

## UNCITRAL Working Group III: Contribution on the ‘Right to Regulate’ Provision<sup>1</sup>

At the forthcoming session of UNCITRAL Working Group III (WGIII) on Investor-State Dispute Settlement (ISDS) Reform (Vienna, 22-26 January 2024), delegates will discuss the Draft Provisions on Procedural and Cross-cutting Issues.<sup>2</sup> Prepared by the UNCITRAL Secretariat in response to a request from WGIII, the provisions include Draft Provision 12 on the ‘Right to Regulate’.

### Draft Provision 12: Right to Regulate

1. Nothing in the Agreement shall be construed as preventing the Contracting Parties from exercising their right to regulate in the public interest and to adopt, maintain and enforce any measure that they consider appropriate to ensure that investments are made in a manner sensitive to the protection of public health, public safety or the environment, the promotion and protection of cultural diversity, or [...].
2. When assessing the alleged breach by a Contracting Party of its obligation under the Agreement, the Tribunal shall give a high level of deference that international law accords to Contracting Parties with regard to the development and implementation of domestic policies, the right to regulate in the public interest and the right to adopt, maintain and enforce measures sensitive to the protection of public health, public safety or the environment, the promotion and protection of cultural diversity, or [...].
3. No claim may be submitted for resolution pursuant to Draft Provisions 3 or 4, if the measure alleged to constitute a breach of the Agreement was adopted by the Contracting State to protect public health, public safety or the environment (including compliance with the Paris Agreement or any principle or commitment contained in articles 3 and 4 of the United Nations Framework Convention on Climate Change), the promotion and protection of cultural diversity, or [...].

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<sup>2</sup> UNCITRAL, ‘Annotated Provisional Agenda (Vienna, 22-26 January 2024)’, para 10; UNCITRAL, ‘Draft Provisions on Procedural and Cross-Cutting Issues: Note by the Secretariat’ (26 July 2023), A/CN.9/WG.III/WP.231.

In recent treaty practice, right-to-regulate provisions aim to address a recurring concern about investment treaties and ISDS: namely, that the broad protection standards and substantial damages awarded to investors may deter legitimate policymaking in the public interest, including regulations related to public health, safety or the environment, leading to what is commonly referred to as ‘regulatory chill’. Right-to-regulate provisions may also seek to address the related concern that ISDS awards inappropriately shift the costs of regulation, including in ways that are inconsistent with the polluter pays principle.

In WGIII, delegates have expressed concerns about regulatory chill from the early stages of the Working Group’s deliberations.<sup>3</sup> Providing a meaningful response to this issue is critical for the Working Group’s reform package to be seen as effectively addressing concerns about ISDS.

During the October 2023 session of WGIII, however, some delegations expressed the view that Draft Provision 12 introduces substantive aspects that are beyond the procedural mandate of the Working Group.<sup>4</sup> It is worth recalling that, in delineating the remit of its WGIII, UNCITRAL established a broad mandate to identify reform solutions for concerns about ISDS.<sup>5</sup> Although, in practice, the Working Group has interpreted its mandate as being limited to procedural issues concerning ISDS,<sup>6</sup> it is not clear that interpretation will or should be strictly applied.

Indeed, over the past several years, various delegations have expressed concerns about this restrictive interpretation, contending, for instance, that procedural and substantive concerns are inherently interlinked.<sup>7</sup> While the ‘right-to-regulate’ framing of Draft Provision 12 (particularly its title and section 1) seems to evoke substantive provisions included in some recent investment treaties,<sup>8</sup> there are several policy options for procedural reform aimed at addressing concerns about regulatory chill. The following two sections explore ideas to support the Working Group’s exploration of these options.

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<sup>3</sup> UNCITRAL, ‘Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of its Thirty-Seventh Session (New York, 1–5 April 2019)’, para 36-38; UNCITRAL, ‘Summary of the Inter-Sessional Meeting on Investor-State Dispute Settlement (ISDS) Reform Submitted by the Government of the Republic of Korea’, paras 46, 47, 50; UNCITRAL, ‘Possible Reform of Investor-State Dispute Settlement (ISDS): Comments by the Government of Indonesia’, para 10; UNCITRAL, ‘Possible Reform of Investor-State Dispute Settlement (ISDS): Submission from the Government of South Africa’, para 11; UNCITRAL, ‘Possible Reform of Investor-State Dispute Settlement (ISDS): Submission by the Government of Burkina Faso’, para 10.

<sup>4</sup> UNCITRAL, ‘Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of its Forty-Sixth Session (Vienna, 9–13 October 2023)’, paras 88 and 97.

<sup>5</sup> UNCITRAL, ‘Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of its Thirty-Fourth Session (Vienna, 27 November–1 December 2017) Part I’, para 6.

