



## **IIEL ISSUE BRIEF 12/2017**

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### **Safeguarding Policy Space in Investment Agreements**

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#### **I. Introduction**

In recent years, critics have attacked bilateral investment treaties and investment chapters in trade agreements (collectively referred to as international investment agreements (IIAs)) on the grounds that they threaten a state's sovereign "right to regulate" and limit the "policy space" of governments. The worry is that investment rules will prevent governments from adopting domestic legislation or regulations designed to promote policies that are in the public interest (referred to as "regulatory chill").<sup>3</sup> This concern is not new, but the proliferation of investment disputes in recent years has brought it into focus, and the criticism has intensified.

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<sup>3</sup> The evidence behind these claims is lacking. In fact, since Philip Morris filed its controversial investment claim challenging Australia's regulations requiring the plain packaging of tobacco products more than 30 countries have tightened tobacco control laws in a host of ways, ranging from banning retail displays to plain packaging and raising the minimum legal age for smoking.

In large part, the problem arises due to the wide scope of IIA obligations. In the early years of the international investment regime, the main worry of foreign investors was expropriation, where a government directly or indirectly takes a foreign investor's property.<sup>4</sup> More recently, though, foreign investors have expanded the scope of their claims and challenged a wide range of host state regulatory actions. Broad provisions in IIAs, such as the obligation of a host state to provide "fair and equitable treatment" (FET), have made it possible to litigate against environmental and public health regulation, among other policies, with recent cases relating to industries such as mining, pharmaceuticals and tobacco causing particular controversy and concern. Such claims demonstrate increasing creativity and legal sophistication by complainants, and have played a large role in the public backlash against IIAs.

Beyond these concerns regarding the intrusion of IIAs into domestic policy-making, another criticism has been the inconsistency of arbitrator rulings.<sup>5</sup> With a host of vague and imprecise provisions, arbitrators must find the meaning through treaty interpretation. Unfortunately, inconsistency has developed in the interpretation of seemingly similar provisions.

Even more, although arbitral tribunals usually attempt to avoid second-guessing governmental policy decisions,<sup>6</sup> it is potentially worrying that some have downplayed or ignored policy and public purposes against compensation obligations.<sup>7</sup> The sensitivity of environmental and health-related cases, coupled with the lack of consistency among arbitral tribunals, threatens to

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<sup>4</sup> On the progressive expansion of the concept of a taking, see MUTHUCUMARASWAMY W. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 363-369 (Cambridge 3d ed. 2010). In regards to indirect expropriation, the tribunal in *Tecmed* considered the difficulty in defining measures "equivalent" or "tantamount" to expropriation and noted that in the absence of "a clear or unequivocal definition, it is generally understood that they materialize through actions or conduct, which do not explicitly express the purpose of depriving one of rights or assets, but actually have that effect. This type of expropriation does not necessarily take place gradually or stealthily ... and may be carried out through a single action, through a series of actions in a short period of time or through simultaneous actions". See *Técnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, ¶ 114 (May 29, 2003).

<sup>5</sup> See Susan Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521, 1522 (2005) ("Decisions about public issues with economic and political consequences are resolved in private before different sets of individuals who can and do come to conflicting decisions on the same points of law and no single body has the capacity to resolve these inconsistencies"). For discussion on precedent in investment law, see Gabrielle Kaufmann-Kohler, *Arbitral Precedent: Dream, Necessity or Excuse? The 2006 Freshfields Lecture*, 23(3) ARBITRATION INTERNATIONAL, 357 (2007).

<sup>6</sup> See *ADF Group Inc. v. United States*, ICSID Case No. ARB (AF)/00/1, Award, ¶ 190 (January 9, 2003) Second Article 1128 Submission of the United Mexican States ("The Tribunal has no authority to review the legal validity and standing of the U.S. measures here in question under U.S. internal administrative law. We do not sit as a court with appellate jurisdiction with respect to the U.S. measures. Our jurisdiction is confined by NAFTA Article 1131(1) to assaying the consistency of the U.S. measures with relevant provisions of NAFTA Chapter 11 and applicable rules of international law.")

