISDS, these provisions give an arbitral tribunal a legal avenue to consider and weigh a state's regulatory interests against the rights of foreign investors. And third, sovereign states continue to look for new ways to limit the jurisdiction of arbitral tribunals over regulatory disputes. The tobacco carve-out of the TPP²⁹ provides the most innovative solution to the jurisdictional puzzle yet. This unique provision—a breakthrough by some accounts³⁰—gives a state party to the TPP the option to revoke the benefits of ISDS with respect to claims challenging a state's tobacco control measures.

But can the tobacco carve-out strike the long-sought balance between the state's regulatory interests and investor protection rights, ensuring that a state can freely regulate? It is highly unlikely. The tobacco carve-out on its own does not reserve for the state the right to regulate the production, marketing, use, or consumption of tobacco. It only seeks to ensure that a state can avoid ISDS on a case-by-case basis with respect to claims challenging its tobacco control measures. Consequently, the tobacco carve-out does not remove substantive investor protection obligations, but simply eliminates one of the forums for investment treaty claims. To ensure that a state can freely regulate in view of its investor protection obligations, an alternative solution is needed.

At the heart of the regulatory disputes problem is the tension between the public and private interests and the question of setting priorities between the rights of sovereign states and those of foreign investors. The borderline between these priorities has shifted over the years. At the birth of trade liberalization and investment agreements in the second half of the twentieth century, governments were willing to compromise on their sovereignty in hopes of promoting trade, attracting foreign investments, and driving economic development. Once their economic and development priorities changed, however, states began revising and rebalancing their investor protection regimes. In addition, countries like China—a predominantly capital importer in the earlier days of IIAs, but a growing capital exporter today—sought to balance their newly found interests as capital exporters with their desire to retain sovereignty and the power to regulate as the host state.

Along the way, governments and public interest groups have begun seeing investment treaty tribunals as protectors of the private interests of foreign corporations. Composed of foreign individuals, far

29. TPP, *supra* note 3, art. 29.5.

30. See, e.g., Sergio Puig & Gregory Shaffer, *A Breakthrough with the TPP: The Tobacco Carve-Out*, 16 YALE J. HEALTH POL'Y L. & ETHICS 327 (2016).

removed from the realities of the host state they are called upon to judge, arbitrators are no longer trusted with the public policy decisions. Understandably, scholars have also expressed concerns over the “privatization” of international law.³¹ In a pendulum movement, there is today a massive push for the “nationalization” of ISDS, which, from a procedural point of view, remains largely a private dispute resolution method.

The most evident effort to convert ISDS into a public dispute resolution method is the call to replace ISDS with a system of international investment courts.³² Similarly, countries that have terminated their BITs or exited the ICSID Convention³³ have urged foreign investors to bring any investment claims to their domestic courts.³⁴ Further, various transparency initiatives have also been implemented in the name of the public interest, making the general public not only aware of a dispute, but also directly involved in the proceeding through *amicus curiae* submissions.³⁵ The logic behind these efforts is to move away from private dispute resolution back to public dispute resolution since only public judicial bodies are now perceived as able to make public policy determinations. The TPP tobacco carve-out that deprives arbitral tribunals of the jurisdiction over tobacco control measures is the latest example of efforts to move investment treaty claims back into the domain of public dispute resolution.³⁶

Against the logic of these efforts, a better way to address concerns over regulatory disputes is to structure ISDS as a mix of both systems—an investor–state arbitration under procedural rules of international commercial arbitration, supplemented by the possibility of limited court review. After all, the ideal dispute resolution mechanism will be called upon to decide on hybrid³⁷ disputes—disputes involving private interests of foreign investors allegedly harmed by government regulatory measures—and so it is only logical

31. See generally Franck, *supra* note 25 (warning against looming legitimacy crisis in investment treaty arbitration due to inconsistent decisions by private arbitral tribunals affecting public international law and the rights of sovereign states).

32. See *supra* note 26 and accompanying text (discussing the European Commission’s proposal to install a permanent international investment court system).

33. ICSID Convention, *supra* note 18.

34. See, e.g., Cecilia Malmström, *Proposing an Investment Court System*, EUROPEAN COMMISSION (Sept. 16, 2015), http://ec.europa.eu/commission/2014-2019/malmstrom/blog/proposing-investment-court-system_en [<https://perma.cc/4CMW-RLPF>] (archived Jan. 20, 2017).

35. See *supra* notes 19–21 and accompanying text for various legal instruments that have been adopted to date to increase transparency in ISDS.

36. TPP, *supra* note 3, art. 29.5 (containing the TPP tobacco carve-out provision).

37. See Zachary Douglas, *The Hybrid Foundations of Investment Treaty Arbitration*, 74 BRIT. Y.B. INT’L L. 151 (2003) (discussing the hybrid origin of investor–state arbitration).

to look for a hybrid institutional and procedural solution to the mechanism of resolving such disputes.

The goal of this Article is twofold. First, the Article explains the essence of the concerns about regulatory disputes in modern ISDS. In doing so, it explores the concept of the “right to regulate,” which allows a host state to adopt measures for legitimate public policy objectives that deviate from the state’s investor protection obligations. The Article also surveys the contours of the right to regulate, as provided by exceptions, exclusions, carve-outs, and other safeguard provisions in international investment law. Second, the Article critically examines the tobacco carve-out and other safeguard provisions in the TPP and suggests a more appropriate solution for ensuring that a state can freely regulate, and, should a dispute arise, that a state can resolve it through ISDS that is amenable to both private interests and public policy considerations.

The Article proceeds as follows: Part II provides an overview of modern international investment law and dispute resolution, with a focus on the nature and general criticism of the ISDS regime. Part III explores the issue of regulatory disputes in investor–state arbitration by explaining the concept of the “right to regulate” and summarizing the major criticism of ISDS—that it allows foreign corporations to challenge legitimate government measures. Part IV first provides insights into the various structural and procedural changes to ISDS to date and summarizes how safeguard provisions can be used in IIAs to reserve the right to regulate. It then critically examines the tobacco carve-out and related provisions in the TPP and offers alternative solutions to challenges incident to investor–state arbitration of regulatory disputes. A short conclusion follows.

II. MODERN INTERNATIONAL INVESTMENT LAW AND DISPUTE RESOLUTION

A. *The Network of International Investment Agreements*

International investment law encompasses a network of over thirty-three hundred IIAs seeking to attract and promote foreign investments in state parties.³⁸ Having largely emerged as BITs, today IIAs also include multilateral and bilateral FTAs with investment chapters, such as the North American Free Trade Agreement

38. U.N. CONFERENCE ON TRADE AND DEV., WORLD INVESTMENT REPORT 2016, INVESTOR NATIONALITY: POLICY CHALLENGES xii (2016) [hereinafter WORLD INVESTMENT REPORT 2016] (“In 2015, 31 new IIAs were concluded, bringing the universe to 3,304 treaties by year-end By the end of May 2016, close to 150 economies were engaged in negotiating at least 57 new IIAs.”).

(NAFTA)³⁹ and, more recently, the EU-Canada Comprehensive Economic and Trade Agreement (CETA)⁴⁰ and the China-Australia Free Trade Agreement (ChAFTA)⁴¹; sector specific agreements, such as the Energy Charter Treaty (ECT)⁴²; and now also “mega-regional” trade and investment agreements, such as the signed TPP and the proposed TTIP. Modern BITs and investment chapters in FTAs largely follow the same structure. First, they provide foreign investors with a combination of investor protection obligations, such as non-discrimination, fair and equitable treatment (FET), full protection and security (FPS), and protection against expropriation. Second, for disputes related to an alleged breach of the above investor protection obligations, IIAs may also provide for ISDS, most commonly, investor–state arbitration. These two types of provisions are referred to in this Article as *substantive* and *procedural* investor protection obligations, respectively.

In recent years, the IIA regime has become the subject of criticism by politicians, lawyers, economists, and civil society groups. They point out that the role of IIAs in promoting investments, trade, and development among participating countries remains unclear.⁴³ Yet the burden of entering into trade liberalization and investment protection agreements with ISDS provisions can be significant. For sovereign governments, such agreements, and the resulting investment disputes, may impede the ability to regulate and lead to multimillion dollar damages awards against states.⁴⁴ For local businesses, there is the

39. North American Free Trade Agreement, Dec. 17, 1992, 32 I.L.M. 289 [hereinafter NAFTA].

40. CETA, *supra* note 27.

41. See ChAFTA, *supra* note 22, ch. 9.

42. Energy Charter Treaty, *opened for signature* Dec. 17, 1994, 2080 U.N.T.S. 95, <http://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECTC-en.pdf> [<https://perma.cc/W7YA-2L99>] (archived Jan. 22, 2017) [hereinafter ECT].

43. See, e.g., Arjan Lejour & Maria Salfi, *The Regional Impact of Bilateral Investment Treaties on Foreign Direct Investment* (CPB Netherlands Bureau for Economic Policy Analysis, CPB Discussion Paper 298, Jan. 16, 2015), <http://www.cpb.nl/en/publication/the-regional-impact-of-bilateral-investment-treaties-on-foreign-direct-investment> [<https://perma.cc/PJ2F-QYPQ>] (archived Feb. 11, 2017) (showing that there might be benefits of BITs for lower and middle income countries, but not to high income countries, although there are observable differences among world regions).

44. The ability of foreign investors to interfere with the government’s ability to regulate is often discussed as part of the chilling effect argument. In particular, it has been argued that governments may react to investor–state arbitrations or the threat of claims by foreign investors by adopting less than optimal level of regulation. For further discussion, see note 16 and the accompanying text. Damages awarded to foreign investors in ISDS may range from several million to hundreds of millions of dollars, with the largest award ever rendered reaching as high as \$50 billion. See U.N. CONFERENCE ON TRADE AND DEV., INVESTOR–STATE DISPUTE SETTLEMENT: REVIEW OF DEVELOPMENTS IN 2015. IIA ISSUES NOTE II 6 (2016) (reporting that in 2015 “[t]en decisions awarded

threat of being unable to compete with foreign multinational corporations and of going out of business. For local communities, investment projects often entail the arrival of foreign companies that operate without regard for community values, local customs, traditions, development needs, and—as failed investment projects have demonstrated—without having to deal with the disastrous environmental and health impact.⁴⁵ Understandably, international investment treaty making today requires persuading governments and other stakeholders that the benefits of trade liberalization outweigh its costs.

The debate on the future of the IIA regime is particularly heated now because of a new trend in treaty making: the conclusion of unprecedentedly large trade liberalization treaties—the mega-regional trade agreements, or the so-called mega-regionals. The TPP⁴⁶ was signed by twelve Pacific Rim countries that have a total GDP of about \$28 trillion and a combined population of nearly 817 million (over 37.6 percent of the world’s GDP and over 11.1 percent of the world population as of 2015).⁴⁷ Together with the United States, it could have become the largest FTA ever concluded, accounting for more than a third of the world trade.⁴⁸ The CETA, which was recently approved by the European Parliament,⁴⁹ would cover economies with a total GDP of nearly \$18 trillion and a combined population of over 545 million as

compensation to the investor, ranging from \$8.6 million to \$383.6 million. The average amount awarded was \$120.2 million and the median \$48.6 million”).

45. See, e.g., *Chevron Corp. v. Republic of Ecuador*, PCA Case No. 2009-23, (UNCITRAL 2009), <http://www.italaw.com/cases/257> [<https://perma.cc/8W68-JRNH>] (archived Jan. 22, 2017) (involving allegations of severe environmental pollution and health damage resulting from Texaco/Chevron operations in the Amazon region of Ecuador).

46. TPP, *supra* note 3.

47. See *GDP at Market Prices (current US\$)*, WORLD BANK DATA <http://data.worldbank.org/indicator/NY.GDP.MKTP.CD> (last visited Apr. 8, 2017) [<https://perma.cc/Q482-4T6F>] (archived Mar. 6, 2017) [hereinafter *GDP, Total*] (calculating a total GDP by adding the 2015 GDPs of the twelve countries that signed the TPP, including the United States). Percentage of the world GDP for the TPP, as well as the CETA and the TTIP mentioned below, were calculated using the 2015 world GDP of 74.152 trillion U.S. dollars. *Id.* *Population, Total*, WORLD BANK DATA <http://data.worldbank.org/indicator/SP.POP.TOTL> [<https://perma.cc/9XVC-TJ3K>] (archived Mar. 6, 2017) [hereinafter *Population, Total*] (calculating the population covered by TPP by adding the 2015 populations of the countries covered by the agreement). Percentage of the world GDP for the TPP, CETA and the TTIP were calculated using the 2015 world population of 7.347 billion. *Id.*

48. See Kevin Granville, *This Was the Trans-Pacific Partnership*, N.Y. TIMES (Nov. 11, 2016), <https://www.nytimes.com/interactive/2016/business/tpp-explained-what-is-trans-pacific-partnership.html> [<https://perma.cc/W5JJ-LNAG>] (archived Jan. 22, 2017). Note, however, that the projected influence of the TPP included the United States, which since has begun its withdrawal from the treaty.

49. CETA, *supra* note 27; see *In Focus: EU-Canada Comprehensive Economic and Trade Agreement (CETA)*, EUR. COMM’N, (Jan. 16, 2017), <http://ec.europa.eu/trade/policy/in-focus/ceta/> [<https://perma.cc/R6XV-7UB4>] (archived Jan. 17, 2017).

of 2015 (over 24.1 percent of the world's GDP and over 7.4 percent of the world population as of 2015).⁵⁰ The proposed TTIP⁵¹ between the United States and the European Union would affect countries with a total GDP of over \$34 trillion and a combined population of 831 million (over 46.3 percent of the world GDP and 11.3 percent of the world population as of 2015).⁵² The importance of these trade liberalization treaties is hard to understate. It also explains the contentiousness of the debates in negotiating and drafting modern IIAs, most notably, with regard to their ISDS provisions.

B. *The Nature and Criticism of the ISDS Regime*

As an international law instrument, ISDS allows a foreign investor to bring a claim—commonly in investor–state arbitration—against the host state for violation of its IIA obligations. States agree to arbitral jurisdiction by giving consent to investor–state arbitration in IIAs, in domestic legislation, or in investment contracts. The right to file a claim in ISDS is rarely conditioned on the exhaustion of local remedies, such as filing a case in local courts or satisfying other domestic legal remedies under host state law. In this sense, IIAs operate like contracts for the benefit of third parties. Although they are concluded by sovereign states, IIAs provide third-party beneficiaries—the foreign investors—with the rights that are directly enforceable in international arbitration against state parties.

Scholars have struggled to advance a single theory of ISDS, often drawing analogies to contract law, international law, and constitutional law.⁵³ Most notably, Gus Van Harten and Martin

50. See *GDP, Total*, *supra* note 47 (calculating a total GDP of the CETA countries by adding the 2015 GDPs of Canada and the twenty-eight Member States of the European Union); *Population, Total*, *supra* note 47 (calculating the population covered by the CETA by adding the 2015 populations of Canada and the European Union).

51. TTIP, *supra* note 6.

52. See *GDP, Total*, *supra* note 47 (calculating a total GDP of the proposed TTIP by adding the 2015 GDPs of the United States and the twenty-eight Member States of the European Union); *Population, Total*, *supra* note 47 (calculating the population covered by the TTIP by adding the 2015 populations of the United States and the European Union).

53. See, e.g., Anthea Roberts, *Triangular Treaties: The Extent and Limits of Investment Treaty Rights*, 56 HARV. INT'L L.J. 353 (2015) (proposing “a new triangular framework that draws on principles from public international law, third-party beneficiary doctrines, and public law in a way that captures the unique, hybrid nature of investment treaties”); Richard C. Chen, *A Contractual Approach to Investor–State Regulatory Disputes*, 40 YALE J. INT'L L. 295, 295–335 (2015); Van Harten & Loughlin, *supra* note 13, at 121 (suggesting an analogy to domestic administrative law is more fitting than an analogy to international commercial arbitration); Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, 107 AM. J. INT'L L. 45 (2013) (using various frameworks and analogies to help foster understanding of the “clash of paradigms” underlying the investment treaty system); Douglas, *supra* note 37, at 152–55.

Loughlin have developed the theory of *global administrative law*, arguing that the right to initiate a claim in investor–state arbitration is analogous to judicial review of the state’s regulatory acts in domestic courts.⁵⁴ In developing their theory, they first identified four specific features of investment treaty arbitration, namely, (1) the authorization in IIAs of individual claims by foreign investors against host states, (2) the expanded reach of investment arbitration as an “international mechanism of adjudicative review” through forum shopping facilitated by IIA, (3) the availability of claims for damages against host states, and (4) the direct enforcement of awards in domestic courts worldwide.⁵⁵ They further observed that the cumulative effect of these features is “to subject the regulatory conduct of states to control through compulsory international adjudication to an unusual extent.”⁵⁶ Consequently, they argued that, because of the potential of this international mechanism to “exert a strong disciplinary influence over domestic administrative programmes . . . investment arbitration should be seen to constitute a powerful species of global administrative law.”⁵⁷

Procedurally, ISDS is, of course, most similar to international commercial arbitration. In fact, investor protection agreements often allow a foreign investor to submit its claim to arbitration using the rules of international commercial arbitration, such as the UNCITRAL Arbitration Rules.⁵⁸ Beyond these rules, the parties may arbitrate by relying on the ICSID Convention and the ICSID Rules on Procedure for Arbitration Proceedings or the ICSID Additional Facility Rules.⁵⁹

Over the years, the ISDS regime has been criticized for the shortcomings of a number of its features.⁶⁰ For instance, the ISDS system is notoriously one-sided in its design. It provides a foreign investor—but not a host state—with a right to sue and a right to choose

54. See, e.g., Van Harten & Loughlin, *supra* note 13, at 121, 140 (“Investment arbitration is constituted by a sovereign act, as opposed to a private act, of the state and this . . . makes investment arbitration more closely analogous to domestic juridical review of the regulatory conduct of the state.”). See generally Benedict Kingsbury et al., *The Emergence of Global Administrative Law*, 68 L. & CONTEMP. PROBS. 15 (2005) (discussing the factors encouraging and those constraining the development of global administrative law).

