# ASSESSING THE EFFECTS OF 'SUSTAINABLE DEVELOPMENT' PROVISIONS IN BILATERAL INVESTMENT TREATIES

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**CONTENTS**

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## LIST OF ABBREVIATIONS

| | |
|---|---|
| **ACIA** | ASEAN Comprehensive Investment Agreement |
| **ARSIWA** | Draft Articles on the Responsibility of States for Internationally Wrongful Acts |
| **ASEAN** | Association of Southeast Asian Nations |
| **BIT** | Bilateral Investment Treaty |
| **BLEU** | Belgium-Luxembourg Economic Union |
| **CCIA** | Revised Investment Agreement for the Common Market for Eastern and South Africa |
| **CFIA** | Cooperation and Facilitation Investment Agreement |
| **CIL** | Customary International Law |
| **COMESA** | Common Market for Eastern and South Africa |
| **CSR** | Corporate Social Responsibility |
| **FET** | Fair and Equitable Treatment |
| **FIPA/IPA** | Foreign Investment Protection Agreement/Investment Protection Agreement |
| **FTA** | Free Trade Agreement |
| **GATT** | General Agreement on Tariffs and Trade |
| **GATS** | General Agreement on Trade in Services |
| **HR** | Human Rights |
| **ICCPR** | International Covenant on Civil and Political Rights |
| **IIA** | International Investment Agreement |
| **ILO** | International Labour Organisation |
| **ISDS** | Investor-State Dispute Settlement |
| **MEA** | Multilateral Environmental Agreement |
| **MST** | Minimum Standard of Treatment |
| **MFN** | Most Favoured Nation |
| **NAFTA** | North American Free Trade Agreement |
| **NPM** | Non-Precluded Measures |
| **NT** | National Treatment |

| | |
|---|---|
| **OECD** | Organisation for Economic Co-operation and Development |
| **RC** | Recognition and Commitment |
| **REIO** | Regional Economic Integration Organisation |
| **SDP** | Sustainable Development Provision |
| **TIP** | Treaties with Investment Provisions |
| **UN** | United Nations |
| **UNCTAD** | United Nations Conference on Trade and Development |
| **UNESCAP** | United Nations Economic and Social Commission for Asia and the Pacific |
| **UNFCCC** | United Nations Framework Convention on Climate Change |
| **VCLT** | Vienna Convention on the Law of Treaties |

## EXECUTIVE SUMMARY

1. This Report maps the legal and practical implications of including sustainable development-oriented provisions ('SDPs') in bilateral investment treaties ('BITs') and provides recommendations on potential drafting approaches that Czechia may take in its revised or newly concluded BITs with third, non-European Union ('EU') countries.

2. Three broad categories of SDPs are examined in particular. First, are provisions that seek to protect the host state's space to regulate for public policy objectives, including for sustainable development objectives. Such provisions include general exception clauses and right to regulate clauses. Second, are provisions that introduce clarifications to investment protection obligations which could exclude regulatory measures relating to sustainable development objectives from the scope of the treaty obligation in each case (herein broadly referred to as 'carve-outs'). Third, are provisions that include hortatory, or 'soft law', norms related to sustainable development, such as clauses that provide for the voluntary adoption of standards of Corporate Social Responsibility, among others.

3. Our view on the present legal and practical implications of the above broad categories of sustainable development-oriented provisions is as follows:

4. Firstly, the use of specific carve-outs to the standards of protection (with the most widely practised example being the carve-out to the protection against indirect expropriation) seems to be effective, albeit its scope is naturally limited to the standard it addresses. This feature has resulted in a drawback in practice, namely, it being used for an *argumentum e contrario* reasoning with regard to other standards that do not contain a similar specific carve-out.[1]

5. Secondly, reliance on general exception clauses has so far not been particularly effective in providing an adequate safeguard for host states, although we note that the number of cases directly dealing with a general exception clause is still rather small.

6. Further to this, although newer generation treaties often include a standalone clause referring to the right to regulate, it is at this stage unclear whether such clauses will effectively exclude liability in investor-state dispute settlement ('ISDS'). At present, academic commentary and arbitral practice suggest that such clauses may be seen as a norm that merely affirms the host state's right to regulate.