<sup>7</sup> *Compañía del Desarrollo de Santa Elena SA v Costa Rica*, ICSID Case No. ARB/96/1, Final Award, ¶ 72 (February 17, 2000) ("Expropriatory environmental measures—no matter how laudable and beneficial to society as a whole—are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains.")

derail the entire regime, with many calls to abolish the system of investor-state dispute settlement (ISDS).<sup>8</sup> The system is facing a legitimacy crisis and is under serious threat.<sup>9</sup>

Governments have responded to the criticism in a number of ways. First, the EU recently proposed major procedural reforms to the arbitral process, making it more accountable and predictable, and adding a permanent court in place of ad hoc “private” arbitrators.<sup>10</sup> Second, many recent IIAs add precision to and narrow the scope of substantive obligations in an attempt to provide better guidance to treaty interpreters and to limit the possibility of encroachment on non-discriminatory public welfare measures.<sup>11</sup> As an example, the most recent EU investment agreements offer more specific details on the scope and meaning of FET than do past agreements.<sup>12</sup> Finally, two agreements have essentially excluded or “carved out” an entire industry – tobacco – from ISDS, in an effort to better protect a sub-set of measures taken for the promotion of public health from challenge.

This *Issue Brief* focuses on the substantive reforms – greater drafting precision, and carve outs and exclusions from the use of ISDS. In our view, carve outs and exclusions are problematic for a number of reasons, and unnecessary to achieve the goal of preserving policy space. Instead of blanket carve outs and exclusions for particular industries, we propose that governments instead continue improving the treaty text so as to protect legitimate public welfare measures, such as the environment and public health. In particular, we argue that broader “general exceptions” provisions would be helpful in this regard. Such provisions have a long history in

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<sup>8</sup> There have recently been many calls of this nature. See Statement of Concern about Planned Provisions on Investment Protection and Investor-State Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership (TTIP) of July 2014, [https://www.kent.ac.uk/law/isds\\_treaty\\_consultation.html](https://www.kent.ac.uk/law/isds_treaty_consultation.html) (submission in response to European Commission Press Release IP/14/292, European Commission Launches Public Online Consultation on Investor Protection in TTIP (Mar. 27, 2014)); see also Public Statement on the International Investment Regime of 31 August 2010, <http://www.osgoode.yorku.ca/public-statement-international-investment-regime-31-august-2010/>.

<sup>9</sup> For background and useful reform options, see Stephan W. Schill, *Reforming Investor-State Dispute Settlement (ISDS): Conceptual Framework and Options for the Way Forward*, E15 Task Force on Investment Policy, THINK PIECE (July 2015), <http://e15initiative.org/wp-content/uploads/2015/07/E15-Investment-Schill-FINAL.pdf>.

<sup>10</sup> See European Commission Concept Paper “Investment in TTIP and beyond – The path for reform” (May 5, 2015), [http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc\\_153408.PDF](http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF); European Commission Press Release IP/15/6059, EU Finalises Proposal for Investment Protection and Court System for TTIP (Nov. 12, 2015), [http://europa.eu/rapid/press-release\\_IP-15-6059\\_en.html](http://europa.eu/rapid/press-release_IP-15-6059_en.html); European Commission Press Release IP/16/4349, European Commission and Canadian Government Co-host Discussions on a Future Multilateral Investment Court (Dec. 13, 2016), [http://europa.eu/rapid/press-release\\_IP-16-4349\\_en.htm](http://europa.eu/rapid/press-release_IP-16-4349_en.htm). For commentary, see Stephan W. Schill, *The European Commission’s Proposal of an “Investment Court System” for TTIP: Stepping Stone or Stumbling Block for Multilateralizing International Investment Law?*, ASIL INSIGHT Apr. 22, 2016.

<sup>11</sup> For detailed commentary on this issue as it relates to arbitral interpretation, see Jürgen Kurtz, *Balancing Investor Protection and Regulatory Freedom in International Investment Law: The Necessary, Complex and Vital Search for State Purpose*, in *YEARBOOK ON INTERNATIONAL INVESTMENT LAW & POLICY 2013-2014* (Andrea K. Bjorklund ed., Oxford Univ. Press 2015).