<sup>6</sup> *Ibid*, para 20.

<sup>7</sup> UNCITRAL, ‘Possible Reform of Investor-State Dispute Settlement (ISDS): Submission from the Government of Bahrain’, paras 65-67; UNCITRAL, ‘Possible Reform of investor-State Dispute Settlement (ISDS): Submission from the Government of Thailand’, paras 28-29; UNCITRAL, ‘Possible Reform of Investor-State Dispute Settlement (ISDS): Submission from the Government of South Africa’, para 20; UNCITRAL, ‘Possible Reform of Investor-State Dispute Settlement (ISDS): Comments by the Government of Indonesia’, paras 1-2.

<sup>8</sup> For example, Norwegian Draft Model BIT (2015), Art. 12; Argentina-Qatar BIT (2016), Art. 10; Brazil-India Investment Cooperation and Facilitation Treaty (2020), Art. 23; EU-Viet Nam FTA, Art. 8.1(1); Japan-Uruguay BIT (2015), Art. 22; Canada-China BIT (2012), Art. 33.

## **A. Narrowing the scope of consent to arbitration**

One reform option may involve narrowing the scope of consent for submitting disputes to ISDS. This can be done by excluding certain types of measures, assets, sectors or even causes of action from open offers of consent. An approach carving out certain types of measures is reflected in Draft Provision 12(3), which excludes public interest measures, including those aimed at protecting public health, public safety, the environment (including climate change) or cultural diversity.

In addition to falling more squarely within procedural reforms, narrowing the scope of consent to arbitration may help overcome the limitations of many right-to-regulate and general exceptions clauses: the former do not explicitly rule out liability for public-interest measures and, according to some arbitral tribunals, the latter do not affect the state's duty to compensate the claimant.<sup>9</sup> In light of these limitations, a provision limiting the scope of consent, such as contemplated by section 3 of Draft Provision 12, may be particularly important for effectively addressing identified concerns.

Carve-outs based on the nature of the measures may raise questions of interpretation and application. For example, disputes may arise over whether a measure qualifies as a climate measure and therefore is excluded from ISDS by the carve-out. Therefore, and as discussed further below, it may be useful to consider who will decide on the applicability of the carve-out and through what process. It may also be useful to consider alternative or complementary carve-outs that are simpler to apply. Sector-based carve-outs, such as a provision excluding fossil fuel investments from consent to arbitration, may be easier to administer than measure-based ones. See Box for an illustrative example.

### **Narrowing the scope of consent to arbitration: the example of a fossil fuel carveout**

1. Consent to investor-state arbitration under all current or future investment treaties concluded between the parties to this agreement shall exclude investments in the exploration, extraction, refining, transportation, distribution, export or import of fossil fuels, and no claims related to such investments may be initiated.
2. For greater certainty, "fossil fuels" includes coal, crude oil, natural gas and related downstream hydrocarbon fuels for energy purposes.

Additionally, carve-outs from all or certain causes of action can also be an administratively simple way to reduce risks of undue regulatory chill or regulatory cost-shifting. A provision could exclude all advance consent to ISDS, thereby making all ISDS claims subject to further agreement between the investor and State and/or State-to-State dispute settlement.

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<sup>9</sup> *Eco Oro Minerals Corp. v. The Republic of Colombia*, ICSID Case No. Arb/16/41, Decision on Jurisdiction, Liability and Directions on Quantum (9 Sept. 2021), paras 822-837.

Alternatively, an exclusion could cover certain provisions, such as the fair and equitable treatment and indirect expropriation, which give rise to heightened concerns that they may over-deter government action in the public interest. Under this approach, ISDS claims alleging breach of other standards, such as direct expropriation, could potentially still be brought.<sup>10</sup>

## **B. Procedural filters**

An additional and potentially complementary option might involve establishing procedural filters, particularly if consent to arbitration is excluded for certain types of measures. These filters would enable state parties to the relevant investment treaty to assess whether a measure falls within the scope of a measure-based carve-out, thereby excluding it from the consent to arbitration. Such procedural filters have featured in some recent treaty practice,<sup>11</sup> providing a foundation for the Working Group to further develop this approach. See Box for an illustrative example.