7. Thirdly, SDPs that make reference to the contracting parties' commitment to sustainable development goals and international legal obligations may be of some relevance as a safeguard against the host state's liability in ISDS, by forming part of the treaty's context

[1] This will be discussed in detail in Section I. An emblematic recent case in this regard is *Eco Oro Minerals Corp*. *v Republic of Colombia*, ICSID Case No. ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum (9 September 2021) (*'Eco Oro'*).

during the process of treaty interpretation. However, such SDPs may not be sufficient to reliably exclude any liability to pay compensation in all instances.[2]

8. In accordance with these observations, we set out three principal recommendations on the drafting of new or reformed BITs which Czechia may wish to consider. In our view, recommendations 1 and 2 are of a higher level of priority compared to recommendation 3.

**RECOMMENDATION 1: CLARIFICATION OF PRIMARY TREATY OBLIGATIONS THROUGH THE USE OF QUALIFICATIONS AND EXPLICIT CARVE-OUTS**

9. Czechia may consider clarifying the scope and content of each investment protection standard through the use of qualifications or carve-outs. An example may be taken from contemporary approaches to the drafting of the protection from indirect expropriation, where the treaty obligation is often accompanied with interpretative guidance providing that certain types of regulatory measures are excluded from the scope of 'indirect expropriation'.[3] Treaties could clarify that under certain circumstances a measure does not violate an investment protection standard and thus does not give rise to a duty to pay compensation. The exact set of circumstances might vary depending on the investment protection standard concerned but could include criteria such as due process, non-discrimination, a public policy objective and proportionality. Czechia could also consider defining these criteria in greater detail in order to delineate its margin of discretion as a regulating host state and to provide further guidance to tribunals that the host state's international sustainable development obligations should be taken into account when assessing the application of these investment protection standards.[4]

10. It may also be possible to generalise this drafting practice to the other investment protections typically found in an IIA. In our view, the use of carve-outs and qualifications have the potential to maximise the predictability of arbitral outcomes and to be effective in safeguarding the host state's regulatory space, while affording a reasonable standard of protection to investors.[5]

**RECOMMENDATION 2: DRAFTING GENERAL EXCEPTION CLAUSES AND RIGHT TO REGULATE CLAUSES IN A MORE DETAILED MANNER**

11. Czechia may also consider drafting general exception clauses and right to regulate clauses in greater detail. Our review of current arbitral practice indicates that a potential drawback of existing general exception clauses is that they typically do not spell out their relationship to:

[2] This will be discussed in detail in Sections V, VI and VII of this Report.

[3] See, for example, Annex 811 to the Canada-Colombia FTA (2011); Section I of this Report.

[4] Sections I and II of this Report.

[5] Sections I and II of this Report.

(a) the IIA's other standards of protection;
(b) any existing specific carve-outs from those standards; and
(c) other defences at general international law, such as the police powers doctrine.

In addition, general exception clauses do not clearly spell out the consequences of their application, thus leaving such matters open to tribunals' interpretation.

12. Such omissions can lead to uncertain and unintended practical outcomes, whereby states may be found liable to pay compensation notwithstanding the presence of a general exception clause in the IIA. We would therefore recommend that language could be added to general exception clauses in future treaties clarifying the above relationships and consequences. Without such clarifications, states expose themselves to arbitrators' varying and uncertain categorisation and interpretation of general exception clauses.[6]

**RECOMMENDATION 3: INCLUSION OF CLAUSES THAT CONTAIN COMMITMENTS TO NATIONAL AND INTERNATIONAL LEGAL TEXTS CONCERNING SUSTAINABLE DEVELOPMENT**

13. It is still unclear what the impact of inserting clauses that contain declaratory or hortatory commitments, among others, to not lower sustainable development standards or to implement national laws or international agreements related to sustainable development is.

14. There are several possible applications for such clauses. Firstly, they may inform the scope of application of the standards of investment protection. Additionally, they could also possibly serve as defences. Lastly, they could also potentially provide a basis for counterclaims by the host state during ISDS.