<sup>12</sup> See, e.g., Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union and its Member States, art. 8.10, Oct. 30, 2016, <http://ec.europa.eu/trade/policy/in-focus/ceta/ceta-chapter-by-chapter>.

international trade law, and already appear in several IIAs. Unfortunately, the two most important economies, the United States (U.S.) and the European Union (EU), have resisted fully incorporating general exceptions clauses into their IIAs. We argue that the use of general exceptions provisions in IIAs should be expanded, and are more effective and appropriate than industry carve-outs and exclusions for preserving domestic policy space. When combined with more precise drafting of the obligations, general exceptions can go a long way towards addressing the criticisms of IIAs.<sup>13</sup>

## II. Policy Space and Trends in Treaty Drafting

Critics contend that IIAs restrict the host states' right to regulate in the public interest. In particular, they worry that non-discriminatory measures taken in good faith for the public interest could be deemed to violate a substantive treaty obligation such as national or most favoured nation treatment, expropriation without compensation or FET.<sup>14</sup>

Such worries discount important government attempts to preserve policy space. In recent years, governments have paid greater attention to this issue and negotiated a series of provisions aimed at further safeguarding public interest. These include express provisions on the host state's right to regulate, interpretive statements, provisions designed to narrow the scope of expropriation and FET, preambular language underscoring the importance of public policy concerns, and as mentioned above and the focus of this *Issue Brief*, general exceptions clauses.

While it is beyond the scope of this *Issue Brief* to provide detail on every such attempt, it is useful to offer a few examples. One early effort is a 2001 clarification issued by the NAFTA countries on the minimum standard of treatment obligation, which attempts to place limits on the scope of this obligation by providing, *inter alia*, that "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.<sup>15</sup>

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<sup>13</sup> We note that some commentators argue that general exceptions clauses are unnecessary as existing safeguards in modern agreements adequately protect public welfare measures. See, e.g., Andrew Newcombe, *General Exceptions in International Investment Agreements*, in SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW 351, 355 and 369–370 (Marie-Claire Cordonier et al. eds., The Hague: Kluwer International Law 2011). While there may be some validity to this argument, adding an additional layer of protection not only provides enhanced comfort to governments and onlookers but also sends a strong signal to arbitrators regarding the intent of the parties.

<sup>14</sup> KYLA TIENHAARA, THE EXPROPRIATION OF ENVIRONMENTAL GOVERNANCE, PROTECTING FOREIGN INVESTORS AT THE EXPENSE OF PUBLIC POLICY (Cambridge University Press 2009). For an activist perspective, see NICHOLAS HILDYARD & GREG MUTTITT, TURBO-CHARGING INVESTOR SOVEREIGNTY: INVESTMENT AGREEMENTS AND CORPORATE COLONIALISM (The Corner House 2006).

<sup>15</sup> North American Free Trade Agreement - Notes of Interpretation of Certain Chapter 11 Provisions, NAFTA Free Trade Commission (July 31, 2001) [http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding\\_e.asp](http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding_e.asp). In a similar regard, see the "Joint Interpretative Instrument on the Comprehensive Economic and Trade Agreement (CETA) between Canada & the European Union and its Member States" agreed at the time of signing the CETA, <http://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/jii-iic.aspx?lang=eng>.

It is also common for countries to attempt to safeguard public welfare measures in the context of indirect expropriation obligations. In this regard, Annex 11-B(3)(b) of the KORUS FTA (and numerous other agreements) includes the following language:

Except in rare circumstances, such as, for example, when an action or a series of actions is extremely severe or disproportionate in light of its purpose or effect, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, the environment, and real estate price stabilization (through, for example, measures to improve the housing conditions for low-income households), do not constitute indirect expropriations.<sup>16</sup>

More recently, countries have attempted to protect public welfare measure more broadly by adding general language supporting a “right to regulate,” such as that in Article 8.9, para. 1 of the Canada – EU Trade Agreement (CETA), which reads:

For the purpose of this Chapter, the Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer protection or the promotion and protection of cultural diversity.

These are just a few ways in which countries have tried to limit the risk that nondiscriminatory measures taken for legitimate public welfare reasons would be deemed to violate international investment law.<sup>17</sup> Such measures are clearly worded and provide comfort to governments while still maintaining the balance of security and predictability of foreign investors.

Beyond these general efforts, in light of two recent cases brought by Philip Morris – against Australia’s measures relating to the plain packaging of tobacco products and various Uruguayan tobacco regulation measures<sup>18</sup> – public health advocates have pressed for a carve-out which specifically excludes tobacco control measures from the scope of IIAs.<sup>19</sup> This issue is addressed in the next section.