55. Van Harten & Loughlin, *supra* note 13, at 122.

56. *Id.*

57. *Id.*

58. See, e.g., TPP, *supra* note 3, art. 9.19 ¶ 4(c) (listing the UNCITRAL Arbitration Rules as an alternative under which the claimant may submit a claim).

59. See, e.g., TPP, *supra* note 3, art. 9.19 ¶ 4(a)–(b) (listing the ICSID Convention and the ICSID *Rules of Procedure for Arbitration Proceedings*, as well as the ICSID Additional Facility Rules, as alternatives under which the claimant may submit a claim).

60. See, e.g., *Fact Sheet: Investment Protection and Investor-to-State Dispute Settlement in EU Agreements*, EUR. COMM’N (2013), <http://trade.ec.europa.eu/doclib/html/151916.htm> [<https://perma.cc/9QRY-WYFM>] (archived Jan. 22, 2017) (addressing imperfections of the current system of ISDS in IIAs).

the arbitration mechanism. More specifically, with the exception of rarely permitted counterclaims, ISDS gives the right to bring a claim to foreign investors, but not to the host state.⁶¹ The choice of arbitration rules and procedure is similarly given to foreign investors, who can select a particular arbitration mechanism from the list of options available under an investment protection treaty.⁶² Moreover, in IIAs, parties give an offer of consent to ISDS with any and all foreign investors granted protection under a treaty.⁶³ Hence, the state does not know in advance if and when an investment arbitration will be commenced against it, or which of its investors will choose to perfect the ISDS consent. Consequently, foreign investors always get the first-mover advantage in investment dispute resolution.

Despite such imbalance between the rights of foreign investors and the rights of the host state, governments reportedly win more often than foreign investors in investor–state arbitrations if wins at the jurisdictional and the merits phase are combined together.⁶⁴ Yet, to win a case, a host state is required to defend itself in an investor–state arbitration. This is a very costly endeavor for many states, requiring, on average, \$4.5 million in defense costs in addition to about \$373,200 in tribunal costs (if tribunal costs are split equally between parties).⁶⁵

61. See, e.g., 2012 U.S. Model BIT, *supra* note 12, art. 1 (defining “claimant” as “an investor of a Party that is a party to an investment dispute with the other Party”). See also TPP, *supra* note 3, art. 9.19; CETA, *supra* note 27, art. 8.23; NAFTA, *supra* note 39, art. 1120.

62. 2012 U.S. Model BIT, *supra* note 12, art. 9.19 ¶ 4(c); TPP, *supra* note 3, art. 9.19 ¶ 4; CETA, *supra* note 27, art. 8.23 ¶ 2; NAFTA, *supra* note 39, art. 1120.

63. By their design, IIAs are treaties for the benefit of the third party—foreign investor. As such, IIAs provide protection under the treaty to all investors and/or investments that fall within the scope of the treaty.

64. Most recently, the United Nations Conference on Trade and Development (UNCTAD) reported that out of total 444 ISDS proceedings concluded by the end of 2015, about one third was decided in favor of the state and about one quarter—in favor of the investor. See WORLD INVESTMENT REPORT 2016, *supra* note 38, at 107. UNCTAD further reports that about one half of cases that ended in favor of the state were dismissed for the lack of jurisdiction. *Id.* Out of the decisions on the merits, states won only 40 percent of cases, while 60 percent of cases were decided in favor of foreign investors. *Id.*

65. *Counting the Cost of Investment Treaty Arbitration*, GLOBAL ARB. REV. (Mar. 24, 2014), <http://globalarbitrationreview.com/news/article/32513/> [<https://perma.cc/D8ZW-ZCWT>] (archived Jan. 16, 2017) (describing an Allen & Overy study of 176 investment treaty arbitration cases with data showing that “the average party costs were quite similar, at US\$4,437,000 for claimants and US\$4,559,000 for respondents” and that “the average [tribunal] costs are US\$746,000 (median US\$590,000), or just over US\$373,200 for each party (split on a 50:50 basis)”). A more recent study of 138 ICSID arbitrations concluded in the period of July 1, 2010 to June 30, 2015, revealed higher costs of, on average, \$5,619,261.74 for claimants and \$4,954,461.27 for respondents, in addition to \$882,668.19 in tribunal costs. See Jeffery P. Commission, *How Much Does an ICSID Arbitration Cost? A Snapshot of the Last Five Years*, KLUWER ARB. BLOG (Feb. 29, 2016), <http://kluwerarbitrationblog.com/2016/02/29/how-much-does-an-icsid-arbitration-cost-a-snapshot-of-the-last-five-years/> [<https://perma.cc/FVV4-M9T6>] (archived Mar. 19, 2017).

Other shortcomings of ISDS include the lack of transparency and the absence of an appeals mechanism that would ensure secondary review, consistency, and predictability in arbitral awards.⁶⁶ Furthermore, ISDS has been criticized for its reliance on private arbitrators instead of professional judges with training and experience in international law.⁶⁷ Relatedly, investor–state arbitrators are often suspected of bias and self-interest.⁶⁸ Critics of ISDS further attest that, in borderline cases, private arbitrators have a tendency to establish jurisdiction in order to hear a case and receive remuneration for their work.⁶⁹ Some arbitrators are even accused of always voting for the state or always voting for the foreign investor, allegedly to secure future appointments by claimants or defendants.⁷⁰ These concerns about the legitimacy of ISDS have become common arguments in the debate on the future of ISDS.⁷¹

Additionally, critics of ISDS point out that, through the most-favored-nation (MFN) clause and corporate reorganizations, the investment law regime promotes socially wasteful treaty and forum

66. See, e.g., U.N. CONFERENCE ON TRADE AND DEV., REFORM OF INVESTOR–STATE DISPUTE SETTLEMENT: IN SEARCH OF A ROADMAP, 3–4 (June 26, 2013) (listing the lack of sufficient legitimacy, transparency, and consistency in arbitral decisions among the main concerns in current ISDS regime).

67. See, e.g., Elizabeth Warren, *The Trans-Pacific Partnership Clause Everyone Should Oppose*, WASH. POST (Feb. 23, 2015), https://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html?utm_term=.f60d2389166b [<https://perma.cc/XW7S-W2JM>] (archived Mar. 6, 2017) (“ISDS could lead to gigantic fines, but it wouldn’t employ independent judges. Instead, highly paid corporate lawyers would go back and forth between representing corporations one day and sitting in judgment the next. Maybe that makes sense in an arbitration between two corporations, but not in cases between corporations and governments. If you’re a lawyer looking to maintain or attract high-paying corporate clients, how likely are you to rule against those corporations when it’s your turn in the judge’s seat?”).

68. *Id.*

69. See, e.g., PIA EBERHARDT ET AL., PROFITING FROM INJUSTICE: HOW LAW FIRMS, ARBITRATORS AND FINANCIERS ARE FUELLING AN INVESTMENT ARBITRATION BOOM 35 (Helen Burley ed., 2012) (observing that “[a]rbitrators, to a far greater degree than judges, have a financial and professional stake in the system. They earn handsome rewards for their services. Unlike judges, there is no flat salary, no cap on financial remuneration. Arbitrators’ fees can range from US \$375 to US \$700 per hour depending on where the arbitration takes place. How much an arbitrator earns per case will depend on the case’s length and complexity, but for a US\$100 million dispute, arbitrators could earn on average up to US \$350,000.” (footnotes omitted)). In addition, in a relatively small world of arbitrators acting in ISDS, there are reputation concerns that may motivate arbitrators to perform their functions with a view of securing future appointments.

70. Daphna Kapeliuk, *Collegial Games: Analyzing the Effect of Panel Composition on Outcome in Investment Arbitration*, 31 REV. LITIG. 267, 278 (2012).

71. See generally Franck, *supra* note 25 (discussing solutions to challenges facing investment treaty arbitration).

shopping.⁷² Another problem of ISDS is that a challenged regulatory measure may be covered by several treaties or chapters of the agreement (e.g., trade and investment chapters), which allows a foreign investor not only to forum shop for a more preferential treaty and jurisdiction, but also to use the benefits of several treaties. Commentators have also criticized ISDS for providing multinational corporations with the power to sue sovereign governments, interfering with the state's power to regulate.⁷³ And some have expressed general skepticism about the ability of private arbitrators to address complex disputes with public policy implications.⁷⁴

Dissatisfaction with ISDS is fueled by the fact that it is still unclear whether IIAs contribute to attracting foreign investments to a country.⁷⁵ Thus, the benefits of foreign investment protection regimes for the economic development of host states remain contentious. This is a concern because opening up to foreign investors and providing a consent to ISDS in IIAs may lead to costly investor–state arbitrations. Some countries have therefore chosen to revoke their ISDS consent or reconsider investment protection regimes.⁷⁶ Despite all of this,

72. See, e.g., ROOS VAN OS & ROELINE KNOTTNERUS, DUTCH BILATERAL INVESTMENT TREATIES: A GATEWAY TO 'TREATY SHOPPING' FOR INVESTMENT PROTECTION BY MULTINATIONAL COMPANIES 31 (2011) (discussing "treaty shopping" and how Dutch BITs are used by multinational corporations to sue sovereign governments in ISDS); see, e.g., LISE JOHNSON ET AL., COLUM. CTR. ON SUSTAINABLE INV., INVESTOR-STATE DISPUTE SETTLEMENT, PUBLIC INTEREST AND U.S. DOMESTIC LAW 11–14 (2015) (explaining that forum shopping is used to gain access to ISDS).

73. See Claire Provost & Matt Kennard, *The Obscure Legal System That Lets Corporations Sue Countries*, GUARDIAN (June 10, 2015), <https://www.theguardian.com/business/2015/jun/10/obscure-legal-system-lets-corporations-sue-states-ttip-icsid> [<https://perma.cc/H8W3-7RBQ>] (archived Jan. 16, 2017) (noting that "[t]here was sharp opposition to this [ISDS] system from its inception, with a bloc of developing countries warning that it would undermine their sovereignty").

74. See, e.g., William W. Burke-White & Andreas von Staden, *Private Litigation in a Public Law Sphere: The Standard of Review in Investor-State Arbitrations*, 35 YALE J. INT'L L. 283, 336 (2010) ("The inherent problem with ICSID tribunals . . . is that they are not well positioned or equipped to engage in lawmaking, to internalize the context, and to weigh the policy considerations at play in a particular case ICSID arbitrators are far removed from the politics over whom they exercise control. They often lack expertise in the particular circumstances and fact patterns of the case." (footnote omitted)).

75. See, e.g., Jason Webb Yackee, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*, 51 VA. J. INT'L L. 397 (2010) (questioning generally whether international investment agreements attract foreign investments); U.N. CONFERENCE ON TRADE AND DEV., *The Impact of International Investment Agreements on Foreign Direct Investment: An Overview of Empirical Studies 1998-2004* (Working Draft 2014) (discussing the impact of IIAs on foreign investment).

76. A number of sovereign states have cancelled their investment protection treaties. Examples include South Africa (which has terminated its BITs with Austria, Belgium and Luxembourg, Denmark, France, Germany, the Netherlands, Spain, Switzerland, and the United Kingdom), Indonesia (which to date has terminated fourteen of its BITs), Italy (which announced its withdrawal from the ECT with a notice

however, ISDS continues to play an important role in the interpretation and enforcement of the provisions of international investment agreements.

III. REGULATORY DISPUTES IN INVESTOR–STATE ARBITRATION

A. *The Right to Regulate in International Investment Law*

Of particular concern to the critics of ISDS are the so-called *regulatory disputes*. Regulatory disputes are investor–state disputes that challenge government measures and, as such, may have a chilling effect on the state’s power to regulate. The ability to regulate within its own borders is a core feature of the sovereign state. Through its legislative, administrative, and judicial bodies, the state is generally free to adopt, maintain, and enforce the measures necessary for the advancement of its public policy goals. Government regulation is thus understood broadly and may include any act of the legislature, public administration, or courts that is an exercise of the regulatory or police power of the state. It is also in the expression of the right to regulate that a state may enter into international investment treaties and, in doing so, undertake investor protection obligations.

The words *to regulate*, *regulatory*, and *regulation* are increasingly common in modern IIAs that seek to reserve for the state the right to regulate for the public interest. Investor protection treaties acknowledge a number of legitimate public policy goals, such as the protection of public health, the environment, competition, human rights, and social values.⁷⁷

Most commonly, the right to regulate is invoked in IIAs as part of the *general exceptions*. General exceptions are treaty provisions that allow the state to adopt measures that deviate from its investor protection obligations. Consequently, investment law scholars have

to the ECT Secretariat in January 2015). See generally *International Investment Agreements Navigator*, U.N. CONFERENCE ON TRADE AND DEV. (Jan. 31, 2017), <http://investmentpolicyhub.unctad.org/IIA> [https://perma.cc/7EC8-7RZU] (archived Feb. 1, 2017).

77. See, e.g., TPP, *supra* note 3, art. 9.16 (“Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental, health or other *regulatory* objectives” (emphasis added)); see also EU-Vietnam FTA, *supra* note 23, § 2, art. 13bis (“1. The Parties reaffirm the right to *regulate* within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, environment or public morals, social or consumer protection or promotion and protection of cultural diversity. 2. For greater certainty, the provisions of this section shall not be interpreted as a commitment from a Party that it will not change the legal and *regulatory* framework, including in a manner that may negatively affect the operation of covered investments or the investor’s expectations of profits.” (emphasis added)).

suggested a more narrow definition of the right to regulate that reflects the specific understanding of such a right under investor protection treaties. For instance, Aikaterini Titi has defined the right to regulate in international investment law as “the legal right exceptionally permitting the host state to regulate in derogation of international commitments it has undertaken by means of an investment agreement without incurring a duty to compensate.”⁷⁸ However, in the public policy debate over the legitimacy of ISDS, the right to regulate is generally used in its broadest sense. Most frequently, it is invoked to express concerns over constraints that investor protection obligations impose on the state’s regulatory power in its domestic policymaking.

Similarly, the concept of *public interest* is relatively new for IIAs. Scholars have noted that earlier investor protection treaties and other legal instruments did not contain references to the public interest.⁷⁹ Instead, these legal instruments employed “narrower categories such as ‘government’ or ‘consumer’ interests, or juxtapose[d] the public interest and private sector interests, mingling the first order objective with the second-order trade-offs required to attain it.”⁸⁰ The latest generation of IIAs employ the term *public interest* generously. For instance, investor protection treaties allow state parties to expropriate only for a public purpose.⁸¹ Furthermore, general exceptions name public interest as a ground for adopting regulatory measures that would otherwise be in breach of the IIAs provisions. The exceptions do not define public interest, but frequently list several legitimate regulatory objectives that allow the state to exercise its right to regulate despite its investor protection obligations.

In international investment law, the right to regulate manifests itself in several ways. First, one might see a reference to the right to regulate in the preamble of international investment treaties.⁸² The role of such provisions is usually to establish a general regime for contracting parties and to explain the reasons for entering into a treaty, but not necessarily to create legal obligations for them. Yet preamble provisions are frequently invoked by the host state in international arbitration to support the state’s claim that investor protection obligations are not absolute. Such preamble provisions

78. AIKATERINI TITI, *THE RIGHT TO REGULATE IN INTERNATIONAL INVESTMENT LAW* 33 (2014).

79. See, e.g., Megan Donaldson & Benedict Kingsbury, *Ersatz Normativity or Public Law in Global Governance: The Hard Case of International Prescriptions for National Infrastructure Regulation*, 14 *CHI. J. INT’L L.* 1, 1 (2013) (making such observation with respect to “formally non-binding but influential instruments issued in the 2000s by the World Bank, the OECD, and UNCITRAL” regulating national infrastructure).

80. *Id.* at 27.

81. See, e.g., 2012 U.S. Model BIT, *supra* note 12, art. 6.

82. See, e.g., TITI, *supra* note 78, at 115–22 (discussing the ways international investment treaties include the right to regulate in the preamble and providing examples of such references across various treaties).

reserve for the state the right to regulate for a range of legitimate objectives, including public health, safety, the environment, corporate social responsibility, and sustainable development.⁸³

Second, the right to regulate most noticeably comes into play in the context of disputes over indirect—regulatory or creeping—expropriation.⁸⁴ Here, the key issue has long been “to what extent a government may affect the value of property by regulation, either general in nature or by specific actions in the context of general regulations, for a legitimate public purpose without effecting a ‘taking’ and having to compensate a foreign owner or investor for this act.”⁸⁵ Arbitral tribunals have struggled to establish the exact demarcation line between indirect expropriation, which, under most IIAs, requires adequate compensation, and regulatory measures that do not reach the level of expropriation.⁸⁶ The texts of investor protection treaties often contain provisions on regulatory expropriation.⁸⁷ By contrast, they provide little or no guidance to arbitral tribunals in distinguishing such actions from regulatory measures not subject to compensation. Rare international legal instruments address the possibility that the state may regulate without reaching the level of expropriation that requires compensation.⁸⁸

83. *See id.* at 116 (listing public policy objectives from which regulatory interests stem).

84. *See generally* Katia Yannaca-Small, *Indirect Expropriation and the Right to Regulate: How to Draw the Line?*, in *ARBITRATION UNDER INTERNATIONAL INVESTMENT AGREEMENTS: A GUIDE TO THE KEY ISSUES* 445–77 (Katia Yannaca-Small ed., 2010) (discussing regulation in the instance of expropriation).