15. We take the view that, from the perspective of a host state, the insertion of such clauses is unlikely to pose significant legal risk. However, we believe that states should be wary of relying on such clauses alone to protect their right to regulate for sustainable development purposes, as states may still be found liable by an arbitral tribunal for the breach of a protection standard.[7]

16. Our recommendations are subject to the following caveats. Firstly, even the most specific and carefully drafted treaty language cannot address all possible eventualities. Further to this, subsequent treaty amendment can sometimes be difficult to achieve in practice. Against this background, it could be helpful for states when drafting a new treaty to recall their power to issue authoritative interpretations in accordance with Art 31(3)(a) of the VCLT. In this vein, the Canada Model FIPA (2021) provides in Art 32(2) that the contracting parties

[6] This will be discussed in detail in Sections III and IV of this Report.

[7] Sections V and VI of this Report.

'may agree to adopt an interpretation of this Agreement [which] shall be binding on a Tribunal'.

17. Secondly, we note that the presence of the Most Favoured Nation ('MFN') clause might, depending on the clause's wording and interpretation, undo innovations made in a new treaty to afford greater regulatory space to the host state, by allowing investors to import provisions from older/existing treaties. In this situation, if an MFN clause is to be included in the treaty, it may be helpful to introduce a clarification as to its application. A possible clarification may be phrased as:

> 'The Most Favoured Nation clause in this Treaty cannot be used to circumvent the exclusions and exceptions that limit the scope of its application by pointing to the absence of such exceptions in any other treaty to which a Member State is a party.'[8]

[8] Wolfgang Alschner, *Investment Arbitration and State-Driven Reform: New Treaties, Old Outcomes* (Oxford University Press, 2022), 150 (Table 4.3).

# INTRODUCTION

## A. Scope

18. This Report maps the legal and practical implications of including operative sustainable development-oriented provisions ('SDPs') in bilateral investment treaties ('BITs') and provides recommendations on potential drafting approaches that Czechia may take in its revised or newly concluded BITs with third, non-European Union ('EU') countries.

19. For clarity, the Report does not address preambular references and regional economic integration organisation ('REIO') clauses in IIAs that may refer to sustainable development or the pursuance of sustainable development objectives and other regulatory objectives.

## B. Two caveats

20. Our analysis and recommendations in this Report are subject to two caveats.

21. Firstly, even the most specific and carefully drafted treaty language cannot address all possible eventualities. Further to this, subsequent treaty amendment can sometimes be difficult to achieve in practice. Against this background, it could be helpful for states when drafting a new IIA to recall their power to issue authoritative interpretations in accordance with Art 31(3)(a) of the VCLT. In this vein, the Canada Model FIPA (2021) provides in Art 32(2) that the contracting parties 'may agree to adopt an interpretation of this Agreement [which] shall be binding on a Tribunal'.

22. Secondly, we note that the presence of the Most Favoured Nation ('MFN') clause might, depending on the clause's wording and interpretation, undo any innovations made in a new treaty to afford greater regulatory space, by allowing investors to import provisions from older/existing IIAs. In this situation, if an MFN clause is to be included in the treaty, it may be helpful to introduce a clarification as to its application. A possible clarification may be phrased as:

> 'The Most Favoured Nation clause in this Treaty cannot be used to circumvent the exclusions and exceptions that limit the scope of its application by pointing to the absence of such exceptions in any other treaty to which a Member State is a party.'[9]

[9] Wolfgang Alschner, *Investment Arbitration and State-Driven Reform: New Treaties, Old Outcomes* (Oxford University Press, 2022), 150 (Table 4.3).

## C. Typology development and organisation of the Report

23. To develop a typology of SDPs, we conducted a survey of the IIAs (both BITs and treaties with investment provisions ('TIPs')) available on the UNCTAD Investment Policy Hub IIA Navigator.[10] The IIA Navigator was selected as the database of choice due to its comprehensive content and its mapping functionality. As part of UNCTAD's IIA Mapping Project,[11] a large number of the IIAs available on the database have had similar or common elements mapped, allowing us to filter for these IIAs in particular.