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<sup>16</sup> For a similar clause, see Free Trade Agreement, Austl.-Chile, annex 10-B(3)(b). See also Free Trade Agreement, Chile- U.S., annex 10-D 4(b); Free Trade Agreement, Austrl.-U.S., annex 11-B 4(b); Free Trade Agreement, Austrl.-S. Kor., annex 11-B 5; Bilateral Investment Treaty, Can.-China, annex B.10, article 3; Economic Partnership Agreement, Austrl.-Japan, annex 12, article 4; 2012 U.S. Model Bilateral Investment Treaty, annex B4(b), <https://www.state.gov/documents/organization/188371.pdf>; 2004 Canada Model Bilateral Investment Treaty, annex B.13(1)(c).

<sup>17</sup> For several other examples of targeted safeguards, see Bryan Mercurio, *Safeguarding Public Welfare? – Intellectual Property Rights, Health and the Continuing Evolution of Treaty Drafting in International Investment Agreements*, 6 J. INT'L DISP. SETTLEMENT 252 (2015).

<sup>18</sup> Philip Morris Asia Limited (H.K. v. Austrl.), Case 2012-12 (UNCITRAL), (Perm. Ct. Arb. 2012); Philip Morris Brands Sàrl, Philip Morris Products S.A. & Abal Hermanos S.A. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7, (July 8, 2016).

<sup>19</sup> Deborah Sy, *Warning: Investment Agreements are Dangerous to Your Health*, 43 GEO. WASH. INT'L L. REV. 625, 656 (2011) (“... states must be encouraged to negotiate or renegotiate IIAs/BITs to exclude tobacco companies from the investor state dispute settlement system or to add substantive provisions for the exclusion of tobacco products”); *see also* The World Health Organization Framework Convention on Tobacco Control (WHO

### III. Industry Carve-outs to Address Policy Space Concerns

Safeguarding public welfare measures by excluding certain industries from the scope of investment obligations is the most recent development involving investment agreements and policy space. Thus far, such attempts are limited to tobacco, although in the future the principle could be extended to other products deemed harmful or otherwise undesirable.

The idea was first discussed among governments as part of the Trans Pacific Partnership (TPP) negotiations, when various levels of exclusion of tobacco were considered. While a “full” carve-out of tobacco from the entire investment chapter was discussed, the parties eventually agreed to carve-out only certain tobacco measures from ISDS.<sup>20</sup> More specifically, Article 29.5 of the TPP allows governments to “elect” to “deny the benefits” of ISDS to their “tobacco control measures”.<sup>21</sup> The scope of such measures is broadly defined as measures “related to the production or consumption of manufactured tobacco products (including products made or derived from tobacco), their distribution, labeling, packaging, advertising, marketing, promotion, sale, purchase, or use, as well as enforcement measures, such as inspection, recordkeeping, and reporting requirements.” While the inclusion of such an exemption has excited a few public health groups, it is clear that the carve-out lost key Congressional votes

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FCTC), *Trade and investment issues, including agreements, and legal challenges in relation to the implementation of WHO FCTC*, Report by the Convention Secretariat (FCTC/COP/7/21, 29 July 2016) Conference of the Parties to the WHO Framework Convention on Tobacco Control, Seventh session of 7–12 November, Delhi, India, ¶¶ 22-26 (2016), [http://www.who.int/fctc/cop/cop7/FCTC\\_COP\\_7\\_21\\_EN.pdf?ua=1](http://www.who.int/fctc/cop/cop7/FCTC_COP_7_21_EN.pdf?ua=1).

<sup>20</sup> For background on the tobacco exclusion, see *Mercurio, supra* note 17, 272-275.

<sup>21</sup> Trans-Pacific Partnership, Chapter 29, Exceptions and General Provisions, <https://www.mfat.govt.nz/en/about-us/who-we-are/treaties/trans-pacific-partnership-agreement-tpp/text-of-the-trans-pacific-partnership>. Article 29.5 reads:

“A Party may elect to deny the benefits of Section B of Chapter 9 (Investment) with respect to claims challenging a tobacco control measure<sup>12</sup> 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.

12 A tobacco control measure means 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. For 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.”