85. *Id.* at 446. *See also* CHRISTOPHER F. DUGAN ET AL., *INVESTOR-STATE ARBITRATION* 452 (2008) (“The signal problem is defining with precision when an exercise of regulatory or police power crosses the line and becomes compensable, and a vast literature makes it clear that the line is neither bright nor clear.” (footnote omitted)).

86. *See, e.g.*, Markus Krajewski, *Investment Law and Public Services*, in *INTERNATIONAL INVESTMENT LAW* 1629, 1637 (Marc Bungenberg et al. eds., 2015).

87. For instance, the U.S. FTAs with Australia, Chile, Dominican Republic-Central America, Morocco, Singapore, Peru, and the Model U.S. BIT all contain provisions on indirect expropriation. *See* OECD, “*Indirect Expropriation*” and the “*Right to Regulate*” in *International Investment Law* (OECD Working Papers on International Investment, Paper No. 2004/04 at 6), <http://dx.doi.org/10.1787/780155872321> [<https://perma.cc/M2AV-7VZW>] (archived Feb. 11, 2017).

88. Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms, art. 1, Mar. 20, 1952, E.T.S. No. 9 (“Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.”); *see also* Yannaca-Small, *supra* note 84, at 452 (citing to various legal instruments and other texts recognizing the state’s right to regulate through recognition of “a category of noncompensable takings,” including Article 10(5) of the Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens, prepared by Harvard

Arbitral tribunals rely on several factors in distinguishing legitimate regulation from regulatory expropriation. In *Tecmed v. Mexico*, the tribunal looked at the effect of the regulatory measures and the degree to which a foreign investor is deprived by regulation of its property or rights, explaining that

[t]his determination is important because it is one of the main elements to distinguish, from the point of view of an international tribunal, between a regulatory measure, which is an ordinary expression of the exercise of the state's police power that entails a decrease in assets or rights, and a *de facto* expropriation that deprives those assets and rights of any real substance.⁸⁹

Some tribunals have attempted to distinguish between the two types of regulation by looking at their goals, nature, and the manner in which they were applied. In doing so, they have relieved the state of the obligation to provide compensation where regulation had a legitimate public purpose and was applied in a nondiscriminatory manner.⁹⁰ For instance, the arbitral tribunal in *Methanex v. United States* held that

Methanex [was] correct that an intentionally discriminatory regulation against a foreign investor fulfils a key requirement for establishing expropriation. But as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.⁹¹

Law School under the direction of Professors Louis B. Sohn and R.R. Baxter. OECD Draft Convention on the Protection of Foreign Property art. 3, Oct. 16, 1967 (describing plan to deal with taking of property); RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES cmt. g (AM. LAW INST. 1987) (defining the limits of expropriation and regulation).

89. *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, ¶ 115 (May 29, 2003); see also RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* 100 (1995) (“[I]n determining whether a taking constitutes an ‘indirect expropriation’ it is particularly important to examine the effect that such taking may have had on the investor’s rights.”).

90. Krajewski, *supra* note 86, at 1638.

91. *Methanex Corp. v. United States of America*, NAFTA (UNCITRAL Rules), Final Award of the Tribunal on Jurisdiction and Merits, Part VI, Ch. D, ¶ 7 (Aug. 3, 2005) [hereinafter *Methanex*]; see also *Saluka Inv. BV v. The Czech Republic*, UNCITRAL, Partial Award, ¶ 262 (Mar. 17, 2006) [hereinafter *Saluka*] (stating that a state is not liable for compensation when expropriation is within its police powers).

Other tribunals, such as those in *Santa Elena v. Costa Rica*⁹² and *Metalclad v. Mexico*,⁹³ have disagreed that a legitimate public policy objective on its own can serve as a justification for expropriation without compensation. Similarly, in *Azurix v. Argentina*, the tribunal held that “the issue is not so much whether the measure concerned is legitimate and serves a public purpose, but whether it is a measure that, being legitimate and serving a public purpose, should give rise to a compensation claim.”⁹⁴

Over the years, arbitral tribunals have showed substantial deference to the state regulatory power. In doing so, they set a high threshold for foreign investors seeking to establish indirect expropriation.⁹⁵ Scholars have identified only a few investor–state arbitrations where indirect expropriation was established.⁹⁶ The effect of the regulation has become the most common criteria for distinguishing indirect expropriation from legitimate regulation.⁹⁷

92. *Compañía del Desarrollo de Santa Elena S.A. v. The Republic of Costa Rica*, ICSID Case No. ARB/96/1, Final Award, ¶ 71 (Feb. 17, 2000) (“While an expropriation or taking for environmental reasons may be classified as a taking for a public purpose, and thus may be legitimate, the fact that the Property was taken for this reason does not affect either the nature or the measure of the compensation to be paid for the taking. That is, the purpose of protecting the environment for which the Property was taken does not alter the legal character of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference.” (footnote omitted)).

93. *Metalclad Corp. v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, ¶ 111 (Aug. 30, 2000) (“The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree. . . . However, the Tribunal considers that the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation.”).

94. *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Award, ¶ 310 (July 14, 2006) (explaining that a legitimate public welfare purpose of regulation is not sufficient to allow expropriation without compensation: “[i]n the exercise of their public policy function, governments take all sorts of measures that may affect the economic value of investments without such measures giving rise to a need to compensate. The tribunal in *S.D. Myers* found the purpose of a regulatory measure a helpful criterion to distinguish measures for which a State would not be liable: “Parties [to the Bilateral Treaty] are not liable for economic injury that is the consequence of *bona fide* regulation within the accepted police powers of the State. This Tribunal finds the criterion insufficient and shares the concern expressed by Judge R. Higgins, who questioned whether the difference between expropriation and regulation based on public purpose was intellectually viable” (internal citations omitted)).

95. *See, e.g.*, *Yannaca-Small*, *supra* note 84, at 476 (“Ultimately, however, the tribunals have only in a few cases found an indirect expropriation to occur. This results from the fact that the threshold for characterizing a governmental measure as expropriation is very high.”).

96. *Id.*

97. *See, e.g.*, *DUGAN ET AL.*, *supra* note 85, at 455 (“There is a unanimous agreement that one of the most important factors in determining whether a government act is an indirect or regulatory expropriation is the effect or the consequences of the government act on the investor’s property. In fact, in some arbitrations, the effect is the only factor the tribunal has considered.” (footnote omitted)).

With regulatory expropriation consistently proving difficult to establish, foreign investors then began claiming that host state regulation breaches the FET standard.⁹⁸

And so, the third way that the right to regulate manifests itself in international investment law is as part of the FET analysis. The right to regulate is particularly contentious in this context.⁹⁹ In contrast to the expropriation provisions in IIAs, the FET obligation usually does not contain any direct reference to the right to regulate. Consequently, it is not clear what standards tribunals are expected to follow in order to ensure that foreign companies are not overstepping in their demands for investor protection to the detriment of the public interest.

Commentators have also noted that the FET analysis often necessitates the need to balance the state's right to regulate against the investor's protection rights.¹⁰⁰ Donaldson and Kingsbury have argued that such balancing suggests that the competing interests of the state and of a foreign investor are "of the same order."¹⁰¹ One may question whether this is the correct approach, or, instead, whether the state's right to regulate for the public benefit should be treated as of a higher order than the interest of the foreign investors in the state.

Overall, arbitral tribunals have proved willing to give a high level of deference to the state's own determination of the manner in which it wishes to exercise its regulatory power. For instance, the tribunal in *S.D. Myers v. Canada* famously held that

a breach of Article 1105 [of NAFTA] occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders. The determination must also take

98. See, e.g., Yannaca-Small, *supra* note 84, at 476 (claiming that "recourse to another protection standard such as the violation of the fair and equitable standard, which represents a lower threshold, seems to gain ground").

99. See, e.g., U.N. CONFERENCE ON TRADE AND DEV., FAIR AND EQUITABLE TREATMENT. UNCTAD SERIES ON ISSUES IN INTERNATIONAL INVESTMENT AGREEMENT II 2 (2012) ("As interpreted by arbitral tribunals, the FET standard raises highly complex and contentious issues as to the types of administrative and governmental action that can be reviewed under the standard and the degree of seriousness of breach that is required to activate a compensable claim.").

100. See, e.g., *id.* at xiii ("[T]he application of FET provisions has brought to light the need to balance investment protection with competing policy objectives of the host State, and in particular, with its right to regulate in the public interest.").

101. Donaldson & Kingsbury, *supra* note 79, at 27 ("Regardless of the intention, the prevalence of the references to 'balancing' tends to reinforce a view that the interests of investors on one hand and users, the state, or the public, on the other, are of the same order.").

into account any specific rules of international law that are applicable to the case.¹⁰²

More recent tribunal decisions, such as an award in *Mesa Power v. Canada*,¹⁰³ followed the same approach, acknowledging a high level of deference to the state’s right to regulate.¹⁰⁴

As part of the FET analysis, the right to regulate may also be discussed in the context of the legitimate expectations doctrine.¹⁰⁵ For instance, the tribunal in *Saluka v. Czech Republic* referred to the state’s right to regulate as the rationale for the changes in the regulatory environment, which should be reasonably expected by a foreign investor.¹⁰⁶ The tribunal held that

[m]oreover, the scope of the Treaty’s protection of foreign investment against unfair and inequitable treatment cannot exclusively be determined by foreign investors’ subjective motivations and considerations. Their expectations, in order for them to be protected, must rise to the level of legitimacy and reasonableness in light of the circumstances.¹⁰⁷

Finally, of particular interest to the analysis here is the fourth manifestation of the right to regulate: a direct reference to such right in exceptions, exclusions, and other safeguard provisions in investment

102. *S.D. Myers, Inc. v. Government of Canada*, NAFTA (UNCITRAL Rules), Partial Award, ¶ 263 (Nov. 13, 2000).

103. *Mesa Power Grp., LLC v. Government of Canada*, NAFTA (UNCITRAL Rules), PCA Case No. 2012-17, Award (Mar. 24, 2016).

104. *Id.* ¶ 493 (“[A] finding of a breach of Article 1105 [Minimum Standard of Treatment] ‘must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their borders’”). Note that citing *S.D. Myers v. Canada*, the tribunal in *Bilcon v. Canada* similarly acknowledged the high threshold of deference to the state’s own determination, but ultimately did not grant such deference to Canada. *Clayton et al. v. Government of Canada*, NAFTA (UNCITRAL Rules), PCA Case No. 2009-04, Award on Jurisdiction and Liability, ¶ 440, 725 (Mar. 17, 2015).

105. See, e.g., Rudolf Dolzer, *Fair and Equitable Treatment: Today’s Contours*, 12 SANTA CLARA J. INT’L L. 7, 27–29 (2014) (describing the link between a state’s right to regulate and investors’ legitimate expectations).

106. *Saluka*, *supra* note 91, ¶ 305 (“No investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor’s expectations was justified and reasonable, the host State’s legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. As the *S.D. Myers* tribunal has stated, the determination of a breach of the obligation of ‘fair and equitable treatment’ by the host State must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.” (footnote omitted)).

107. *Id.* ¶ 304. See also *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID Case No. ARB/05/8, Award, ¶ 332 (Sept. 11, 2007) (“It is each State’s undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion As a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power.”).

protection treaties. In these safeguard provisions, the right to regulate for legitimate public policy objectives may serve as an affirmative defense to measures otherwise in breach of the treaty provisions. The right to regulate may also serve as a rationale for carving out regulatory space from the scope of the application of a treaty. It is this manifestation of the right to regulate—arguably, the strongest of all—that was used to introduce the TPP tobacco carve-out, which will be discussed more in depth in Section IV.C below.

Overall, the right to regulate remains a chameleon concept. It changes meaning depending on the context of the public policy discussions and the provision of an investment protection treaty in which it manifests. And it requires a case-by-case analysis by arbitral tribunals to distinguish instances of legitimate government regulation from breaches of investor protection obligations, most commonly in relation to expropriation and violation of the FET standard.

B. Regulatory Disputes as the Challenge for ISDS

The term *regulatory disputes* is used loosely by scholars and commentators to describe investor–state disputes that challenge the government regulation by the host state as part of the substantive claims under IIAs. Both actions (such as introduction of a new law or regulation or a reduction in tax breaks¹⁰⁸) and inactions (such as a failure to commence an investigation into an allegedly fraudulent investment scheme) may lead to regulatory disputes.¹⁰⁹

As a phenomenon, regulatory disputes are not new for investor–state arbitration. Claims alleging the discriminatory or expropriatory effect of government regulation with regard to foreign investments or investors have long been raised in investment arbitration. Early regulatory disputes—*Maffezini*¹¹⁰ and *Methanex*¹¹¹—involved environmental regulations.¹¹² The more recent wave of regulatory disputes expands beyond allegations of discrimination and expropriation, however, to claims of alleged violations of FET

108. See, e.g., *Philip Morris Asia*, *supra* note 1, (where Philip Morris challenged in investment arbitration the Australian tobacco plain packaging legislation).

109. See, e.g., LISE JOHNSON ET AL., COLUM. CTR. ON SUSTAINABLE INV., INVESTOR-STATE DISPUTE SETTLEMENT, PUBLIC INTEREST AND U.S. DOMESTIC LAW 2–3 (2015) (providing a sample of ISDS cases that included challenges to government actions or inactions).

110. *Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7, Award (Nov. 13, 2000).

111. *Methanex*, *supra* note 91.

112. See Julie A. Maupin, *Differentiating Among International Investment Disputes*, in THE FOUNDATIONS OF INTERNATIONAL INVESTMENT LAW: BRIDGING THEORY INTO PRACTICE 467, 492–93 n.108 (Zachary Douglas et al. eds., 2014).

provisions.¹¹³ These claims involve an array of government measures, ranging from legislative acts seeking to reduce tobacco exposure and the health risks associated with smoking¹¹⁴ to measures providing for the nuclear power phase-out in order to reduce the health and environmental risks of nuclear power use.¹¹⁵ It is this public-benefits aspect and the regulatory scope of the challenged government measures that have been identified by legal scholars as distinguishing recent claims from the earlier generation of regulatory disputes.¹¹⁶ While earlier cases involved regulation of a limited scope, addressing a particular industry, territory, or specific foreign investor, the latest regulatory investor–state arbitrations challenge measures that have a very remote connection or no connection at all to foreign investors. Most of these challenges seek damages for the alleged decrease in value of the investment made or expected, but may also seek specific performance, such as abolishing a government measure.¹¹⁷

The ability of private companies—most commonly, multinational corporations—to bring investor–state arbitration claims to challenge government measures before international tribunals has generated a vigorous scholarly and public policy debate and has attracted substantial media attention.¹¹⁸ Critics of ISDS are concerned that

113. See, e.g., *Electrabel S.A. v. Republic of Hung.*, ICSID Case No. ARB/07/19, Award, ¶ 165 (Nov. 25, 2015) (“[T]he application of the ECT’s FET standard allows for a balancing exercise by the host State in appropriate circumstances. The host State is not required to elevate unconditionally the interests of the foreign investor above all other considerations in every circumstance”) [hereinafter *Electrabel S.A. v. Hung.*]; see also *Electrabel S.A. v. Hung.*, ¶ 166 (“[E]ven assuming that Electrabel had an expectation that it would be awarded the maximum compensation for stranded costs permitted under EU law, once weighed against Hungary’s legitimate right to regulate in the public interest, such an expectation does not appear reasonable or legitimate.” (emphasis added)).

114. See *Philip Morris Asia*, *supra* note 1; see also *Philip Morris Brands Sàrl*, *supra* note 1.

115. *Vattenfall*, *supra* note 9.

116. See, e.g., *RESHAPING THE INVESTOR-STATE DISPUTE SETTLEMENT SYSTEM: JOURNEYS FOR THE 21ST CENTURY 500* (Jean E. Kalicki & Anna Joubin-Bret eds., 2015) (observing that “[c]ontemporary investment arbitrations frequently implicate the scope of the regulatory powers of the respondent States and reach well beyond the traditional concerns of simple expropriations and nationalizations. Instead, a much broader variety of regulatory and public goods disputes has come to be addressed through investment arbitrations, ranging from the provision of basic public services, such as water and sanitation, to the maintenance of public order”).

117. See, e.g., *Philip Morris Asia Ltd. v. The Commonwealth of Australia*, PCA Case No. 2012-12, Notice of Arbitration, ¶ 8.2 (UNCITRAL Nov. 21, 2011) (seeking “an order for the suspension of enforcement of plain packaging legislation,” but note that Philip Morris later dropped its specific performance request).