24. Our process in developing a typology followed several steps.

25. First, we looked at the list of Model BITs included in the IIA Navigator to identify those models containing SDPs. In doing so, we prioritised more modern IIAs (between 2010 and 2022) and IIAs of EU member states (e.g. Belgium-Luxembourg ('BLEU') Model BIT (2019), Italy Model BIT (2022)).

26. Second, we expanded our search to concluded IIAs (signed or in force at the time of writing) going back to 2010. These IIAs were in turn filtered using the mapping functionality available on the Mapping Project database of the IIA Navigator. The identified results were filtered for references to:

    - 'health and environment (any mention in the text, excluding preamble)';
    - 'labour standards (any mention in the text, excluding preamble)';
    - 'right to regulate (any mention in the text, excluding preamble)';
    - 'corporate social responsibility (any mention in the text, excluding preamble)';
    - 'expropriation (carve out for regulatory measures)';
    - 'not lowering of standards (any mention in the text, excluding preamble)'; and
    - 'general public policy exception (public health and the environment)'.

    In the course of this process, we also identified what we call 'novel' SDPs, such as clauses on gender and trade, which do not appear to be widely used in existing IIAs. We have taken note of these provisions and have included them in Section VII for Czechia's consideration.

27. Third, all results thus obtained for each kind of SDP were then categorised according to their drafting style. In so doing, this Report further incorporates the comparative and

[10] UNCTAD, IIA Navigator <https://investmentpolicy.unctad.org/international-investment-agreements> accessed 21 January 2023.

[11] See UNCTAD, 'Mapping Project Description and Methodology', UNCTAD Investment Policy Hub <https://investmentpolicy.unctad.org/uploaded-files/document/Mapping%20Project%20Description%20and%20Methodology.pdf> accessed 21 January 2023.

empirical insights from prior typology exercises conducted in the context of ASEAN BITs,[12] as well as sample IIAs and BITs of least developed, land-locked and less developed countries.[13] In view of the extensive literature on the topic, our analysis of Fair and Equitable Treatment clauses in Section II is also largely based on secondary research.

28. The coding guide followed for the above exercise is available as **Appendix 1** to this Report. Our full dataset of IIAs is available as **Appendix 2** to this Report.

29. Based on the above methodology, this Report identifies seven types of SDPs, namely:

(a) Carve-outs from investment protections (Section I);
(b) Qualifications to standards of investment protections (Section II);
(c) General exception clauses (Section III);
(d) Right to regulate clauses (Section IV);
(e) Clauses addressing national levels of sustainable development-oriented protection (Section V);
(f) Clauses addressing international agreements and standards related to sustainable development (Section VI); and
(g) Novel clauses (Section VII).

Types (a) to (d) are typically included in treaties for the purposes of excluding or reducing the host state's liability in ISDS. Types (e) to (g) are typically hortatory, or otherwise 'soft law', norms and typically do not directly operate to exclude the host state's liability in ISDS. They may nonetheless guide the arbitral tribunal's interpretation of other 'hard' treaty provisions, as part of the 'context' of the relevant IIA, within the meaning of Art 31(1) of the Vienna Convention on the Law of Treaties ('VCLT').[14]

30. Sections I through IV of the Report analyse SDP types (a) to (d) respectively.

31. For the purposes of this Report, carve-outs from investment protections are defined as clarificatory 'provisions that remove certain sectors or measures from the scope of coverage of the IIA, or which prevent ISDS claims in relation to certain sectors or measures'.[15] For example, the carve-out to indirect expropriation typically states that the adoption of a covered regulatory measure 'does not constitute indirect expropriation'.

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[12] Mark McLaughlin, 'Mapping Sustainable Development in Investment Treaties' (2022) 17 *Asian Journal of WTO and International Health Law and Policy* 115.

[13] Manjiao Chi, *Sustainable Development Provisions in Investment Treaties* (2018) <https://artnet.unescap.org/publications/books-reports/sustainable-development-provisions-investment-treaties> accessed 10 February 2023.