For discussion, see 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-ruletrade/p37509>; Glynn Moody, *Tobacco Carve-Out from ISDS Starts to Spread: Another Nail in the Coffin of Corporate Sovereignty* (Oct. 17, 2016), <https://goo.gl/x1wPZv>.

and made ratification of the TPP in the U.S. more difficult (prior to President Trump's full withdrawal).<sup>22</sup>

More recently, Australia and Singapore amended their longstanding FTA to explicitly exclude tobacco control measures from the scope of ISDS.<sup>23</sup> This exclusion of tobacco will be the first such carve-out to take effect. Having set this precedent in the Singapore FTA, Australia is likely to negotiate with its other FTA partners to carve-out tobacco from ISDS, and other countries may similarly seek carve-outs in the future.

The rationale for these carve-outs is health related and undoubtedly made in good faith – governments seek to tighten tobacco controls and reduce smoking rates, and want to insulate such measures from being targeted in ISDS. The two prominent ISDS cases brought by Philip Morris have now been rejected by investment tribunals,<sup>24</sup> but this has not stopped critics seeking to completely insulate tobacco control measures from any potential challenge to advocate for their exclusion from the treaty obligations.<sup>25</sup>

In our view, however, carve-outs are both unfair and unnecessary. Carve-outs are unfair as they single out a single industry and take away enforcement of rights which have, in some cases, existed for decades. The argument for ISDS is that it provides investors with security, especially in developing economies. With ISDS taken away, tobacco is the lone sector in which foreign investors will have rights under the treaty but no avenue to enforce those rights. This seems odd in and of itself, and, furthermore, taking away rights that already exist, as in the case with the Australia–Singapore treaty amendment, arguably undermines the very principle of FET. Moreover, one has to question the effect of such a move on business confidence, as other industries may also fear losing enforcement rights under Australian treaties.

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<sup>22</sup> See Thom Tillis (Senator for North Carolina), “Tillis & Burr Respond to Administration’s Partisan TPP Tobacco Carve-Out” Press Release, (Oct. 1, 2015), <https://www.tillis.senate.gov/public/index.cfm/press-releases?ID=E94847E4-B2D9-4E35-9EEF-2D4D49F19137> (Tillis states: “If any carve-out is ultimately included in the TPP, I will work hard to help defeat its ratification.”)

<sup>23</sup> See Agreement to Amend the Singapore–Australia Free Trade Agreement, art. 22, October 2016, <http://dfat.gov.au/trade/agreements/safta/Documents/agreement-to-amend-the-singapore-australia-free-trade-agreement.pdf> (“No claim may be brought under this Section in respect of a tobacco control measure of a Party.”).

<sup>24</sup> *Philip Morris v. Uruguay*, *supra* note 18 ¶ 271 (“The Tribunal concludes that under Uruguayan law or international conventions to which Uruguay is a party the trademark holder does not enjoy an absolute right of use, free of regulation, but only an exclusive right to exclude third parties from the market so that only the trademark holder has the possibility to use the trademark in commerce, subject to the State’s regulatory power”). See also *Philip Morris v. Australia*, *supra* note 18, Award on Jurisdiction and Admissibility ¶ 588, (Dec. 17, 2015).

<sup>25</sup> Incidentally, the impact of plain packaging of tobacco products on the rate of decline in smoking prevalence in Australia is far from certain. See Australian Bureau of Statistics, *National Health Survey (2014-15)*, <http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/4364.0.55.001~2014-15~Main%20Features~Smoking~24> (reporting that in 2014-15, 14.5% of adults aged 18 years and over were daily smokers, down from 16.1% in 2011-12, and concluding “[t]his decrease is a continuation of the trend over the past two decades.”)

Another problem with a blanket exclusion of this kind is that it allows governments to use tobacco control measures to favor domestic industry and can be abused to facilitate cronyism and corruption (whether governments would actually do so is an open question, but they now have that option). Once the measure can be classified as relating to tobacco control, the government could, in theory, include a provision within the measure that discriminates against foreign tobacco in some way, or which constitutes regulatory expropriation, or is simply arbitrary in its application. It is hard to see how such a broad exemption for abusive measures makes sense as a matter of public policy. Favoring domestic industry is unlikely to help with public health, and supporting powerful domestic monopolies through discriminatory regulations could actually make it harder to pass tobacco control measures, as these monopolies would have great power to fight off such regulation. Furthermore, there will be no legal recourse when, under the guise of a tobacco control measure, a corrupt official expropriates property or a business, leaving the market open for him/herself or a friendly local contact. This is patently unfair and clearly counters the letter and spirit of the underlying investment agreement. Such abuse should not be tolerated and the affected industry should be given the opportunity to enforce its rights under the agreement.