118. See, e.g., Elizabeth Warren, *Trade Agreements Should Not Benefit Industry Only*, BOS. GLOBE (June 23, 2015), <https://www.bostonglobe.com/opinion/2015/06/23/warren/CJluXWm4B5VDTdUDsCkwEL/story.html> [<https://perma.cc/VV87-8XMN>] (archived Jan. 17, 2017) (arguing that “multinational corporations don’t have to plead with the government to enforce their claims. Instead, modern trade deals give corporations the

international investment law has empowered foreign corporations to interfere with a state's ability to regulate in the public interest. Some of them argue that foreign corporations are thus encroaching on the state's sovereignty, as the right to regulate is seen by many as the core feature of the sovereign state.¹¹⁹ From the state sovereignty perspective, the issue of regulatory disputes appears especially problematic, as ISDS allows *foreign* corporations to interfere with the *host* government's ability to regulate, constraining the state's capacity to function for the benefit of the public.¹²⁰

Some scholars have further argued that, through ISDS, corporations have not only acquired the right to directly "sue" sovereign states before investment tribunals, but have also received the right to participate in international lawmaking.¹²¹ These developments have made José Alvarez look into whether corporations have become the subjects of international law.¹²²

Other scholars have expressed their concern over the institutional mechanism of investor–state arbitration, which places the responding state at the mercy of a private arbitral tribunal, often too far removed from the host state to properly consider public policy implications of

right to go straight to an arbitration panel when a country passes new laws or applies existing laws in ways that the corporations believe will cost them money. Known as investor-state dispute settlement (ISDS), these international arbitration panels can force countries to pony up billions of dollars in compensation. And these awards stick: No matter how crazy or outrageous the decision, no appeals are permitted. Once the arbitration panel rules, taxpayers must pay"). See also "Worst Trade Deal Ever", *supra* note 14 (noting economist's impression that particular trade deals benefit corporations rather than aid the public's interest); Provost & Kennard, *supra* note 73 (describing recent cases that illustrate international investment tribunal's preferential treatment of corporations).

119. See Van Harten & Loughlin, *supra* note 13, at 147 ("Investment arbitration tribunals apply standards that constrain sovereign acts of a state's legislature, judiciary and administration . . . [B]y obliging states to arbitrate disputes arising from sovereign acts, investment treaties establish investment arbitration as a mechanism to control the exercise of public authority. For this reason, in particular, investment arbitration is best analogized to domestic administrative law.").

120. See, e.g., Charles N. Brower & Lee A. Steven, *Who Then Should Judge? Developing the International Rule of Law Under NAFTA Chapter 11*, 2 CHI. J. INT'L L. 193 (2001).

121. See, e.g., José E. Alvarez, *Are Corporations "Subjects" of International Law?*, 9 SANTA CLARA J. INT'L L. 1, 11–12 (2011) (noting that "[in investor-state arbitration,] states have in effect delegated the making of international investment law to third party private attorneys general, namely the wealthy multinationals that can afford to bring the cases and generate the case law") (footnote omitted). See also Julian Arato, *Corporations as Lawmakers*, 56 HARV. INT'L L.J. 229, 231 (2015) (arguing that, with the help of ISDS, corporations "have developed the capacity to negotiate with states to create norms of *international law*—norms that bear a particular kind of relationship of priority to the state party's domestic legal order").

122. See Alvarez, *supra* note 121, at 12 (explaining how it can be "easy to conclude, based on the international investment regime, that corporations and other investors under BITs and FTAs are international legal persons or subjects of international law" (footnote omitted)).

the state’s government measures.¹²³ Along these lines, William Burke-White and Andreas von Staden have argued that

[t]he inherent problem with ICSID tribunals . . . is that they are not well positioned or equipped to engage in lawmaking, to internalize the context, and to weigh the policy considerations at play in a particular case. . . . ICSID arbitrators are far removed from the politics over whom they exercise control.¹²⁴

Some have criticized international investment law for allowing extensive treaty and forum shopping, which add to the social cost of international dispute resolution and often lead to unfair results in ISDS. In particular, MFN provisions and various loopholes in investor protection treaties allow a foreign corporation to reorganize and establish in a jurisdiction with a more beneficial investor protection regime.¹²⁵ Furthermore, in addition to ISDS, a multinational corporation and its shareholders may challenge the same government measure in other forums, such as domestic courts and—with the assistance of other governments—through the World Trade Organization (WTO) dispute settlement mechanism.¹²⁶ This may lead to overlapping and related claims—taking two bites of the same apple, as the saying goes—with conflicting results by various dispute resolution bodies, double recovery, and enormous costs for a defending state.¹²⁷

Furthermore, commentators are particularly concerned that investor–state arbitrations that challenge government measures may lead to a “regulatory chill,” which is broadly defined as less-than-optimal regulation that would be introduced by the governments because of fear of investor–state claims by foreign investors.¹²⁸ To date, there are no data demonstrating that governments across the world indeed react to ongoing or completed investor–state arbitrations by refusing to regulate where they think their measures may be challenged in ISDS. Yet, the proponents of investor–state arbitration

123. See, e.g., Burke-White & von Staden, *supra* note 74, at 336.

124. *Id.* (footnote omitted).

125. See, e.g., *Philip Morris Asia*, *supra* note 1, ¶ 584 (explaining that Philip Morris restructured its operation to make use of the BIT between Australia and Hong Kong: “[f]rom all the evidence on file, the Tribunal can only conclude that the main and determinative, if not sole, reason for the restructuring was the intention to bring a claim under the Treaty, using an entity from Hong Kong”).

126. Take, for instance, the Philip Morris’ dispute with Australia, where the claimant sought to challenge the Australian tobacco plain packaging legislation in three different fora—domestic courts in Australia, an investor–state arbitration pursuant to the Australia-Hong Kong BIT, and at the WTO. See *Philip Morris Asia*, *supra* note 1.

127. See David Gaukrodger, *Investment Treaties and Shareholder Claims: Analysis of Treaty Practice* 10 (OECD Working Papers on International Investment, Paper No. 2014/03, 2014), <http://dx.doi.org/10.1787/5jxvk6shpvs4-en> [<https://perma.cc/C6CT-SPZV>] (archived Feb. 2, 2017).

128. See, e.g., Tienhaara, *supra* note 16. See also Côté, *supra* note 16.

continue to present arguments to rebut the unsupported allegations that ISDS may have a chilling effect on the right to regulate.¹²⁹

IV. RESPONDING TO ISDS CHALLENGES

A. Procedural and Structural Initiatives

Responding to the most pressing challenges of ISDS, the international community has already proposed and brought to life various measures seeking to improve the ISDS regime. To address the lack of transparency, states and other stakeholders have developed and made available for use the UNCITRAL Rules on Transparency¹³⁰ and the Mauritius Convention on Transparency¹³¹. State parties also increasingly incorporate transparency provisions into their BITs and into the investment chapters of their FTAs.¹³² These provisions seek to make the ISDS process more open and accessible to the public through various disclosure obligations and publication requirements.¹³³ They also allow non-disputing parties and civil society groups to get involved and express their opinion on a dispute by making third-party submissions.¹³⁴ There are also revived efforts to increase the

129. See, e.g., Nikos Lavranos, *After Philipp Morris II: The "Regulatory Chill" Argument Failed – Yet Again*, KLUWER ARB. BLOG (Aug. 18, 2016), <http://kluwerarbitrationblog.com/2016/08/18/after-philipp-morris-ii-the-regulatory-chill-argument-failed-yet-again/> [<https://perma.cc/C4LT-CT97>] (archived Feb. 2, 2017).

130. UNCITRAL Rules on Transparency, *supra* note 19, art. 5(1) (discussing that unless otherwise agreed by the treaty or disputing parties, the rules apply to investor–state arbitrations initiated under the UNCITRAL Arbitration Rules to resolve disputes arising out of IIAs concluded on or after April 1, 2014. The Rules provide for various disclosure obligations—most importantly, publication requirement—which make treaty-based investor–state arbitrations more transparent and accessible for the public).

131. Mauritius Convention on Transparency, *supra* note 21. This Convention, which is yet to enter into force, allows state parties to express their willingness to obey by the UNCITRAL Rules on Transparency with respect to investor–state arbitrations initiated pursuant to IIAs concluded prior to April 1, 2014.

132. See, e.g., ChAFTA, *supra* note 22, art. 9.17 (addressing transparency of arbitral proceedings). See also EUSFTA, *supra* note 24, art. 9.22 and annex 9-G.

133. See UNCITRAL Rules on Transparency, *supra* note 19, arts. 2–3, 6 (providing for a number of transparency-related obligations, such as an obligation to provide information on the investor–state arbitration to the designated repository to publish such information at the commencement of arbitral proceedings, to publish and make available to the public documents on investor–state arbitration, and to make hearings accessible to the public).

134. See *id.* arts. 4–5. Note that transparency is crucial to allow non-disputing parties and civil society groups to prepare third parties submissions. Submissions from non-disputing state parties are particularly relevant in this respect as they allow acquiring information on the content and meaning of the treaty text from the other state-party to the BIT (or, in case of multilateral treaty, other state-parties to the treaty).

accountability of arbitrators by introducing codes of conduct and ethics rules into investment treaties.¹³⁵

Beyond these efforts, some countries seek to bring structural changes to the ISDS regime. The most far-reaching proposal in this respect has been put forward by the European Union, which, since the entry into force of the Lisbon Treaty, has competence on foreign direct investment.¹³⁶ As a result, the European Commission now negotiates comprehensive trade and investment treaties on behalf of the EU Member States, as opposed to the prior practice of individual Member States entering into BITs on their own.¹³⁷ In the context of the TTIP negotiations with the United States, the Commission proposed to replace ISDS with a system of permanent international investment courts that would function similarly to WTO dispute resolution.¹³⁸ The European Union¹³⁹ has already implemented its new approach to

135. See ChAFTA, *supra* note 22, ch. 9, annex 9-A (containing a code of conduct for arbitrators appointed pursuant to the investment chapter of ChAFTA); see also EUSFTA, *supra* note 24, annex 9-F.

136. Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, Dec. 13, 2007, 2007 O.J. (C 306) 1 [hereinafter Lisbon Treaty]; see also Consolidated Version of the Treaty on the Functioning of the European Union art. 207, 2008 O.J. C 115/47, 140. (discussing investment-related provisions: “[t]he common commercial policy shall be based on uniform principles, particularly with regard to changes in tariff rates, the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of intellectual property, *foreign direct investment*, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies.” (emphasis added)) [hereinafter TFEU].

137. The European Union is currently negotiating a number of IIAs on behalf of the European Union and its Member States. This differs from the pre-Lisbon Treaty practice, when individual Member States negotiated and entered into BITs on their own behalf. For older BITs, the future of the treaty may be unclear, especially in cases where both parties to a treaty are now the EU Member States (intra-EU BITs). Some of these treaties will be terminated and concluded on behalf of the European Union. For intra-EU BITs, the European Commission has requested its Member States to terminate the intra-EU BITs. The request has not always been welcomed by the Member States, as often the treaty provisions are broader than the exclusive competence of the European Union, which only covers foreign direct investments (FDIs). And so, there is certain resistance among the EU Member States to terminate their intra-EU BITs, which now has motivated the European Commission to initiate infringement proceedings against states failing to so do (such as Austria, the Netherlands, Romania, Slovakia, and Sweden). See Press Release, European Commission, Commission Asks Member States to Terminate Their Intra-EU Bilateral Investment Treaties (Brussels, June 18, 2015), http://europa.eu/rapid/press-release_IP-15-5198_en.htm [https://perma.cc/ZPB4-UWF3] (archived Feb. 11, 2017).

138. See Press Release European Commission, Commission Proposes New Investment Court System for TTIP and Other EU Trade and Investment Negotiations (Brussels, Sept. 16, 2015), http://europa.eu/rapid/press-release_IP-15-5651_en.htm [https://perma.cc/7Y5N-3VA3] (archived Mar. 6, 2017).

139. INT’L CTR. FOR SETTLEMENT OF INV. DISPUTES, ADDITIONAL FACILITY RULES (effective April 10, 2006), https://icsid.worldbank.org/en/Documents/icsiddocs/AFR_English-final.pdf. [https://perma.cc/34SJ-TKY3] (archived Feb. 2, 2017).

investment dispute resolution in its recent FTAs with Vietnam¹⁴⁰ and Canada,¹⁴¹ where it introduced a two-tier investment tribunal system instead of traditional ISDS.

Both FTAs provide for a permanent tribunal and appellate tribunal to be composed of professional members appointed for a limited term, which can be renewed only once.¹⁴² The treaties set qualification and experience requirements for these members, establishing that they “shall possess the qualifications required in their respective countries for appointment to judicial office, or be jurists of recognised competence,” “shall have demonstrated expertise in public international law,” and preferably “shall have expertise in particular, in international investment law, in international trade law and the resolution of disputes arising under international investment or international trade agreements.”¹⁴³ Yet, under both FTAs, the new mechanism of investment dispute resolution will continue to rely on the commonly used investor–state arbitration rules—the ICSID Convention, the ICSID Additional Facility Rules, and the UNCITRAL Arbitration Rules.¹⁴⁴ If the legitimacy shortcomings of ISDS are in fact best addressed by replacing private arbitrators with professional judges, similar provisions in other IIAs concluded by the European Union may follow. However, it may require some time and a strong political will because many of today’s thirty-three hundred IIAs provide for traditional ISDS.

Outside of the European Union and the ongoing TTIP discussions, three countries (Venezuela, Ecuador, and Bolivia) have chosen to limit their procedural exposure to investor–state arbitration by leaving the ICSID Convention.¹⁴⁵ Another trend in international investment law has been a cancellation by countries of their BITs¹⁴⁶ and multilateral IIAs.¹⁴⁷ By doing so, they seek not only to revoke their promise to arbitrate (most commonly, under the ICSID Convention or the

140. EU-Vietnam FTA, *supra* note 23.

141. CETA, *supra* note 27, art. 8.27–8.28.

142. *Id.*; EU-Vietnam FTA, *supra* note 23, § 3, arts. 12–13.

143. CETA, *supra* note 27, art. 8.27(4); EU-Vietnam FTA, *supra* note 23, § 3, art. 12(4).

144. CETA, *supra* note 27, art. 8.23(2); EU-Vietnam FTA, *supra* note 23, § 3, art. 7.

145. ICSID Convention, *supra* note 18.

146. Notable examples include South Africa and Indonesia, which have been actively terminating their BITs. *See supra* note 17 and accompanying text. *See also International Investment Agreements Navigator*, U.N. CONFERENCE ON TRADE AND DEV. (Jan. 31, 2017), <http://investmentpolicyhub.unctad.org/IIA> [<https://perma.cc/7EC8-7RZU>] (archived Feb. 1, 2017) (tracking information on the status of IIAs, including BITs, by economy and country grouping).

147. Gaetano Iorio Fiorelli, *Italy Withdraws from Energy Charter Treaty*, BAKER MCKENZIE: GLOBAL ARB. NEWS (May 6, 2015), <https://globalarbitrationnews.com/italy-withdraws-from-energy-charter-treaty-20150507/> [<https://perma.cc/S8U9-HTR9>] (archived Feb. 2, 2017) (discussing the Italian government’s withdrawal from the ECT).

UNCITRAL Arbitration Rules¹⁴⁸), but also to eliminate their obligations with respect to substantive investor protection obligations, a violation of which can result in arbitration.

The overall goal of these measures is to address the procedural and structural deficiencies of ISDS. Procedurally, they seek to put the public on notice about an investor–state arbitration, to grant the public access to arbitration materials and the award, and to allow submissions by third parties and non-disputing parties to the treaty. Structurally, they seek to replace private arbitrators with professional judges who possess a sufficient level of expertise and experience, who are financially independent, and who can be held accountable for the timeliness, consistency, and quality of the legal decisions they make. Going forward, governments may respond to the European Commission’s call to replace the current ISDS regime with the permanent international investment court system proposed by the European Commission.

B. Safeguards to Preserve the Right to Regulate

The above initiatives do not directly address the major challenge for ISDS today: regulatory disputes and their potential to produce a chilling effect on the state’s power to regulate. Instead, in an attempt to tackle the threat of regulatory disputes, sovereign states have turned to more careful treaty drafting. In doing so, they gradually replace the first generation of investor protection treaties—usually concise agreements offering broad investor protection obligations—with modern comprehensive BITs and other IIAs.¹⁴⁹ These modern treaties tend to limit the scope and the types of substantive investor protection obligations and, consequently, the scope of claims a foreign investor can submit in arbitration.¹⁵⁰

Another trend in today’s treaty making is the inclusion into IIAs of provisions that reserve for the state the right to regulate—the *safeguard*¹⁵¹ provisions. Most commonly, they recognize the state’s

148. UNCITRAL Arbitration Rules, *supra* note 20, art. 1(3).

149. Compare, e.g., *Investment Policy Hub: 1994 U.S. Model Bilateral Investment Treaty*, UNITED NATIONS UNCTAD (Jan. 22, 2017), <http://investmentpolicyhub.unctad.org/Download/TreatyFile/2867> [https://perma.cc/2PRR-TX36] (archived Feb. 2, 2017) (sixteen articles and an annex), with 2012 U.S. Model BIT, *supra* note 12 (thirty-seven articles and three annexes, reflecting more careful and elaborate treaty-drafting).

150. See, e.g., ChAFTA, *supra* note 22, ch. 9 (providing foreign investors with national treatment (Article 9.3) and most-favored-nation treatment (Article 9.4), but not other common guarantees—such as minimum standard of treatment and non-expropriation—thereby limiting potential exposure to ISDS under the treaty. Article 9.12.2 of ChAFTA then further narrows such exposure by providing consent to ISDS only with respect to claims alleging breach of Article 9.3).

151. See Robert Stumberg, *Safeguards for Tobacco Control: Options for the TPPA*, 39 AM. J.L. & MED. 382, 399 (2013) (applying the term *safeguard* to both exceptions and

right to adopt measures necessary for the protection of public health, the environment, or other policy objectives.¹⁵² Safeguard provisions can be found in the body of a treaty, its preamble, annexes, or even its reservations, declarations, and understandings. In the body of the text, a reference to the right to regulate can be placed in a separate article or incorporated into an article on an individual investor protection, such as non-expropriation¹⁵³ or performance requirements.¹⁵⁴ The U.S. Model BIT adds to this practice by also stipulating the state's right to adopt measures "appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns."¹⁵⁵ Thus, by contrast to most IIAs, the U.S. Model BIT incorporates the right to regulate on particular subject matter—environmental protection. This is in addition to other safeguards already contained in the U.S. Model BIT, such as provisions on performance requirements, non-conforming measures, essential security, taxation, and expropriation.¹⁵⁶

The scope and form of safeguard provisions differ substantially across investor protection treaties. The scope of the application of exceptions and exclusions may cover the whole treaty, a particular chapter, or an individual investor protection obligation. Depending on the scope, it may exclude application of the treaty provisions to a measure, sector, or an industry. There is no consistency in the practice of individual states with regard to the use and application of safeguard

exclusions—discussed further in this Article—with respect to tobacco control measures and explaining the options for such safeguards for the TPP).