[14] Vienna Convention on the Law of Treaties (adopted 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331 ('VCLT').

[15] Joshua Paine and Elizabeth Sheargold, 'A Climate Change Carve-Out for Investment Treaties' (2023) 1 *Journal of International Economic Law* 7 ('Paine and Sheargold').

32. Qualifications in the standards of investment protection are conceptually similar to carve-outs in the sense that both types of clauses serve to 'clarify the scope of an obligation within the context of the clause itself'.[16] However, rather than directly excluding certain covered regulatory measures from the rule, qualifications are usually 'open-textured norms that permit consideration of all relevant circumstances in determining whether the norm has been complied with'.[17] One example of a qualification to an investment protection is the qualifier that the national treatment ('NT') obligation of states applies only with respect to investors or investments in 'like circumstances' and that determining the likeness of circumstances is a determination dependent on the totality of circumstances related to the investor or the investment.[18]

33. General exception clauses differ from carve-outs and qualifications to investment protections in the way they operate. General exception clauses seek to justify conduct that may otherwise be regarded as a breach of another treaty obligation.[19] By contrast, where a regulatory measure falls within a carve-out or a qualification to an investment protection, then there is no question of even a *prima facie* breach of the relevant investment protection obligation, since the qualification is an integral part of the scope of the substantive obligation itself.[20] In this regard, Henckels' description of a general exception clause is highly illuminating and merits reproduction in full:

> 'General exceptions typically employ language such as "nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures …", then impose some restrictions on the design of the measure by specifying a required nexus between the measure and the permissible objective or objectives, such as "necessary to", "related to", or "designed and applied" to further the relevant objective. General exceptions also typically contain a proviso (chapeau) that controls the application of measures, requiring that they are applied in a manner that is even-handed and does not subvert the substantive disciplines in the relevant agreement.'[21]

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[16] Caroline Henckels, 'Permission to Act: The Legal Character of General and Security Exceptions in Investment and Trade Law' (2020) 69 *International & Comparative Law Quarterly* 557, 560 ('Henckels').

[17] Ibid.

[18] Another way to conceive of the difference between carve-outs and qualifications was proposed in Anne van Aaken, 'Smart Flexibility Clauses in International Investment Treaties and Sustainable Development' (2015) 14 *Journal of World Investment and Trade* 827, 832-833. van Aaken suggests that carve-outs are an example of 'explicit flexibility norms' whereas qualifications are an example of flexibility through 'indeterminate norms'.

[19] We develop our reasoning in relation to general exception clauses in greater detail in Section III, et seq.

[20] Claire Oakes Finkelstein, 'When the Rule Swallows the Exception' in L Meyer (ed), *Rules and Reasoning – Essays in Honor of Fred Schauer* (Hart, 1999) 147, 150, observes that 'an exception 'stands outside the rule it qualifies', that is, 'a qualification included in a statement of the rule is not properly speaking an exception to it'.

[21] Henckels (n. 16), 560.

34. General exception clauses are thus aimed to safeguard the host states' right to regulate, yet, in doing so, they must be further distinguished from generic right to regulate clauses. The latter do not operate directly on standards of protection but rather aim to provide an interpretive framework for tribunals to use when interpreting and applying said standards of protection. Moreover, whereas general exception clauses typically enumerate a list of permitted exceptions, right to regulate clauses have a more general scope. They typically state that '[n]othing in this agreement shall prejudice the contracting states' right to regulate' (which is sometimes also expressed as an 'inherent' right to regulate).[22] Such clauses usually also seek to ensure that no provision of the IIA should 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'.[23]

35. After dealing with the above-mentioned clauses that are intended to directly exclude states' liability, the Report will examine clauses that might have an indirect effect on states' liability. These include clauses that address national levels of sustainable development standards (Section V) and clauses that recognise, commit to, or implement international agreements relating to sustainable development (Section VI). A brief look will then be taken at novel clauses that appear only in a handful of recent IIAs and do not squarely fall in any other category (Section VII). An example of a novel clause is one that seeks to ensure that contracting states promote gender equality in economic development, including in international investment.[24]

[22] See e.g.: CETA art 8.9; Indonesia-Switzerland BIT (2022) art 12; Colombia-Spain BIT (2021) art 14; Hungary-Kyrgyzstan BIT (2020) art 3; Hungary-Cabo Verde BIT (2019) art 3; Belarus-Hungary (2019) art 3; EU-Singapore IPA (2018) art 2.2; Lithuania-Turkey BIT (2018) art 3; Argentina-Chile FTA (2017) arts 8.2(4), 8.4.