Beyond these fundamental fairness issues, it is certainly the case that measures taken for legitimate public policy purposes should not conflict with international investment rules. But carving out of a specific industry is unnecessary to protect governments' ability to regulate and promote public welfare measures. There are better ways to accomplish that objective, as described in the next section.

#### **IV. General Exceptions as an Alternative to Ensure Policy Space**

Carve-outs and industry specific exclusions are unnecessary, as IIAs could include safeguards to protect public welfare measures without compromising fairness. Improvements to the drafting of investment obligations have been helpful in past agreements, and instead of a special rule targeting tobacco, the trend of more nuanced and better treaty provisions should be continued.

Another way to improve upon this trend and ensure adequate policy space for a host government is through the use of general exception clauses. Such clauses have been part of trade agreements for as long as they have dealt with domestic regulation and are becoming more common in investment agreements. Modelled on the WTO GATS (art XIV) or GATT (art XX), general exception clauses are designed to shield measures taken in good faith which are “necessary,” “relating to,” and “designed and applied for” the protection of certain policy objectives and are not applied in an arbitrary or unjustifiably discriminatory manner. While the form of such clauses differs slightly between agreements, Article 22.1 (General Exceptions) of the Australia-Korea FTA provides a useful example:

3. For the purposes of Chapter 11 (Investment), subject to the requirement that such measures are not applied in a manner which 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 Party from adopting or enforcing measures:

- (a) necessary to protect human, animal or plant life or health;
- (b) necessary to ensure compliance with laws and regulations that are not inconsistent with this Agreement;
- (c) imposed for the protection of national treasures of artistic, historic or archaeological value; or
- (d) relating to the conservation of living or non-living exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

The Parties understand that the measures referred to subparagraph (a) include environmental measures to protect human, animal or plant life or health, and that the measures referred to in subparagraph (d) include environmental measures relating to the conservation of living and non-living exhaustible natural resources.

Canada frequently includes general exception clauses in its investment agreements,<sup>26</sup> as does EFTA,<sup>27</sup> Japan<sup>28</sup> and Australia.<sup>29</sup> In fact, the current Article 21 (to be revised to Article 19) of the Australia–Singapore FTA includes a general exceptions provision. Thus, the inclusion of a tobacco carve-out seems unnecessary and particularly strange in this context, and illustrates what seems to be a new Australian policy to specifically exclude tobacco in all of its agreements, regardless of the need.

The U.S. is somewhat of an outlier on this issue, having never included such general exceptions in any IIAs. And while the U.S. attempts to craft its IIAs so as to reflect existing property protection rights under the Constitution, and therefore arguably may not be able to have a general exception clause in an IIA which applies to expropriation, there do not appear to be any constraints which prevent the U.S. from having a general exception clause apply to other provisions, including FET. Meanwhile European governments have not traditionally included exceptions in their IIAs, but recently the EU has taken over responsibility for investment policy

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<sup>26</sup> See Foreign Investment Promotion and Protection Agreement, Can.-China, art. 33.2, Sep. 9, 2012; Foreign Investment Promotion and Protection Agreement, Can.-Phil., art. XVII; Foreign Investment Promotion and Protection Agreement, Can.-Ecuador, art. XVII; Foreign Investment Promotion and Protection Agreement, Can.-Pan., art. XVII; Foreign Investment Promotion and Protection Agreement, Can.-Thai., art. XVII; Foreign Investment Promotion and Protection Agreement, Can.-Côte d'Ivoire, art. 17; Foreign Investment Promotion and Protection Agreement, Can.-Czech, art. IX; Foreign Investment Promotion and Protection Agreement, Can.-Jordan, art. 10; <https://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/index.aspx?lang=eng> .

<sup>27</sup> See, e.g., Free Trade Agreement Between the EFTA States and Hong Kong, H.K.-Ice.-Liech.-Nor.-Switz., art. 4.9, June 21, 2011 (incorporating Articles XIV and XIVbis of the GATS); Free Trade Agreement Between the EFTA States and Colombia, Colom.-Ice.-Liech.-Nor.-Switz., art. 5.8 Nov. 25, 2008 (incorporating Articles XIV of the GATS); <http://www.efta.int/free-trade/free-trade-agreements> .