152. See EU-Vietnam FTA, *supra* note 23, § 2 (discussing the fact that one of the recent examples of this practice is Article 13 bis(1): "[t]he Parties reaffirm the right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, environment or public morals, social or consumer protection or promotion and protection of cultural diversity").

153. See, e.g., *id.* § 2, (proving in para. 3 that: "[f]or greater certainty, except in the rare circumstances where the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures or series of measures by a Party that are designed to protect legitimate public policy objectives do not constitute indirect expropriation"); see also 2012 U.S. Model BIT, *supra* note 12, annex B ("Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.").

154. See, e.g., 2012 U.S. Model BIT, *supra* note 12, art. 8(3)(c) (in particular, reserving for the state the right to adopt and maintain "measures, including environmental measures . . . [that are] necessary to protect human, animal, or plant life or health [and measures that are] related to the conservation of living or non-living exhaustible natural resources").

155. See, e.g., *id.* art. 12(3) (recognizing each Party's right to "exercise discretion with respect to regulatory, compliance, investigatory, and prosecutorial matters, and to make decisions regarding the allocation of resources to enforcement with respect to other environmental matters determined to have higher priorities").

156. *Id.* arts. 8(3)(c), 14, 18, 21, and Annex B.

provisions, but all safeguards are alike in that they seek to reserve for the state some regulatory space by (1) allowing enumerated policy objectives to serve as an affirmative defense for a measure otherwise in breach of the treaty and/or by (2) excluding application of the investment protection treaty to certain subject matter.

1. Exceptions

Provisions of IIAs that most commonly protect the state's power to regulate are known as *exceptions*¹⁵⁷ in international investment law. Generally speaking, exceptions are safeguard provisions that reserve for the state the right to adopt and enforce measures necessary for the protection of legitimate public welfare objectives, such as human life, health, the environment, or public morals.¹⁵⁸ Some scholars have argued that exceptions are distinct from other safeguard provisions in that they serve as an affirmative defense for regulatory measures falling within the scope of the exception.¹⁵⁹ Consequently, if successfully invoked, exceptions eliminate the state's liability and damages for such measures, which are otherwise in breach of the treaty obligations.¹⁶⁰ This is a narrow understanding of exceptions and

157. The variety of terms used with respect to safeguard provisions is astounding and includes such terms as exceptions, exclusions, exemptions, derogations, reservations, non-conforming measures (NCM), non-precluded measures (NPM). Among these terms, the terms exceptions, NCM and NPM are used in the treaties, while most other terms are employed only in scholarly and public policy debates.

158. See WTO Analytical Index: Vol. 1, WORLD TRADE ORGANIZATION, art. XX 845 (2nd ed. 2007), https://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_07_e.htm [<https://perma.cc/S5UZ-QRLB>] (archived Jan. 31, 2017) (“Paragraphs (a) to (j) comprise measures that are recognized as *exceptions to substantive obligations* established in the GATT 1994, because the domestic policies embodied in such measures have been recognized as important and legitimate in character.” (quoting the Appellate Body in *US-Shrimp*, Appellate Body Report, United States—Import Prohibition of Certain Shrimp and Shrimp Products, ¶ 121, WT/DS58/AB/R (Oct. 12, 1998) [<https://perma.cc/SP2U-D3JT>] (archived Jan. 31, 2017)).

159. See Stumberg, *supra* note 151, at 402–03 (“In the dispute settlement process, the purpose of an exception is to enable a country to present an affirmative defense of a measure that would otherwise violate a trade or investment rule. From a health perspective, the opportunity to defend protects the public interest. From a trade perspective, the opportunity to “weigh and balance” a health measure protects trade-promotion objectives from all but the most efficiently designed health measures.”).

160. William W. Burke-White & Andreas von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties*, 48 VA. J. INT'L L. 307, 332–35. See also Josef Ostránský, *How Can States Use Exceptions in Treaties to Defend Tobacco Control Legislation?*, 9 TRANSNAT'L DISP. MGMT. 1, 3 (2012) (disagreeing with the interpretation of the function and operation of exceptions, arguing that exceptions effectively remove the measure from the application of a treaty: “[t]he result of successfully invoking an exceptions clause is that the treaty does not apply to the particular conduct in question. In other words, once the conduct falls within the exception, investment protection does

is the understanding adopted in this Article. Other scholars, however, use the word *exception* in its broad sense, applying it to any deviation from the investor protection regime, including instances where a measure is excluded from the application of a treaty.¹⁶¹

A typical exception can be found in Article XVII(3) of the BIT between Canada and Romania, which provides that,

[s]ubject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Contracting Party from adopting or enforcing measures necessary:

- (a) to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
- (b) to protect human, animal or plant life or health; or
- (c) for the conservation of living or non-living exhaustible natural resources.¹⁶²

In addition, modern IIAs often contain a separate article on general exceptions, which can be found both in BITs and FTAs (in the latter case, either as part of the investment chapter or a separate chapter, usually applicable only to the selected chapters of an FTA).¹⁶³ Some IIAs incorporate by reference the articles on general exceptions

not apply to such conduct. The host state cannot be held liable as there is no breach of an international obligation.”).

161. See, e.g., ANDREW NEWCOMBE & LLUÍS PARADELL, LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT 481 (2009) (“[General] exceptions are used to *exclude* particular sectors or subject matters from IIA obligations or to *permit* measures necessary to meet specific objectives, including protecting essential security interests, public order, human health and the environment.” (emphases added)).

162. Agreement Between the Government of Canada and the Government of Romania for the Promotion and Reciprocal Protection of Investments, Can.-Rom. art. XVII, Aug. 5, 2009, <http://www.treaty-accord.gc.ca/text-texte.aspx?id=105170> [<https://perma.cc/7TVU-D9Z4>] (archived Jan. 31, 2017).

163. See, e.g., TPP, *supra* note 3, art. 29.1 (the article is a part of Chapter 29 titled “Exceptions and General Provisions”); ChAFTA, *supra* note 22, art. 9.8 (this article titled “General Exceptions” is included directly into the investment chapter of the treaty, and not into a separate chapter of the FTA applicable to the treaty as a whole); see also Agreement Between Japan and the Oriental Republic of Uruguay for the Liberalization, Promotion and Protection of Investment, Japan-Uru., art. 22, Jan. 26, 2015; Canada-China BIT art. 33, Sept. 9, 2012; Agreement between the Government of the Republic of Macedonia and the Government of the Republic of Kazakhstan on the Reciprocal Promotion and Protection of Investments, Maced.-Kaz., art. 13, July 2, 2012 [hereinafter Macedonia-Kazakhstan BIT]; Agreement Between the Government of the Republic of Turkey and the Government of the Islamic Republic of Pakistan Concerning the Reciprocal Promotion and Protection of Investments, Pak.-Turk., art. 5, May 22, 2012 [hereinafter Pakistan-Turkey BIT].

contained in Article XX¹⁶⁴ and Article XIV¹⁶⁵ of the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS), respectively. These two articles allow Member States to adopt and enforce measures necessary to protect or secure important public policy objectives, including the protection of public morals and human or animal health and maintenance of public order. In doing so, Member States are allowed to “act inconsistently with obligations set out in other provisions of the respective agreements, provided that all of the conditions set out therein are satisfied.”¹⁶⁶ To date, the WTO has developed a comprehensive body of law interpreting the scope, degree of deference, and other elements of general exceptions.¹⁶⁷

Exceptions may be difficult for a state to successfully invoke in ISDS, largely because of the need to satisfy the nexus requirement—that is, to prove that a measure is necessary to achieve a public policy objective.¹⁶⁸ Arbitral tribunals have used various criteria to assess a challenged regulatory measure in view of the state’s investor protection obligations. Borrowing from international customary law,

164. WTO Analytical Index: Vol. 1, *supra* note 158, art. XX (providing, in particular, that: “[s]ubject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same condition prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures . . . (b) necessary to protect human, animal or plant life or health”).

165. General Agreement on Trade in Services, art. XIV, Apr. 15, 1994, https://www.wto.org/english/res_e/booksp_e/analytic_index_e/gats_02_e.htm#article14 [<https://perma.cc/E5DW-8QAR>] (archived Feb. 2, 2017); *see also* Marrakesh Agreement Establishing the World Trade Organization, annex 1B, 284 (1999), 1869 U.N.T.S. 183, 33 I.L.M. 1167, https://www.wto.org/english/docs_e/legal_e/26-gats.pdf [<https://perma.cc/L656-XT3W>] (archived Jan. 31, 2017) (providing, in particular, that: “[s]ubject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures: (a) necessary to protect public morals or to maintain public order; (b) necessary to protect human, animal or plant life or health”).

166. WTO Analytical Index: General Agreement on Trade in Services, WORLD TRADE ORGANIZATION, art. XIV, ¶ 74, https://www.wto.org/english/res_e/booksp_e/analytic_index_e/gats_02_e.htm#article14 [<https://perma.cc/X2FC-V93W>] (archived Jan. 31, 2017).

167. *See* WTO Analytical Index: Vol. 1, *supra* note 158, ¶¶ 844–955 (interpreting and applying general exceptions under Article XX of the GATT in the WTO jurisprudence); WTO Analytical Index: General Agreement on Trade in Services, *supra* note 166, ¶¶ 74–92 (interpreting and applying general exceptions under Article XIV of the GATS). *See also* Stumberg, *supra* note 151, at 404 (distinguishing six elements of a hypothetical exception, including its scope, protection, deference, nexus, objective and additional restriction, and suggesting that “exceptions have at least four elements and as many as six; exclusions usually have three”).

168. *See* Stumberg, *supra* note 151, at 405 (explaining that the WTO health exception does little to prevent litigation because of its complexity, which requires for stages of analysis, and the “vagueness of text,” which gives dispute panels broad discretion to interpret terms like “necessity” (footnote omitted)).

tribunals sometimes analyze the measure using the stringent “but for” requirement.¹⁶⁹ In other instances they apply a balancing test or proportionality analysis.¹⁷⁰ In any case, such analyses always reflect the tribunal’s own perception as to what measure is necessary for the achievement of the public policy goal.¹⁷¹

Additionally, general exceptions provide for different permissible objectives, ranging from public health and morality to environmental protection. Legal scholars have suggested that exceptions with different objectives may require a different degree of deference to the state’s own determination as to what measures are necessary to achieve a regulatory objective.¹⁷² They further argue that arbitral tribunals may be willing to allow a state to use the self-judging exception¹⁷³ to determine what makes a measure “necessary” for some regulatory objectives but not others.¹⁷⁴ For instance, tribunals might recognize that a defending state knows better what constitutes its public morals and what measures are necessary to protect them.¹⁷⁵ By contrast, tribunals might be less willing to defer to the state’s own determination as to what constitutes a threat to public health.¹⁷⁶ There, the claim is more easily verifiable for a tribunal, for instance, by relying on scientific evidence.¹⁷⁷ Consequently, invoking a general exception with a clear legitimate objective may be a highly unpredictable defense.¹⁷⁸

Finally, exceptions should not be confused with other declarations that can be made by a state with respect to a treaty, such as

169. See NEWCOMBE & PARADELL, *supra* note 161, at 486–87 (discussing the Appellate Body of the World Trade Organization’s interpretation of the GATT).

170. See Stumberg, *supra* note 151, at 405.

171. *Id.*

172. Burke-White & von Staden, *supra* note 160, at 332–36, 369 (arguing that because some deference to the state’s own determination is implied in treaties, “it is appropriate, both as a matter of treaty interpretation and judicial policy, to read NPM clauses as incorporating a ‘margin of appreciation’ that grants states some latitude to make initial determinations as to whether their actions are covered by an NPM clause. The function of a tribunal, then, ought to be the determination of the permissible and legitimate boundaries of the margin of appreciation that arises from the terms of an NPM clause.”).

173. See, e.g., Stumberg, *supra* note 151, at 413–14 (discussing the self-judging exception).

174. Burke-White & von Staden, *supra* note 160, at 332–36.

175. *Id.* at 364.

176. *Id.* at 361.

177. *Id.* at 361 (“What distinguishes public health from most of the other permissible objectives is that the existence of threats is far more susceptible to objective scientific proof than, for example, the more subjective threats to a nation’s security.”).

178. See Stumberg, *supra* note 151, at 403 (“The vagueness of [exceptions] terms (like “measures necessary” to protect health) requires interpretation, and the factual context will change with every measures that a country or investor decides to challenge.”).

clarifications, understandings, and reservations.¹⁷⁹ In contrast to these declarations, which are largely unilateral statements, exceptions are mutually agreed upon by the treaty parties. As a result, exceptions change the investor protection regime for all the parties to a treaty, while declarations do so only for the state that makes a declaration. Exceptions are also distinct from defenses under customary international law, such as necessity, *force majeure*, distress, and consent.¹⁸⁰ Most importantly, in contrast to such customary law defenses, exceptions are based on treaty law. They serve as an affirmative defense for regulatory measures otherwise in breach of international investment law, performing the function of *lex specialis* to other defenses under international law.¹⁸¹

A separate type of general exception is a *security exception*¹⁸² such as the national security exception under Article 2102 of NAFTA¹⁸³ or the security exceptions under Article 29.2 of the TPP.¹⁸⁴ Security exceptions have specific objectives, typically the “maintenance or restoration of international peace and security, or protection of [the host state’s] own essential security interests.”¹⁸⁵ A survey of essential security exceptions in BITs and FTAs revealed that most of such

179. Vienna Convention on the Law of the Treaties art. 2(d), May 23, 1969, 1155 U.N.T.S. 331 (noting that reservation “means a unilateral statement, however phrased or named, made by a State, when signing, ratifying, accepting, approving or acceding to a treaty, whereby it purports to exclude or to modify the legal effect of certain provisions of the treaty in their application to that State”) [hereinafter Vienna Convention].

180. See, e.g., NEWCOMBE & PARADELL, *supra* note 161, at 480 (noting that “state responsibility for breaches of IIA obligations may be precluded under customary international law on a number of bases, including consent, *force majeure* and necessity,” as well as other defenses, such as acquiescence and estoppel).

181. See, e.g., Burke-White & von Staden, *supra* note 160, at 321 (explaining that “customary defenses provide an excuse for breaching a treaty that may absolve a state of international legal responsibility after the fact. In contrast, NPM clauses remove certain types of state actions from the substantive protections of a particular treaty instrument”; and further distinguishing NPM and customary defenses in terms of “their theoretical justification, their source of legal authority, and their scope of applicability.”).

182. See generally Katia Yannaca-Small, *Essential Security Interests under International Investment Law*, in INTERNATIONAL INVESTMENT PERSPECTIVES: FREEDOM OF INVESTMENT IN A CHANGING WORLD 93–134 (2007) (providing a review of the security exceptions across various investor protection treaties, provisions of customary international law, interpretations by arbitral tribunals in investor–state disputes, and containing a table of BITs and FTAs with investment chapters, which include provisions on essential security interests).

183. NAFTA, *supra* note 39, art. 2102.

184. See TPP, *supra* note 3, art. 29.2 (providing “[n]othing in this Agreement shall be construed to: (a) require a Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests; or (b) preclude a Party from applying measures that it considers necessary for the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests”); see also Agreement on the Promotion and Reciprocal Protection of Investments, Egypt–Switz., art. 10, June 7, 2010 (outlining security exceptions).

185. *Id.* art. 29.2.

exceptions “are limited in their scope to circumstances related to periods of war, traffic of arms or other emergency.”¹⁸⁶ Reliance on the specific security exception is usually accepted for a shorter period of time, limited by the goal of the exception, such as until international peace or security is restored. The distinction between the general and specific exceptions does not always make sense, as some treaties include maintenance of international peace and security and/or protection of essential security interests in a single article on general exceptions.¹⁸⁷

2. Exclusions

Another group of safeguard provisions is *exclusions*. In legal scholarship and tribunal awards, exclusions are sometimes considered to be a type of exception.¹⁸⁸ But other scholars distinguish exclusions from exceptions, employing the term *exclusions* solely with respect to provisions that *exclude* application of a treaty (its chapters, or individual provisions) from a certain measure all together.¹⁸⁹ Consequently, as these scholars explain, with respect to covered measures, exclusions “deny jurisdiction for dispute settlement and hence . . . preclude liability for trade sanctions or compensation to investors.”¹⁹⁰ By contrast, exceptions apply to measures *covered* by the treaty, but serve as an affirmative defense once the violation of a treaty is established.¹⁹¹

A common example of an exclusion is a tax carve-out—a provision removing tax measures from the application of a BIT.¹⁹² The most recent example of an exclusion—and a very troublesome one in my

186. Yannaca-Small, *supra* note 182, at 94; *see also* ECT, *supra* note 42, art. 24.

187. *See, e.g.*, Macedonia-Kazakhstan BIT, *supra* note 163, art. 13 (“General exceptions[:] Nothing in this Agreement shall be interpreted as interfering to commit by the Parties of the actions necessary for protection of national security or measures necessary for maintenance of a public order, or measures in line with their obligations under the United Nations Charter for maintenance of international peace and security, provided that application of such measures would not mean unconditioned or unreasonable discrimination by the Party, or the latent restriction of investments.”); *see also* Pakistan-Turkey BIT, *supra* note 163, art. 5 (including security interests within general exceptions).