[23] Ibid.

[24] See the Netherlands Model BIT (2019) art 6(3).

## I. CARVE-OUT FROM INVESTMENT PROTECTION STANDARDS

**BOX 1: INDIRECT EXPROPRIATION CLAUSE IN THE ITALY MODEL BIT (2022)**

For greater certainty, **[**except in the rare circumstance**]**[Note 1] **[**when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive**]**[Note 2], non-discriminatory measures by a Party that are **[**designed and applied to protect legitimate policy objectives**]**[Note 3], such as the protection of public health, social services, public education, safety, environment including climate change, public morals, social or consumer protection, privacy and data protection, or the promotion and protection of cultural diversity do not constitute indirect expropriations.

Source: Italy Model BIT (2022) Annex II [3].

### A. Definition of a carve-out

36. This Report defines carve-outs as 'provisions that remove certain sectors or measures from the scope of coverage of the IIA, or which prevent ISDS claims in relation to certain sectors or measures'.[25] Carve-outs thus exclude liability in ISDS by limiting the scope of investment protection.

37. In modern IIA practice, a prominent carve-out in relation to sustainable development objectives is often found in the protection against indirect expropriation (although, we note that it is in principle possible to create carve-outs in relation to other standards of investment protection too). If a carve-out to indirect expropriation applies, then regulatory measures that are covered by the carve-out 'do not constitute indirect expropriations'.[26] This has practical significance because expropriations are compensable under international law, even when made in a non-discriminatory and otherwise legitimate manner.[27]

38. Arbitral tribunals have treated carve-outs from indirect expropriation in IIAs as a 'codification' of the police powers doctrine found in customary international law ('CIL'). As noted in *Philip Morris v Uruguay*,[28] '[carve-outs], whether or not introduced *ex abundanti cautela,* reflect

[25] Paine and Sheargold (n. 15), 7.

[26] Christian Riffel, 'Indirect Expropriation and the Protection of Public Interests' (2022) 71 *International & Comparative Law Quarterly* 945, 950 ('Riffel').

[27] See e.g. *Santa Elena v Costa Rica,* ICSID Case No ARB/96/1, Award (17 February 2000), [72], noting that 'where property is expropriated, even for environmental purposes … the state's obligation to pay compensation remains' ('*Santa Elena*').

[28] *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award (8 July 2016), [301] ('*Philip Morris'*).

the position under general international law'. This analysis was later affirmed in *Eco Oro*, where the arbitral tribunal noted that:

> '[a carve-out] does not expressly exclude the application of general international law when seeking to understand and apply it. Indeed, parties to a Treaty cannot contract out of the system of international law'.[29]

39. One possible issue facing the use of carve-outs is that the definitional nature of carve-outs may create friction with other treaty provisions addressing the legality of expropriatory conduct. As Riffel observes, the language of the carve-out tends to overlap with the definition of a lawful expropriation.[30] For example, in the USMCA (2018):

Art 14.8.1 states,

> 'No Party shall expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization (expropriation), except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation in accordance with paragraphs 2, 3, and 4; and (d) in accordance with due process of law';

Art 14.8.5 states,

> 'For greater certainty, whether an action or series of actions by a Party constitutes an expropriation shall be determined in accordance with paragraph 1 of this Article and Annex 14-B (Expropriation)'; and

Annex 14-B states,

> 'Non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations, except in rare circumstances.'