<sup>28</sup> See, e.g., Economic Partnership Agreement, Japan-Switz., art. 95, Feb. 19, 2009, <http://www.mofa.go.jp/region/europe/switzerland/epa0902/index.html> (incorporating Articles XIV and XIVbis of the GATS).

<sup>29</sup> See, e.g., Economic Partnership Agreement, Austrl.- Japan, art. 14.15, July 8, 2014, <http://dfat.gov.au/trade/agreements/jaepa/official-documents/Pages/official-documents.aspx> .

from member states, and has made major reforms. The new EU policy favours including, but severely limiting, a general exceptions clause. For instance, Article 9.3(3) of the EU–Singapore FTA limits the applicability of its general exception clause to national treatment. Likewise, the CETA sets out some general exceptions, including for investment measures, in Article 28.3(2); however, it only applies to certain investment obligations, Section B (Establishment) and Section C (non-discrimination), but not the crucial FET provisions and expropriation provisions of Section D. It is rather odd, to say the least, that the EU finds it necessary to include a general exception clause in relation to national treatment but not for other obligations such as expropriation and FET. The EU is not alone in limiting the scope of the general exceptions clause. For instance, Article 95 of the Switzerland–Japan FTA expressly incorporates Articles XIV and XIV<sup>bis</sup> of the GATS, but excludes expropriation, FET and treatment in case of strife from its application.

The wording of exception clauses is still a work in progress, and more precision may be needed. For example, there is no need to slavishly conform to existing WTO language. Instead, the scope of the list of permissible objectives, and the use of “relating to” rather than “necessary,” could dramatically change the usefulness of the provision. In this regard, governments could shift the textual language so that the exception applies to measures “relating to” (as opposed to the stricter “necessary”) policies such as the protection of human, animal or plant life or health. Such language would greatly assist in assuring governments that non-discriminatory regulatory measures would not be affected by the agreement.

Governments could also establish a flexible and comprehensive list of potential policies to be covered, perhaps even relying on a non-exhaustive list. Such an approach is not entirely novel. For example, Article 2.2 of the WTO TBT Agreement – which is not an exception but nevertheless instructive – sets out the scope of policies covered as follows:

Such legitimate objectives are, *inter alia*: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment. In assessing such risks, relevant elements of consideration are, *inter alia*: available scientific and technical information, related processing technology or intended end-uses of products.

To be clear, including exception clauses does not mean that investment will be curtailed. On the contrary, governments will better know what actions they can take, and investors will be informed and able to calculate potential risks before making the investment. Exception clauses set out a clearer scope for the obligations, but should not be viewed as a way to give governments unlimited regulatory discretion, and arguments will still take place over whether a measure is “aimed at” or “related to” the relevant provision and whether a measure is “arbitrary”, “unjustifiable” or “a disguised restriction” on investors or the investment. In this regard, investment tribunals can draw upon the rich body of WTO jurisprudence for interpretive guidance.

Finally, it should be emphasized that, as opposed to targeting a single industry, a general exceptions clause applies to all public policy measures. Of the more than 750 publicly available

ISDS cases, the Philip Morris claims are the only two relating to tobacco control measures, so the reality is that the tobacco industry has not actively used or abused the process. Rather, it is using ISDS just like every other industry does, to assert what it believes are its rights under international agreements. As a result, in order to preserve domestic policy space, it is more sensible to utilize general exceptions to safeguard a broader range of public welfare measures, instead of targeting just one industry through a carve-out.

## **VI. Conclusion**

As the public backlash against IIAs has grown, governments have taken action to clarify and narrow the scope of these agreements. While some of these efforts have been useful, the tobacco carve-out is a misguided attempt to safeguard the public interest. The tobacco carve-out ignores the larger problem of policy space, while providing an overbroad response in the context of this one industry. Moreover, we contend that discriminating against one currently disfavored industry – and possibly others in the future – undermines the basic principles embodied in investment agreements. General exceptions clauses, which have a long history in trade agreements and have already found a place in the investment realm, provide a more effective solution to the problem of intrusions by IIAs into domestic policy space. The key is to bring major players such as the U.S. and EU fully on board with this practice and perhaps continue working to craft better and more effective treaty language which protects public policy space, while preventing abuse and targeted discrimination against particular industries.