188. *See* Stumberg, *supra* note 151, at 401.

189. *Id.* at 401–02.

190. *Id.* at 402.

191. *Id.*

192. *See, e.g.*, 2012 U.S. Model BIT, *supra* note 12, art. 21 (establishing a carve-out for taxation measures, except as provided by the treaty itself, for instance, under Article 6 (Expropriation), which is applicable to taxation measures); *see also* TPP, *supra* note 3, art. 29.4; Free Trade Agreement, S. Kor.-U.S., art. 23.3, June 30, 2007 (entered into force Mar. 15, 2012), <https://ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text> [<https://perma.cc/7GSP-LRRK>] (archived Feb. 2, 2017) (“Except as set out in this Article, nothing in this Agreement shall apply to taxation measures.”).

view—is the option for the subject-matter jurisdictional carve-out with respect to tobacco control measures in the TPP.¹⁹³

The distinction between exceptions and exclusions is not always easy to draw. The text of the treaty and its interpretation are crucial to identifying the type of safeguard to which a particular provision belongs. Generally, exceptions contain wording as follows: “nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures . . . necessary to protect human, animal or plant life or health.”¹⁹⁴ Exclusions often use words such as the following: “nothing in this Agreement shall apply to . . .” or a similar statement of excluding nature.¹⁹⁵

Legal scholars have identified two types of exclusions: *partial* and *full* exclusions.¹⁹⁶ Partial exclusions exclude application of a chapter or an article of the treaty “to a particular product, a subject (e.g., tobacco control), a sector, or more broadly, to a particular country.”¹⁹⁷ Full exclusions carve out certain measures or a subject of regulation from the application of a treaty as a whole.¹⁹⁸ Along these lines, the term *carve-out*—which is more common in scholarly and policy papers than in treaties—is used as a synonym for *full exclusion* with regard to broad provisions that exclude application of a treaty to a sector, industry, or activity.¹⁹⁹ Yet there is no uniformity in the application of these terms. Scholars and commentators may use the term *carve-out* even where an exclusion removes a measure from the application of a separate chapter only.²⁰⁰

3. Non-Precluded Measures

Other investor protection treaties provide for safeguards by enumerating measures with respect to which a treaty will not apply.²⁰¹ In international investment law, such measures are known as *non-precluded measures* (NPMs)²⁰² or *non-conforming measures*

193. TPP, *supra* note 3, art. 29.5.

194. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194, art. XX.

195. *See, e.g.*, Free Trade Agreement, U.S.-Austl., art. 22.3, May 18, 2004, 43 I.L.M. 1248 (stating that “[e]xcept as set out in this Article, nothing in this Agreement shall apply to taxation measures”).

196. *See* Stumberg, *supra* note 151, at 401–02.

197. *Id.* at 401.

198. *Id.* at 402.

199. *Id.*

200. *See* Puig & Shaffer, *supra* note 30 (referring to the TPP’s tobacco safeguard provision under Article 29.5 as a “carve-out,” while the article allows a state party to deny the benefits of only Section B of the TPP’s investment chapter, and not of the TPP as a whole).

201. *See e.g.*, TPP, *supra* note 3, ch. 9, art. 9.12.1.

202. *See, e.g.*, Treaty Concerning the Encouragement and Reciprocal Protection of Investment art. 14.1, Bahr.-U.S., Sept. 29, 1999, S. TREATY DOC. No. 106-25 (“This

(NCMs).²⁰³ Modern IIAs often contain annexes with schedules of all existing NPMs and provide for continuation, renewal, or amendment of such measures. State parties may also agree that a treaty will not apply to any future measure adopted or maintained by the state party in a particular industry, sector, or activity.²⁰⁴ Consequently, as Burke-White and von Staden explain, NPMs perform a “risk-allocation function” by “transferring the costs of harming an investment from host states to investors in exceptional circumstances.”²⁰⁵

Exceptions and NPMs perform essentially the same function: they provide the state with the regulatory space for domestic policymaking.²⁰⁶ A state may prefer exceptions because they allow a state to keep its regulatory options open, adopting any measure it sees fit in order to achieve a particular regulatory objective. Exceptions, however, require a case-by-case assessment with regard to whether a measure falls within the scope of a legitimate regulatory objective. Treaty provisions do not provide much guidance in this respect, and so arbitral tribunals often have to decide what standard to apply and how much deference to give to the state’s own determination.²⁰⁷ By contrast, NPMs are listed up front by the state party to an investor protection treaty. Consequently, NPM provisions are more limiting on the state’s regulatory power, but they provide more certainty to the investor protection regime by putting a foreign investor on notice with regard to any non-conforming measures. NPMs are often used in BITs

Treaty shall not *preclude* a Party from applying measures which it considers necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.” (emphasis added)); Treaty Concerning the Encouragement and Reciprocal Protection of Investment art. IX, Ukr.-U.S., Mar. 4, 1994, S. TREATY DOC. No. 103-37 (“This Treaty shall not *preclude* the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.” (emphasis added)).

203. See TPP, *supra* note 3, ch. 9, art. 9.12.1 (providing for an exclusion from national treatment and most-favored-nation treatment for any existing *non-conforming measure*—as specified for each state party in its Schedule to Annex I to the TPP—as well as the continuation, renewal, and certain amendments to such measure); see also *id.* ch. 9, art. 9.12.2 (providing for an exclusion for “any measure that a Party adopts or maintains with respect to sectors, subsectors or activities” as specified for the respective state party in its Schedule to Annex II of the TPP).

204. *E.g.*, TPP, *supra* note 3, ch. 9, art. 9.12.2.

205. Burke-White & von Staden, *supra* note 160, at 314.

206. See, *e.g.*, NEWCOMBE & PARADELL, *supra* note 161, at 483 (arguing that “[t]he reference to non-conforming measures is simply another way to refer to express reservations to the treaty”); see also Stumberg, *supra* note 151, at 403 (observing that “[s]ome investment arbitrators and commentators view *NPM* and *exception* as interchangeable concepts, depending on the plain language of the text”) (footnotes omitted).

207. For the WTO jurisprudence interpreting and applying general exceptions under Article XX of the GATT, see, for instance, WTO Analytical Index: Vol. 1, *supra* note 158, ¶¶ 844–955.

concluded by the United States, while other countries largely rely on exceptions.²⁰⁸

Overall, there is no consistency in the practice of individual states with respect to providing for exceptions and other safeguard provisions in investor protection treaties. A state may include exceptions in some of its BITs but not in others. It may also use varying terminology across a treaty. For instance, the United States and Uruguay employ the term *non-conforming measures* in Article 14 of the U.S.-Uruguay BIT (2005),²⁰⁹ but in Article 18(2) of the same treaty they utilize the term *preclude* to reserve for the state parties the right to adopt measures necessary for the protection of essential security—which indicates a non-precluded measure.²¹⁰

Studies of safeguard provisions in IIAs report that exceptions are generally rare in the context of BITs,²¹¹ but are more common in recent FTAs and the newest generation of BITs.²¹² Some scholars have even suggested that BITs are no longer exclusively investor protection treaties.²¹³ Instead, they argue, there is a substantial element of protection of states and the states' right to regulate, although usually only in "exceptional circumstances."²¹⁴

At the end of the day, the application of a safeguard provision in ISDS depends on interpretation of the treaty text by a tribunal. To date, tribunal interpretations of exceptions in ISDS have been rare²¹⁵

208. See Stumberg, *supra* note 151, at 403 (noting that "[w]hat some call an NPM, however, Canada, Singapore, Mexico, India, Korea and other countries call *exceptions* in both investment and trade agreements" (footnote omitted)).

209. Treaty Concerning the Encouragement and Reciprocal Protection of Investment, U.S.-Uru., art. 14, Nov. 4, 2005, S. TREATY DOC. No. 109-9.

210. *Id.*, art. 18 (providing that "nothing in this Treaty shall be construed . . . to *preclude* a Party from applying measures that it considers necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests" (emphasis added)).

211. See, e.g., Ostřanský, *supra* note 160, at 2 ("Exception clauses are not rare feature of IIAs – they appear in bilateral investment treaties ('BITs') entered into by Canada, the United States, Switzerland, China, Colombia and New Zealand. They are increasingly being included in newly concluded Free Trade Agreements ('FTAs'). Nevertheless, it cannot be said that they are a regular type of provisions, as they are estimated to appear in approximately only 10 per cent of IIAs." (footnotes omitted)).

212. See Burke-White & von Staden, *supra* note 160, at 313 (establishing in 2008 that at least 10 percent of BITs (two hundred treaties of about two thousand BITs then in force) have clauses on non-precluded measures).

213. *Id.* at 316 ("[This] Article's first theoretical contribution is to question the standard assumption that BITs are solely the instruments of investment protection by recognizing that such treaties often incorporate significant exceptions that preserve state freedom of action in exceptional circumstances.").

214. *Id.*

215. See, e.g., *id.* at 337 ("Despite the prevalence of NPM clauses in BITs, they were not a focus of investor-state arbitration until the Argentine financial collapse of 2001–2002.").

and inconsistent.²¹⁶ Where exceptions are available under the treaty, they may serve as a safeguard mechanism ensuring that more weight is given to the state's regulatory interests than to the rights of foreign investors. Yet, it is unclear whether arbitral tribunals will be willing to give a particular exception a broad interpretation, or, instead, will subject a state's regulatory interest to its investor protection obligations.²¹⁷

Finally, judging by the WTO jurisprudence and the decisions of arbitral tribunals interpreting exceptions and exclusions provisions, it is unclear whether exceptions expand or narrow a state's right to regulate. Some scholars have argued that, apart from a greater certainty of law, exceptions add little to the IIA regime, as arbitral tribunals have recognized a state's right to regulate even in the absence of explicit provisions to this effect.²¹⁸ Others have suggested that exceptions provisions in IIAs may in fact limit a state's right to regulate.²¹⁹ For instance, the nexus requirement in the general exception can limit the scope of a state's regulatory power by allowing the state to adopt only those measures which are necessary for the achievement of a legitimate public policy goal. Interpreted in the most narrow way—that is, applying a “but for” requirement under customary international law—such a condition would clear fewer regulatory measures than the state could generally adopt for legitimate public policy objectives.

216. Burke-White and von Staden are very critical of the tribunal's interpretation of the NPM clause in the United States and Argentina BIT Treaty Concerning the Reciprocal Encouragement and Protection of Investment. Arg.-U.S., art. XI, Nov. 14, 1991, S. TREATY DOC. No. 103-2, and the necessity defense under customary international law in three arbitrations involving Argentina. *See also* CMS Gas Transmission Co. v. Arg., Case No. ARB/01/8, Final Award (ICSID May 12, 2005), http://icsidfiles.worldbank.org/icsid/ICSIDBLOBS/OnlineAwards/C4/DC504_En.pdf [<https://perma.cc/NL2L-LHFL>] (archived Jan. 20, 2017); LG&E Energy Corp. v. Arg., Case No. ARB/02/1, Decision on Liability (ICSID Oct. 3, 2006), <http://www.italaw.com/sites/default/files/case-documents/ita0460.pdf> [<https://perma.cc/F9ZL-337E>] (archived Jan. 20, 2017); Enron Corp. v. Arg., Case No. ARB/01/3, Award (ICSID May 22, 2007), <http://www.italaw.com/sites/default/files/case-documents/ita0293.pdf> [<https://perma.cc/35AY-6REX>] (archived Jan. 20, 2017).

217. For instance, the state's right to regulate appears to be secondary and subordinated to the investor rights in treaties permitting the state to adopt any measure “otherwise consistent with” the BIT or investment chapter in the FTA. *See* TPP, *supra* note 3, art. 9.16 (demonstrating the wording of these provisions suggests that the state's measure may not be in breach of the investor protection obligations and, as such, more narrow than the general right to regulate).

218. *See, e.g.,* Jörn Griebel, *The New EU Investment Policy Approach*, in *INTERNATIONAL INVESTMENT LAW: A HANDBOOK* 304, 317–18 (Marc Bungenberg et al. eds., 2015) (“Explicit clauses would therefore only have the effect to codify such tendencies and to provide for greater certainty of law.”).

219. *See, e.g.,* Stumberg, *supra* note 151, at 417–18 (noting that additional restrictions prevent countries from “abusing” the exceptions).

C. The TPP Tobacco Carve-Out

1. Analyzing the Treaty Provisions

The TPP is the largest and most complex trade liberalization and investment agreement ever signed. It is also particularly rich in exceptions, exclusions, carve-outs, exceptions to exceptions, and other safeguard provisions.²²⁰ For the ISDS regime, the most notable of these provisions is the tobacco carve-out contained in Article 29.5 (Tobacco Control Measures) of Chapter 29 (Exceptions and General Provisions). The article provides as follows:

A Party may elect to deny the benefits of Section B of Chapter 9 (Investment) with respect to claims challenging a tobacco control measure of the Party. Such a claim shall not be submitted to arbitration under Section B of Chapter 9 (Investment) if a Party has made such an election. If a Party has not elected to deny benefits with respect to such claims by the time of the submission of such a claim to arbitration under Section B of Chapter 9 (Investment), a Party may elect to deny benefits during the proceedings. For greater certainty, if a Party elects to deny benefits with respect to such claims, any such claim shall be dismissed.²²¹

There are also two footnotes to this article that explain the operation of the carve-out with respect to the TPP's denial-of-benefits and state-to-state dispute settlement provisions and define the term *tobacco control measure*. The first of them—footnote 11—clarifies that

220. See, e.g., Thomas J. Bollyky, *TPP Tobacco Exception Proves the New Rule in Trade*, COUNCIL ON FOREIGN RELATIONS (Feb. 4, 2016), <http://www.cfr.org/trade/tpp-tobacco-exception-proves-new-rule-trade/p37509> [<https://perma.cc/ZGE5-RGRU>] (archived Jan. 20, 2017) (“At nearly 2,700 pages, the TPP may be the longest, most complex, and exception-filled trade agreement ever negotiated. There are exceptions to general principle (Art. 2.4.1), exceptions to exceptions (Art. 2.4.7), explicit exclusions (Art. 9.11), implicit exclusions (Annex 15-A), grandfathering (Annex 18-B), optional undertakings (Art. 25.4.1), clarifications (Art. 13.2.3), caveats (Art. 11.1), limiting rules of application (Art. 11.2.2-5), and, of course, carve-outs (Annex 17-D; Art. 16.9; Art. 9.7.6). Exceptions appear in nearly every chapter of the TPP, including its preamble.”).

221. TPP, *supra* note 3, art. 29.5. (footnotes omitted). The wording of the tobacco carve-out provision is reminiscent of the denial-of-benefits provisions common for modern IIAs. However, the TPP already contains a separate denial-of-benefits provision in Article 9.15 of the investment chapter. By contrast, the tobacco carve-out is included in another chapter of the TPP—Chapter 29 “Exceptions and General Provisions.” Furthermore, a footnote to Article 29.5 of the TPP specifically indicates that the article does not preclude the operation of the TPP's denial-of-benefits provision. As such, two provisions appear to be distinct and have different scopes of application. Noticeably, unlike regular denial-of-benefits provisions, the tobacco carve-out only covers the ISDS benefit of the TPP. It does not allow to deny the benefits of substantive investor protections that may be denied under denial-of-benefits provisions. The carve-out can also be employed *after* the benefit of ISDS is invoked by a foreign investor by filing a claim in arbitration. Consequently, the tobacco carve-out is a distinctly unique provision, unlike any other safeguard provision or denial-of-benefits provision known to IIAs.

“[f]or greater certainty, this Article does not prejudice: (i) the operation of Article 9.15 (Denial of Benefits); or (ii) a Party’s rights under Chapter 28 (Dispute Settlement) in relation to a tobacco control measure.”²²² The second footnote—footnote 12—defines a tobacco control measure as “a measure of a Party related to the production or consumption of manufactured tobacco products (including products made or derived from tobacco), their distribution, labelling, packaging, advertising, marketing, promotion, sale, purchase, or use, as well as enforcement measures, such as inspection, recordkeeping, and reporting requirements.”²²³ This definition is exceptionally broad and visibly seeks to encompass an absolute majority of the tobacco industry’s operations, as well as the consumption of tobacco. The definition appears to exclude the “agricultural tobacco production,”²²⁴ as the footnote concludes by noting that “[f]or greater certainty, a measure with respect to tobacco leaf that is not in the possession of a manufacturer of tobacco products or that is not part of a manufactured tobacco product is not a tobacco control measure.”²²⁵

The tobacco carve-out under Article 29.5 of the TPP is distinct from any other safeguard provision in international investment law. Most strikingly, it deals only with a procedural obligation of investor protection by giving the host state the option to deny the benefits of ISDS with respect to a claim challenging a tobacco control measure. Accordingly, the TPP tobacco carve-out does not reserve the regulatory space for the treaty parties with respect to tobacco production, marketing, sale, use, or consumption. It only targets ISDS by allowing a state party to revoke its (offer of) consent to ISDS under the TPP. By contrast, other exceptions and exclusions in the investor protection agreements focus on reserving for the state the right to regulate a particular industry or a type of activity. Apart from the TPP, not a single investor protection agreement provides the state with the ability to avoid ISDS on a case-by-case basis when a dispute arises. This means Article 29.5 is not a subject-matter (tobacco) carve-out from the TPP, but rather an option for the subject-matter *jurisdictional exclusion* from ISDS.