40. As seen above, Annex 14-B and Art 14.8.1 duplicate the requirements of 'public purpose' and 'non-discrimination', but for different ends. In Annex 14-B, this analysis is directed at determining whether there has been an indirect expropriation. In Art 14.8.1, these requirements are directed at determining the legality of expropriatory conduct in general (i.e., including direct and indirect expropriation). In such a case, it is conceivable that an arbitral tribunal would face difficulty in distinguishing lawful expropriation from unlawful direct or indirect takings constituting expropriations and from situations where there is no indirect expropriation at all.

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[29] *Eco Oro,* [627].

[30] Riffel (n. 26), 951 et seq.

41. This ambiguity can be resolved by treaty language explaining the proper approach towards analysing the carve-out. It is necessary to first determine the existence of any indirect expropriation, since this would determine the lawfulness of the host state's conduct. Arguably, Art 14.8.5. USMCA would serve this purpose. If the investor's claim is one of indirect expropriation, the carve-out should be analysed before the general provisions on lawful expropriation. If a tribunal determines that an indirect expropriation has taken place, then the tribunal would need to assess the legality of the expropriation. If, by contrast, the tribunal determines that the challenged action or measure fell within the scope of the carve-out and as a result did not constitute an indirect expropriation, then this would not incur the host state's international responsibility.

### B. Variations in the content or level of legal obligation

42. Whereas some treaties include indirect expropriation carve-outs within the treaty text itself,[31] in other treaties such carve-outs are contained in an annex.[32]

43. **Note 1 – 'Except in the rare circumstance'/'Except in rare circumstances':** Indirect expropriation carve-outs often include provisos for their successful invocation. One such proviso is that the carve-out would normally apply except in the presence of rare circumstance(s). Two variations of this proviso have been observed.

44. One variation can be seen in the Italy Model BIT (2022), where the indirect expropriation carve-out is framed in the following terms:

> 'For greater certainty, **except in the rare circumstance** when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, …'[33] [emphasis added]

Importantly, this phrase clarifies that there is only one 'rare circumstance' in which the carve-out will not apply, which is 'when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive'.

45. By contrast, the second variation of the provision can be seen in the texts of the US Model BIT (2012) and the Austria-Kyrgyzstan BIT (2016), which indicate that there are potentially multiple 'rare circumstances' in which the carve-out may not apply. For example, the Austria-Kyrgyzstan BIT (2016) states that:

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[31] See e.g. Slovakia Model BIT (2019) art 7(6).

[32] See e.g. Italy Model BIT (2022) Annex 2; ASEAN Comprehensive Investment Agreement ('ACIA') (2009) Annex 2; US Model BIT (2012) Annex B.

[33] Italy Model BIT (2022) Annex 2 [3].

> '**[E]xcept in rare circumstances, such as** when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith.'[34]

This change can be significant because recent arbitral practice has noted that where such language is used, the test of 'so severe in light of its purpose that it appears manifestly excessive' is to be treated as one example of a 'rare circumstance', rather than as being exhaustive of the meaning of that phrase.[35]

46. The practical effect of the phrase 'rare circumstance' or 'rare circumstances' is not immediately clear. Arguably, the intended impact might have been to adopt the qualification, introduced in *Saluka Investments B.V. v The Czech Republic,* that the police powers doctrine only applies to the exercise of 'normal' regulatory conduct.[36] Still, recent arbitral practice and academic commentary have discussed two possible interpretations of the phrase. It should be noted, however, that these two potential interpretations are not mutually exclusive.

47. One interpretation, proposed by academic commentary, is procedural. It distinguishes between ordinary and exceptional regulatory conduct and creates a rebuttable presumption that a regulatory measure has been taken in the course of ordinary regulatory conduct. The burden of proof is then placed on the party seeking relief to justify the exceptional or rare nature of the regulatory conduct. Importantly, this interpretation does not affect the definition of indirect expropriation but only shifts the burden of proof.[37]

48. Notably, this rebuttable presumption of normalcy should be distinguished from a presumption that the regulatory measure was undertaken in good faith. As pointed out by the tribunal in *Bear Creek,* 'there is no part of the applicable legal standard that requires presuming that Respondent acted in good faith'.[38] In that tribunal's view, the phrase is rather: 'intended to reflect that ordinary regulatory measures will not lead to international liability, except in rare circumstances. "Rare" is commonly defined as something "not occurring very often"'.[39]

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[34] US Model BIT (2012) Annex B [4].