### **Procedural filter for public welfare measures**

1. Measures taken by a Party for the legitimate public welfare objectives of public health, safety, the environment, public morals or public order shall not be the basis for an arbitration claim initiated by an Investor under this Section.
2. If an Investor of a Party submits a claim to arbitration under this Section, and the Respondent contends that the dispute involves measures mentioned in paragraph (1), the Respondent may invoke the following procedures for claims related to those measures.
3. No later than the date set by the tribunal for the Respondent to submit its principal submission on the merits, such as the counter-memorial, the Respondent may submit a written request to [the Designated Contact of the other Party] for a joint determination by the relevant authorities of the Parties on whether, and to what extent, a measure falls within paragraph (1). The Respondent shall provide the tribunal, if constituted, a copy of its request. The tribunal shall proceed to hear the claim only as provided in paragraphs (5), (6), or (7).
4. With respect to the joint determination by the relevant authorities of the Parties referred to in paragraph (3):
  - i. the relevant authorities of the Parties shall have 6 months from the date of receiving the request to exchange positions;
  - ii. the relevant authorities of the Parties shall have 6 months from the exchange of positions under subparagraph (i) to make a joint determination;

<sup>10</sup> On these aspects, see CCSI, IIED and IISD, *Draft Treaty Language: Withdrawal of Consent to Arbitrate and Termination of International Investment Agreements*, Submission to UNCITRAL Working Group III on ISDS Reform (15 July 2019), <https://ccsi.columbia.edu/sites/default/files/content/docs/publications/UNCITRAL-submission-Withdrawal-of-Consent-and-Termination.pdf>.

<sup>11</sup> See e.g. China-Australia FTA, Arts. 9.11.4- 9.11.8; US Model BIT, Arts. 20, 21(2), 31; Canada-China Foreign Investment Promotion and Protection Agreement (FIPA), Art. 20(2); Canada's Model FIPA (2021), Art. 45.

- iii. if the relevant authorities of the Parties have made a joint determination under subparagraph (ii), the relevant authorities of either Party shall transmit the joint determination to the disputing parties and the tribunal, if constituted; and
  - iv. if the relevant authorities of the Parties have not made a joint determination under subparagraph (ii), either Party may, within 13 months of receiving the written request for a joint determination, request an arbitral panel to be established under Section [] (State-to-State Dispute Settlement) to decide whether, and to what extent, the measure falls within paragraph (1). The arbitral panel shall transmit its decision to the disputing parties and to the tribunal, if constituted.
5. If the relevant authorities of the Parties in a joint determination referred to in paragraph (4)(ii), or the arbitral panel in a decision referred to in paragraph (4)(iv), determine that paragraph (1) constitutes a valid preclusion of the claim, the Claimant is deemed to have withdrawn its claim and to have discontinued the proceeding, with prejudice. The tribunal, if constituted, shall acknowledge the discontinuance of the claim in an order, after which the authority of the tribunal shall cease.
6. If the relevant authorities of the Parties in a joint determination referred to in paragraph (4)(ii), or the arbitral panel in a decision referred to in paragraph (4)(iv), determine that the paragraph asserted is a valid preclusion of only a part of the claim, the Claimant is deemed to have withdrawn that part of the claim and to have discontinued that part of the proceeding, with prejudice. The tribunal shall acknowledge the discontinuance of that part of the claim in an order, and shall not proceed with that part of the claim.
7. If the relevant authorities of the Parties do not make a joint determination under paragraph (4)(ii), and neither Party has requested the establishment of an arbitral panel under paragraph (4)(iv), the tribunal may make the decision, provided that:
  - i. the Party of the Investor, in addition to the disputing parties, may make oral or written submissions to the tribunal on the matter of whether, and to what extent, the paragraph asserted serves as a valid defence to the claim before the tribunal addresses this issue. Unless it makes such submission, the Party of the Investor shall be presumed, for the purposes of the arbitration, to adopt a position on the application of the paragraph asserted that is not inconsistent with the position of the Respondent; and
  - ii. the tribunal shall draw no inference regarding the application of the paragraph asserted from the fact that the relevant authorities of the Parties have not made a joint determination referred to in paragraph 4(ii).
8. If the Respondent does not elect to invoke the procedures under paragraph (2), it is not prevented from advancing any arguments before the tribunal that the measure is covered by paragraph (1), or by any other exclusion or exception set forth in this

Agreement (including the Annexes to this Agreement). The tribunal shall draw no inferences regarding the applicability of paragraph (1), or any other exception or exclusion, from the fact that the Respondent did not invoke the procedures of paragraph (2).

### **Adoption procedure**

Deliberations about the content of the Draft Provisions are intricately tied to the procedure UNCITRAL will ultimately employ to officially adopt these provisions. A carve-out would modify the scope of consent to arbitration, which reflects the intentions of states as expressed in the regional and bilateral investment treaties to which they are parties. Likewise, procedural filters would introduce new mechanisms for state parties to an investment treaty to resolve questions about whether a measure falls within the carveout. These considerations necessitate the reform instrument to be adopted as part of the core provisions of the multilateral instrument to implement reforms, capable of amending investment treaties in force between the parties to the multilateral treaty once ratified. It is also important to consider the relationship with other provisions, for example on damages and third-party funding.