Another distinction between this tobacco carve-out and other safeguard provisions is the option it gives to the host state to deny the benefits of ISDS with respect to a claim related to a tobacco control measure. This option can be exercised prior to the submission of a claim to investment treaty arbitration, or after the investor–state arbitration has commenced—which is especially worrisome, in my view. This puts the claimant and the tribunal in the uncomfortable position of not

222. TPP, *supra* note 3, art. 29.5 n.11.

223. *Id.* art. 29.5 n.12.

224. See Bollyky, *supra* note 220.

225. TPP, *supra* note 3, art. 29.5 n.12.

knowing whether their arbitration will proceed, bringing uncertainty to the arbitral process.

Furthermore, the TPP tobacco carve-out does not prohibit state-to-state arbitration.²²⁶ It also does not guide the claimant as to the availability of an alternative forum for its claim. The tobacco carve-out does not even seek to provide the host state with the regulatory space to freely regulate the tobacco industry, the use and consumption of tobacco products, or the effects of tobacco on the environment. Instead, the primary and only focus of the carve-out is ISDS, or, more specifically, ensuring that a defending state may revoke jurisdiction of an investment treaty tribunal over claims challenging a tobacco control measure.

A bigger problem with the proposed TPP tobacco carve-out is that it provides the host state with the ability to unilaterally revoke its offer of consent to investor–state arbitration. This goes against the fundamental principle of irrevocability of consent in ISDS. According to this principle, once a foreign investor perfects a state’s consent to ISDS by submitting a claim to arbitration, a party to a dispute cannot unilaterally revoke its consent.²²⁷ And yet, this is exactly what the TPP tobacco carve-out allows the host state to do. Such an option directly contradicts the provisions of the ICSID Convention,²²⁸ which is one of the alternative mechanisms of arbitration that can be chosen by a claimant under Article 9.19.4 of the TPP.²²⁹

Will this tobacco carve-out permit the state to regulate the tobacco industry without the fear that its regulatory measures might be challenged by a foreign investor? I strongly doubt it. It is of course true that, if under Article 29.5 a host state elects to deny the benefits of ISDS with respect to a claim, the state will generally avoid an *investor–state arbitration* with regard to a tobacco control measure. However, the TPP’s tobacco carve-out does not make the state free to adopt measures necessary to protect human life, health, or the environment

226. TPP, *supra* note 3, art. 29.5 n.11 (noting that “[f]or greater certainty, this Article does not prejudice: (i) the operation of Article 9.15 (Denial of Benefits); or (ii) a Party’s rights under Chapter 28 (Dispute Settlement) in relation to a tobacco control measure”).

227. *See, e.g.*, DUGAN ET AL., *supra* note 85, at 222 (“It is generally accepted that once a state has given its consent to arbitrate investment disputes and this consent has been perfected, it cannot be revoked unilaterally.” (footnote omitted)). *See also* RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 254 (2012) (discussing that apart from treaties, such as BITs and other IIAs, consent to investment arbitration may be given in domestic laws of the host state or in an investment contract between the parties, for instance, a concession agreement).

228. ICSID Convention, *supra* note 18, art. 25(1) (“When the parties have given their consent, no party may withdraw its consent unilaterally.”).

229. TPP, *supra* note 3, art. 9.19.4 (“The claimant may submit a claim referred to in paragraph 1 under one of the following alternatives: (a) the ICSID Convention and the ICSID *Rules of Procedure for Arbitration Proceedings*, provided that both the respondent and the Party of the claimant are parties to the ICSID Convention.”).

from the effects of tobacco. Article 29.5 on its own does not eliminate a state's substantive obligations, given to foreign investors, including those in the tobacco industry. There is certainly nothing to this effect in the carve-out itself, which, on its face, is concerned with avoiding ISDS but not with strengthening a state's right to regulate for the benefit of the public. Consequently, if a dispute arises with regard to a tobacco control measure, a foreign investor might still have a substantive claim, but, without ISDS, may not have a meaningful forum in which to submit it.

Moreover, the tobacco carve-out in the TPP does not help a defending state either. If a dispute escalates into litigation or arbitration, a defending state will not be able to invoke the tobacco carve-out in its defense. As just argued, Article 29.5 of the TPP does not grant the right to regulate as such. A defending state could look for alternative safeguards in the TPP, such as Article 9.16 (Investment and Environmental, Health and Other Regulatory Objectives)²³⁰—one of the exceptions in the investment chapter. However, this article also does not secure a state's right to regulate for legitimate public policy objectives, such as the protection of public health. Instead, it reiterates the host state's right to regulate foreign investors "to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental, health or other regulatory objectives."²³¹

To successfully invoke Article 9.16 in a dispute resolution, the host state would have to ensure that any government measure adopted pursuant to Article 9.16 falls within the scope of the article's regulatory objectives. The state will also have to demonstrate that its measures were directed to the regulation of a foreign investor's activity in its territory, but not to the regulation for the benefit of the public at large. For instance, Australia would not be able to invoke Article 9.16 of the TPP to defend its plain tobacco packaging legislation precisely because its legislation has a broad public policy objective—the protection of public health.²³² The case would be different if Australia sought to regulate Philip Morris's operations in Australia to ensure that the tobacco company operates in a manner sensitive to the country's regulatory objectives. Some may disagree with this interpretation of Article 9.16 of the TPP, but an analysis of its text indicates that a host state will certainly have less leeway to successfully invoke Article 9.16

230. TPP, *supra* note 3, art. 9.16 (providing that "[n]othing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental, health or other regulatory objectives").

231. *Id.* art. 9.16.

232. See *Philip Morris Asia*, *supra* note 1 (noting that this proposition is what Australia argued in its investor-state arbitration with Philip Morris).

than, for instance, to rely on a general exception under Article XX of the GATT.

Additionally, the TPP requires the host state's measures under Article 9.16 to be "otherwise consistent" with Chapter 9 of the TPP—the investment chapter.²³³ This requirement makes any policy-making initiatives by a host state pursuant to Article 9.16 secondary and subordinated to the rights of a foreign investor in the host state.²³⁴ As a result, a host state will have to ensure that its regulatory measures under Article 9.16 are consistent with its investor protection obligations under Chapter 9 of the TPP. In contrast, more broadly worded general exceptions allow the host state to adopt regulatory measures in deviation from its investor protection obligations under the IIA regime. Consequently, Article 9.16 of the TPP will be relevant and applicable only to some government measures seeking to regulate the activities of the foreign investors in the country. Article 9.16 will not provide the host state with the regulatory space for broad domestic policymaking.

Other provisions of the TPP that can be of use for state parties seeking to protect their regulatory measures include Article 9.12 (Non-Conforming Measures) and paragraph 3(b) of Annex 9-B (Expropriation). In particular, Annex 9-B seeks to distinguish between legitimate regulatory measures and indirect expropriation. In doing so, it gives a very strong level of protection to the state's regulatory power by providing that "[n]on-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriation, except in rare circumstances."²³⁵

This provision thus establishes a very high threshold for proving indirect expropriation, limiting it to instances of discriminatory regulatory actions by the state. Other exceptions in the TPP are either not applicable to the investment chapter (e.g., general exceptions under Article 29.1²³⁶) or are not relevant to measures adopted for

233. TPP, *supra* note 3, art. 9.16.

234. See, e.g., Ostřanský, *supra* note 160, at 3 ("In this sense, the idea of pursuing policy ends . . . is an exception, whilst following international investment obligations is the norm. Viewed in this way, we see that international investment law positions itself as superior to domestic considerations, and as the ultimate arbiter of what policy objectives may or may not be pursued.")

235. TPP, *supra* note 3, annex 9-B, ¶ 3(b), n.37 (providing (within the Article's footnote): "[f]or greater certainty and without limiting the scope of this subparagraph, regulatory actions to protect public health include, among others, such measures with respect to the regulation, pricing and supply of, and reimbursement for, pharmaceuticals (including biological products), diagnostics, vaccines, medical devices, gene therapies and technologies, health-related aids and appliances and blood and blood-related products").

236. TPP, *supra* note 3, art. 29.1. Article 29.1 on general exceptions incorporates and makes part of the TPP agreement Article XX of GATT 1994 and its interpretative

general public welfare objectives because of their specific public policy goals (e.g., “maintenance or restoration of international peace or security, or the protection of [a State’s] own essential security interests” under Article 29.2;²³⁷ or “adopting or maintaining restrictive measures with regard to payments or transfers relating to the movement of capital” under Article 29.3.2²³⁸).

As a legal rule, the TPP tobacco carve-out will most likely not produce the effect it is meant to achieve: to allow a state to freely regulate the tobacco industry. This TPP provision is also questionable as to its consistency with a state’s other international law obligations, such as those under the ICSID Convention, as it allows a defending state to unilaterally revoke its consent to ISDS. But the tobacco carve-out is also a bad public policy choice. It leaves foreign investors that have claims under the TPP’s investment chapter without a meaningful dispute resolution forum in which to pursue their claims. It also raises an array of difficult questions as to what other regulatory measures, if any, should be protected with individual jurisdictional carve-outs.

From a public policy perspective, the tobacco industry is an easy target. There is a strong consensus among scientists that tobacco consumption negatively affects every part of the human body, increasing the chances of developing cancer, heart disease, stroke, and many other health issues. According to the National Cancer Institute, smoking “causes cancers of the lung, esophagus, larynx, mouth, throat, kidney, bladder, liver, pancreas, stomach, cervix, colon, and rectum, as well as acute myeloid leukemia.”²³⁹ Most people would probably concede that there is a strong need for government regulation in this industry. But how to provide for a state’s regulatory power with respect to other sectors and activities in the IIA regime is a difficult question. What areas should be included on a list of legitimate regulatory objectives? Soda drinks portion limits? Genetically modified food? Atomic energy? Should there be similar jurisdictional carve-outs in trade and investment agreements for these as well? In other words, how do we identify sectors and activities that warrant carve-outs from those that do not?

The answers to these difficult questions require balancing important public policy objectives and making hard choices. However, it is absolutely clear that a state cannot afford to protect its domestic

notes, as well as article XIV of GATS, to a list of enumerated chapters of the TPP. Chapter 9 on investment is not listed among these chapters, making general exceptions not applicable to investment chapter.

237. *Id.* art. 29.2.

238. *Id.* art. 29.3.2.

239. *Harms of Cigarette Smoking and Health Benefits of Quitting*, NAT’L CANCER INST. (Dec. 3, 2014), <http://www.cancer.gov/about-cancer/causes-prevention/risk/tobacco/cessation-fact-sheet#r1> [<https://perma.cc/JHH2-VANX>] (archived Jan. 23, 2017).

policymaking by incorporating individual carve-outs for each sector or activity it wants to regulate.

2. The Tobacco Carve-Out as Part of the Global Reform of ISDS

On a broader scale, looking at the structural, procedural, and substantive changes to ISDS together, it is immediately clear that removing the most contentious public policy claims from the jurisdiction of arbitral tribunals is not a solution to the problem of regulatory disputes.

First, unless there is an alternative treaty regime, as is the case for taxation matters, industry-specific carve-outs do not make sense in view of the improvements introduced to ISDS to date. Take, for instance, transparency and legitimacy initiatives. Implemented successfully, they will convert ISDS into the most competent instrument of investment dispute resolution. No other court in the world would be better positioned to resolve regulatory disputes than ISDS in its improved version.

Second, by removing the jurisdiction of arbitral tribunals over a whole industry or sector, investors are deprived of the benefits of ISDS and left with no other option but to resort to domestic courts or diplomatic protection²⁴⁰—the same mechanisms ISDS was created to replace. Yet, due to the perceived bias of domestic courts and state immunity concerns, litigating investment disputes in the courts of the host state or any other country is not an ideal, or even a feasible, option due to state immunity that sovereign states generally enjoy. Furthermore, litigating disputes over state regulatory measures is an even more challenging task because of their public policy implications. Nevertheless, foreign investors will have no other forum but domestic courts unless they are allowed to use investor–state arbitration.

Third, international arbitral tribunals have long proved capable of resolving public policy concerns in the context of private dispute resolution.²⁴¹ Investor–state arbitration, because of its hybrid²⁴² origin, is even better positioned to take into account public policy

240. For instance, the tobacco carve-out in the TPP does not prejudice the state parties' rights under Chapter 28 (Dispute Settlement). Consequently, a foreign investor may seek assistance of its home state to commence a dispute settlement procedure under TPP's Chapter 28 with respect to a tobacco control measure.

241. Vera Korzun, *Arbitrating Antitrust Claims: From Suspicion to Trust*, 48 N.Y.U. J. INT'L L. & POL. 867, 930 (2016) (arguing that international arbitration “has repeatedly proved capable of settling private disputes involving public policy concerns, such as international arbitration of domestic antitrust claims . . . [and] has gained trust not only from private parties choosing arbitration for the resolution of their international disputes, but also from national courts and public antitrust authorities”).

242. See generally Douglas, *supra* note 37.

considerations. There is no reason to doubt the ability of arbitrators to address regulatory disputes in investor–state arbitrations.

With these considerations in mind, we should reconsider and avoid jurisdictional subject-matter carve-outs, unless there is an alternative treaty regime in place for the subject matter we seek to exclude. For instance, tax carve-outs—the most recognized subject-matter exclusions to the IIA regime to date—have arguably worked because tax matters generally fall under a network of tax treaties that have their own dispute resolution mechanisms.²⁴³ In the case of the tobacco industry, and other sectors and activities that may follow in the footsteps of the TPP tobacco carve-out, there is no comparable international law regime in place.

Consequently, the TPP tobacco carve-out is anything but the gold standard for regulatory objectives. The tobacco carve-out does not help anyone. It does not help sovereign states in securing regulatory space for tobacco control measures, and it certainly does not help foreign investors in the tobacco industry, as they will not know in advance whether they can rely on the benefits of ISDS. Moreover, investors can be deprived of such benefits even after they submit a claim to arbitration.

In addition, once a claim with a reference to a tobacco control measure is submitted to arbitration, one can expect “fights for jurisdiction” by arbitral tribunals in instances where it is unclear whether a tobacco control measure is being challenged in arbitration or, instead, is being invoked by a claimant to substantiate its claim of expropriation or violation of the FET standard. The outcome of these fights for jurisdiction will often depend on the standard used by arbitral tribunals (e.g., relying on the self-judging principle, or seeking a joint determination by the state parties) in determining what constitutes a claim “challenging a tobacco control measure of the Party” under Article 29.5 of the TPP.²⁴⁴

When such preliminary issues arise in an international commercial arbitration, courts are always there as a fallback solution for disputing parties. There is no such luxury for foreign investors in the ISDS world. Once the ISDS option falls apart, a foreign investor would have to revert to the outdated methods of investment dispute resolution that ISDS sought to replace—diplomatic protection or

243. See generally JULIEN CHAISSE, E15INITIATIVE, INTERNATIONAL INVESTMENT LAW AND TAXATION: FROM COEXISTENCE TO COOPERATION (2016), <http://e15initiative.org/wp-content/uploads/2015/09/E15-Investment-Chaisse-Final.pdf> [<https://perma.cc/QML6-JKPD>] (archived Mar. 6, 2017) (discussing the coexistence of tax treaties and international investment agreements, including the dispute resolution mechanisms under such instruments of international law). See also Thomas Wälde, *National Tax Measures Affecting Foreign Investors under the Discipline of International Investment Treaties*, 102 AM. SOC'Y INT'L L. PROC. 55 (2008).

244. TPP, *supra* note 3, art. 29.5 (footnotes omitted).

litigation in the (biased) domestic courts of the host state where an investment treaty is self-executing and provides a private right of action.²⁴⁵ These are very unfortunate projections for the TPP, considering the undeniable merits and track record of investment treaty arbitration.

D. *Seeking Alternative Solutions*

The nature of ISDS claims has evolved over the years from relatively simple claims of discrimination and expropriation to claims challenging the legitimacy of government measures as part of a claim of regulatory expropriation or FET violation. Multinational corporations have acquired, through ISDS, an unprecedented opportunity to interfere with a government's ability to regulate for the public interest, encroaching on a core feature of state sovereignty. Multinational corporations have also demonstrated the willingness to invoke their ISDS right, at times employing inventive treaty- and forum-shopping techniques in search of a more beneficial investor protection regime.

In response to these downsides of modern ISDS, governments and other stakeholders have introduced a series of procedural and structural changes to ISDS, focusing on increasing transparency, consistency, and the overall legitimacy of investor–state arbitration. To address concerns over regulatory disputes, they have also sought to clarify their substantive investor protection obligations, to revoke the offer to arbitrate in IIAs, or to withdraw from the ICSID Convention. Along these lines, the drafters of the TPP have attempted the most inventive approach to date: a tobacco carve-out as the first ever subject-matter jurisdictional exclusion. Yet, as argued above, the tobacco carve-out on its own, and, even together with other safeguard provisions in the TPP, is unable to resolve the challenges posed by regulatory disputes. Consequently, alternative solutions are needed to ensure that a balance is reached in ISDS between the interests of a state in preserving space for domestic policymaking and the interests of foreign investors who choose to invest in the host state in part relying on offered investor protections.

But, first and foremost, irrespective of the forum used to resolve investment disputes—arbitration or domestic or international courts—the substantive investor protection regime must be improved. Arbitral

245. See, e.g., Roger Alford, *BIT Provisions That are Self-Executing But Do Not Confer a Private Right of Action*, KLUWER ARB. BLOG (Sept. 30, 2011), <http://kluwarbitrationblog.com/2011/09/30/bit-provisions-that-are-self-executing-but-do-not-confer-a-private-right-of-action/> [https://perma.cc/YX2F-728D] (archived Jan. 23, 2017) (pointing to the U.S.–Rwanda BIT as an example of an investor protection treaty with both self-executing and non-self-executing provisions, but providing no private rights of action enforceable in U.S. courts).

tribunals and courts interpret and apply provisions of investment treaties in the merit phase of international dispute resolution. If no reference to the right to regulate is made in a treaty, any of these dispute resolution institutions may apply textualism and conclude that no right to regulate is reserved for a state, thus shifting the balance to foreign investors. Although the chances of this happening are slim in modern ISDS, it is still prudent to include a reference to the right to regulate in BITs and other IIAs.

First, the right to regulate for legitimate government objectives should be included in the preamble of investor protection agreements. Arbitral tribunals and state parties may not view such a reference as creating an international law obligation, but it can serve as an indication that the right to regulate is reserved for the host state. The list of public policy objectives for state regulation can be tailored for the needs of treaty parties, but, at a minimum, should include the protection of human life, health, and the environment.

Second, the right to regulate in the context of a non-expropriation obligation raises fewer concerns. Investor protection treaties typically include comprehensive provisions on expropriation and may also address regulatory expropriation. Even where no right to regulate is mentioned in the treaty, arbitral tribunals have consistently acknowledged a state's right to regulate. Over the years tribunals have developed a very high threshold for establishing indirect expropriation. Here, adding a separate clause to the treaty providing that, in the absence of discrimination, regulatory measures do not amount to expropriation could further strengthen the state in the IIA regime.²⁴⁶ Such a provision would prevent investors from bringing frivolous claims and would provide guidance to arbitral tribunals with regard to distinguishing between instances of legitimate non-compensable regulation and indirect expropriation.

Third, there is a strong need for clear criteria in arbitration to identify when regulation by a host state may amount to a FET violation. Presently, arbitral tribunals are left to their own devices in identifying and establishing such criteria. In attempting to balance the right of the state against the rights of investors, they have generally relied on the proportionality criteria and showed deference to the state's own determination. Yet a clear rule would contribute to the predictability of the ISDS regime and would certainly eliminate frivolous claims of a FET violation through challenges of government measures.

Fourth, exceptions and other safeguard provisions provide a critical safety net for all other challenges to a state's regulatory

246. For instance, treaty drafters may follow the example of the TPP, which already includes such a provision in its annex on expropriation. *See* TPP, *supra* note 3, annex 9-B, ¶ 3(b) (footnote omitted).

measures through ISDS. General exceptions are especially useful in this respect, as they allow a state to adopt measures that deviate from its investor protection obligations. Yet, as Robert Stumberg has pointed out, general exceptions in trade liberalization and investment agreements may not be general in their scope.²⁴⁷ For instance, in the U.S. FTA practice, the GATT/GATS general exceptions are made applicable only to select chapters of a treaty, which do not include the investment chapter.²⁴⁸ The most recent example of this practice is the TPP itself. It incorporates by reference and makes part of the TPP, *mutatis mutandis*, Article XX of GATT 1994 and its interpretative notes, as well as Article XIV of GATS, but not for the purposes of Chapter 9 (Investments).²⁴⁹ Thus, the general exceptions of the TPP do not apply to the investment chapter and cannot be used as an affirmative defense for breaches of investor protection obligations under the TPP. This treaty practice should be reconsidered, as legal scholars have suggested.²⁵⁰ The state's regulatory power can be better protected by ensuring that exceptions are available and applicable to the investment chapters in FTAs.²⁵¹ For instance, treaties may follow the example of the ChAFTA, which incorporates a separate article on general exceptions directly into the investment chapter.²⁵²

The above changes would improve the substantive law and provide a better balance between the state's right to regulate and the investor protection rights. They do not, however, address how the institutional and procedural mechanisms for resolution of investment disputes can be improved. Since foreign investors do not entirely trust the impartiality of the domestic courts of a host state, and state parties do not trust private arbitrators' ability to make public policy determinations, these two systems of dispute resolution should be

247. See Stumberg, *supra* note 151, at 406 ("In the U.S. model for exceptions in FTAs, the general exception is not truly general. The scope element incorporates the GATT/GATS exception by reference and applies it to selected chapters, including market access for goods, technical barriers to trade, and cross-border services, among others. It does not apply the exception to chapters on investment or intellectual property." (footnote omitted)).

248. Note that the United States has currently in force FTAs with twenty countries. Where such treaties incorporate by reference the GATT/GATS general exceptions, none of these treaties makes general exceptions applicable to the investment chapter. See, e.g., OFFICE OF THE U.S. TRADE REPRESENTATIVE, UNITED STATES-PERU FREE TRADE AGREEMENT, U.S.-PERU, ch. 22, art. 22.1, Apr. 12, 2006, https://ustr.gov/sites/default/files/uploads/agreements/fta/peru/asset_upload_file841_9542.pdf [<https://perma.cc/RRX5-G2VN>] (archived Jan. 23, 2017).

249. See TPP, *supra* note 3, art. 29.1.1–3.

250. See Stumberg, *supra* note 151, at 406–07 (arguing for the expansion of the scope of the general exception and providing a table with precedents from several TPP countries—Brunei, Canada, Malaysia, New Zealand, Peru, Singapore and Vietnam— which already have FTAs with general exceptions applicable to investment chapters).

251. *Id.*

252. ChAFTA, *supra* note 22, ch. 9, art 9.8.

combined by supplementing investor–state arbitration with the availability of limited court review.

An excellent example of how to procedurally structure such a system comes from the international commercial arbitration of antitrust claims.²⁵³ There, private arbitral tribunals are allowed to consider antitrust claims as part of international commercial dispute resolution. In addition, domestic courts reserve the right to review the resultant arbitral awards on the public policy ground in setting aside and recognition and enforcement proceedings.²⁵⁴ And, judging by the lack of review on the merits and the very few challenges to such awards in domestic courts, the system works very well.²⁵⁵ Further, there are many benefits to it. For private parties, it provides all the advantages of international commercial arbitration. For states and courts, it saves on the social cost of litigating antitrust issues in addition to arbitrating the commercial aspects of the parties' dispute. But, through their courts, states also keep the power of review to ensure that international arbitration is not used to evade mandatory domestic antitrust law. For arbitrators, this process provides incentives—enforced by the reputation mechanism—to ensure that antitrust law is considered in arbitration and the resultant award is enforceable in domestic courts.

A similar mechanism could be employed in ISDS. To achieve this, the state would have to limit its consent to ISDS to the arbitration rules of international commercial arbitration, most notably, the UNCITRAL Arbitration Rules.²⁵⁶ This would subject arbitrations

253. See generally Korzun, *supra* note 241.

254. See, e.g., UNCITRAL Model Law on International Commercial Arbitration Article 24(2)(b)(ii), 1985 (with amendments as adopted in 2006); G.A. Res. 40/72, United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration, U.N. Doc. A/RES/40/72 (Dec. 11, 1985) *amended by* G.A. Res. 61/33, U.N. Doc. A/RES/61/33, at art. 34(2)(b)(ii) (Dec. 18, 2006). For recognition and enforcement, see Article V(2)(b) of the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention). United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 330 U.N.T.S. 38, art. V(2)(b) [hereinafter New York Convention].

255. See Korzun, *supra* note 241, at 927 (observing that “one would certainly expect more challenges related to antitrust law than currently appear in the U.S. courts” and that “[disputing parties] appear to be willing to comply with antitrust-related arbitral awards, without using a second chance to fight such awards in a setting aside or enforcement proceeding”).

256. UNCITRAL Arbitration Rules, *supra* note 20. Most IIAs already include the UNCITRAL Arbitration Rules as a set of procedural rules available for conducting investor–state arbitration. Court review in setting aside or enforcement proceedings is also available for arbitrations under any other rules of international commercial arbitration, as well as the ICSID Additional Facility Rules. And so, this proposal would not necessarily require conclusion or revision of investment protection treaties to allow for application of such rules. However, the choice of procedural rules to conduct investor–state arbitration is currently left to a foreign investor that might prefer to submit its

conducted under these rules to domestic court review on limited grounds at the seat of arbitration or the place of enforcement. Such court review would largely occur in the domestic courts of a country other than the host state.²⁵⁷ These courts may not be as deferential to the public policy determinations of the host state. Yet, the availability of court review may serve as quality control and an additional incentive for arbitral tribunals to ensure that their award is recognized and enforced. Additionally, of course, different public policy objectives may require different levels of deference on the side of reviewing court. For instance, a higher level of deference might be granted to host state measures seeking to protect moral values, in contrast to those measures adopted to protect public health.

For investment treaty arbitrations under the ICSID Convention, state parties could expand the grounds for annulment under Article 52 to include public policy.²⁵⁸ Until such amendments are introduced into the ICSID Convention, the states wishing to have a second bite at the apple to ensure that their public policy concerns are addressed in arbitration, would have to rely on the UNCITRAL Arbitration Rules. The system could also be enforced through reputation mechanisms, which are inherently more powerful in investor–state arbitration than in international commercial arbitration because of the growing transparency of ISDS and the more closely knit family of arbitrators deciding investor–state cases.²⁵⁹

Finally, the proposed system could also make use of the mechanism of joint party determinations, as adopted by ChAFTA. In particular, Article 9.11.4 of ChAFTA provides that “[m]easures of a Party that are non-discriminatory and for the legitimate public welfare

claim to arbitration under the ICSID Convention. *See* ICSID Convention, *supra* note 18. Under the ICSID Convention, the review of arbitral awards is limited to the annulment procedure under Article 52 of the Convention. *Id.*, art. 52. The ICSID Convention award is also not subject to an appeal and is recognized as binding and enforced under the Convention itself (Articles 53–54). The award is therefore outside of the scope of judicial control available in the recognition and enforcement proceedings under the New York Convention. New York Convention, *supra* note 254.

257. In some instances, host states may be able to submit their setting aside application in their own domestic courts. For instance, having lost a NAFTA investor–state arbitration under the UNCITRAL Arbitration Rules with the seat in Toronto, Ontario, Canada, the country filed for setting aside at the Federal Court of Canada. *See* William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton and Bilcon of Delaware Inc. v. Government of Canada, UNCITRAL, PCA Case No. 2009-04, Award on Jurisdiction and Liability (Mar. 17, 2015) (addressing arbitral awards).

258. ICSID Convention, *supra* note 18, art. 52.

259. *See, e.g.,* EBERHARDT ET AL., *supra* note 69, at 38–41 (identifying “a group of 15 arbitrators that can be considered the movers and shakers of international investment arbitration,” and presenting data on these 15 elite arbitrators, who together decided on “55% (247 cases) out of 450 investment-treaty disputes known today, 64% (79 cases) out of 123 treaty disputes of at least \$100 million, 75% (12 cases) out of 16 treaty dispute of at least \$4 billion”).

objectives of public health, safety, the environment, public morals or public order shall not be the subject of a claim under this Section.”²⁶⁰ This is a newer mechanism for affording a state regulatory space in the investor protection regime.²⁶¹ The ChAFTA mechanism has a number of distinct features. First, the exception in ChAFTA is incorporated into an article on consultations, which are a prerequisite for submitting a claim to arbitration under the treaty.²⁶² Second, the exception supplements the general exceptions article already contained in the same investment chapter of ChAFTA, making general exceptions directly applicable to investments.²⁶³ Consequently, ChAFTA has successfully addressed a long-expressed concern that general exceptions cannot be used by a defending state in an investment arbitration, as most FTAs do not make general exceptions applicable to their investment chapters.

Third, the exception in Article 9.11.4 also contains a number of permissible public welfare objectives. This makes it more likely that a government measure would benefit from the exception on one basis or another. Most unusually, the exception is not only pronounced in the treaty, but is also followed by a procedure that may be invoked by a responding state claiming the exception.²⁶⁴ In particular, the state may submit a so-called public welfare notice to a foreign investor and a non-disputing party “specifying the basis for its proposition” that a disputed measure falls within the scope of Article 9.11.²⁶⁵ The notice then leads to a consultation between the host state and the non-disputing party, which triggers an automatic suspension of dispute resolution under the treaty for a period of ninety days.²⁶⁶ The consultation allows the state parties to make a decision as to whether a challenged measure is “of a kind described in [Article 9.11.4].”²⁶⁷ The outcome of such consultations is to be made available to the claimant in the case, as well as to the general public.²⁶⁸ Under Article 9.18.3, “[a] decision between the respondent and the non-disputing Party that a measure is of the kind described in Article 9.11.4 shall be binding on a tribunal and any decision or award issued by a tribunal must be consistent with

260. ChAFTA, *supra* note 22, art. 9.11.4.

261. See, e.g., Anthea Roberts & Richard Braddock, *Protecting Public Welfare Regulation Through Joint Treaty Party Control: A ChAFTA Innovation*, Columbia FDI Perspectives, No. 176 (2016) (arguing that “[t]his ChAFTA mechanism represents a new step in a broader trend of states seeking to recalibrate the balance between investor protection and state sovereignty, and between the interpretative power of arbitral tribunals and treaty parties”).

262. ChAFTA, *supra* note 22, art. 9.12.2.

263. *Id.* art. 9.8.

264. *Id.* art. 9.11.5–9.11.8.

265. *Id.* art. 9.11.5.

266. *Id.* art. 9.11.6.

267. *Id.* art. 9.11.6–9.11.8.

268. *Id.* art. 9.11.7.

that decision.”²⁶⁹ Furthermore, the host state may rely on the benefits of Article 9.11.4 even if it chooses not to file the public welfare notice, or, having filed it, fails to reach a decision with the non-disputing state.²⁷⁰

The above procedure provides an opportunity for state parties to jointly interpret the treaty provisions, as applied to a particular government measure.²⁷¹ In doing so, it avoids reliance on self-judging criteria that could be abused by a host state.²⁷² However, as Anthea Roberts and Richard Braddock observe, foreign investors might be critical of the ChAFTA public welfare procedure as “repoliticizing investor–state disputes by leaving investors at the mercy of joint decisions of the treaty parties.”²⁷³

A similar mechanism could be used by countries in BITs and other IIAs. This would allow a host state to regulate for the public benefit, although within the scope of the exception to the state’s investor protection regime. Most importantly, the mechanism would allow a defending state to invoke the assistance of a non-disputing party—reminiscent of the requirement for a preliminary ruling from the European Court of Justice to interpret the European Union law—instead of requiring exclusive reliance on the arbitral tribunal for the interpretation of treaty provisions. And, for disputes heading to investor–state arbitration, such joint determinations could serve as a screening mechanism to distinguish non-compensable regulation

269. *Id.* art. 9.18.3.

270. ChAFTA, *supra* note 22, art. 9.11.8.

271. Other treaties contain similar provisions on joint determination by state parties of issues material to further dispute resolution by arbitral tribunals. *See, e.g.*, TPP, *supra* note 3, art. 29.4.8 (extending application of Article 9.8 (Expropriation and Compensation) of the TPP to taxation measures). This is an exception to the general exclusion of taxation measures from the application of the TPP agreement. As a prerequisite for invoking Article 9.8 and submitting a claim with respect to a taxation measure to ISDS, Article 29.4.8 requires that a foreign investor first submits to “designated authorities” of the Parties the “issue of whether that taxation measure is not an expropriation.” *Id.* If such authorities do not agree to consider the issue, or accept it for consideration but fail to agree that it is “not an expropriation,” the investor may proceed with submitting its claim to arbitration under Article 9.19 of the TPP. *Id.* *See also* TPP, *supra* note 3, art. 29.4.4 (providing that “an issue . . . as to whether any inconsistency exists between this Agreement and the tax convention [between two or more Parties] . . . shall be referred to the designated authorities of the Parties in question.”; *id.* at art. 29.4.4 (providing that “[a] panel or tribunal [in an arbitration initiated under Article 9.19] established to consider a dispute related to a taxation measure shall accept as binding a determination of the designated authorities of the Parties made under this paragraph”).

272. *See, e.g.*, Roberts & Braddock, *supra* note 261 (observing that “by requiring a joint decision of the treaty parties, ChAFTA limits the ability of respondent states to abuse the mechanism, which would be a more significant risk if the clause were self-judging”).

273. *Id.*

subject to the treaty exception from other instances of regulation to be reviewed and assessed in ISDS.

V. CONCLUSION

Investor–state arbitration—a unique dispute resolution method whereby foreign investors bring claims against sovereign states for breaches of investor protection obligations—has been hit with a wave of criticism in recent years. The opponents of ISDS name the lack of transparency, consistency, predictability, and overall legitimacy as the major shortcomings of the modern system of ISDS. They therefore seek to reform the ISDS regime or to replace it with a system of permanent international investment courts.

Concerns over regulatory disputes may pose the biggest challenge to ISDS. Regulatory disputes involve claims by foreign investors challenging government measures adopted for legitimate public welfare objectives. Such disputes interfere with a government’s ability to regulate, encroach on a state’s sovereignty, and may have a chilling effect on regulation worldwide. Thus, concerns over regulatory disputes have become the primary focus of ISDS opponents in the vigorous debate on the future of ISDS.

In response to this criticism, the international community has already enhanced the transparency and legitimacy of the ISDS regime by developing the UNCITRAL Rules on Transparency and the Mauritius Convention on Transparency, as well as by incorporating provisions on qualifications, experience, ethics, and codes of conduct for arbitrators into IIAs. States have also become more careful in their treaty drafting, seeking to clarify their investor protection obligations to reduce the potential for regulatory disputes.

A recent multilateral trade and investment treaty, the TPP, has gone even farther: the TPP incorporates a tobacco carve-out that allows a host state to unilaterally revoke its consent to ISDS on a case-by-case basis with respect to claims challenging a tobacco control measure. But this may not be optimal. The best answer to the concerns over regulatory disputes may be not choosing arbitration over litigation, or vice versa. Instead, it may be relying on a hybrid dispute resolution system—an investor–state arbitration with the availability of limited domestic court review—that would make it amenable to both private interests and sovereign public policy considerations.