[35] See generally the analysis in *Eco Oro* [643].

[36] *Saluka Investments B.V. v The Czech Republic,* UNCITRAL, Partial Award (17 March 2007) (*'Saluka'*), [255], noting that 'states are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare'.

[37] Riffel (n. 26); Suzy Nikiema, 'Indirect Expropriation' (2006) IISD Best Practices Series, 13 <https://www.iisd.org/system/files/publications/best_practice_indirect_expropriation.pdf> accessed 31 March 2023 ('Nikiema').

[38] *Bear Creek Mining Corporation v Republic of Peru*, ICSID Case No. ARB/14/21, Award (30 November 2017), [346] (*'Bear Creek'*).

[39] Ibid.

49. The second possible interpretation is substantive. It denotes a high bar for exclusion from the carve-out. The arbitral tribunal in *Eco Oro* took this approach, observing that:

> '... there must be a very significant aggravating element or factor in the conduct of the State and not just a bureaucratic muddle or State inefficiency before it would be deemed to be a "rare circumstance".'[40]

50. The decision in *Eco Oro,* however, demonstrates why the addition of 'except in rare circumstances' may be somewhat superfluous. In that case*,* a mining concession granted to the investor was withdrawn as it overlapped with a *páramo* ecosystem. Though the Colombian government had at times acted inconsistently with its obligation to protect the *páramo* ecosystem, the arbitral tribunal found that it was nevertheless acting in *bona fide*. The tribunal in reaching its conclusion did not seem to have interpreted the 'rar[ity]' of the circumstances of the regulatory taking in isolation of the other terms of the carve-out.[41] Rather, it based its decision on the finding that the government's measures were not so severe in light of their purpose as to be in bad faith.[42]

51. Lastly, another drafting approach observed completely eschews the use of the 'except in the rare circumstance' or 'except in rare circumstances' proviso. This drafting approach is adopted in treaties such as the Canada Model FIPA (2021),[43] the Colombia Model BIT (2017),[44] the Cambodia-Turkey BIT (2018),[45] the COMESA CCIA (2007),[46] and ACIA (2009).[47] For instance, Art 9(3) of the Canada Model FIPA (2021) uses the following formulation:

> 'A non-discriminatory measure of a Party that is adopted and maintained in good faith to protect legitimate public welfare objectives, such as health, safety and the environment, does not constitute indirect expropriation, even if it has an effect equivalent to direct expropriation.'

This drafting option leans more heavily in favour of host state protection over investor protection. One author opines that such a drafting practice creates a 'definitive, impenetrable barrier between indirect expropriation and certain types of state regulation'.[48]

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[40] *Eco Oro* [643].

[41] *Eco Oro* [643].

[42] *Eco Oro* [698].

[43] Canada Model FIPA (2021) art 9(3).

[44] Colombia Model BIT (2017) art [##] on expropriation.

[45] Cambodia-Turkey BIT (2018) art 5(2).

[46] COMESA CCIA (2007) art 20(8).

[47] ACIA (2009) Annex II [4].

[48] Nikiema (n. 37), 14.

52. **Note 2A – '…when the impact of a measure or series of measures is so severe in light of its purpose…':** One major point of divergence in the treaties examined is the standard required to invoke the carve-out. While all treaties surveyed impose a requirement that covered measures must be 'non-discriminatory', some treaties also included the requirement that covered measures must not be 'so severe in the light of their purpose that they are manifestly excessive'. This is typically expressed as a further elaboration on the term 'rare circumstance': a measure will be a 'rare circumstance' if this test is met. For example, the standard contained in the Italy Model BIT (2022) is phrased in the following terms:

> 'For greater certainty, except in the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, …'[49]

53. Arbitral tribunals have not set out a definitive approach in relation to the test of 'when the impact of a measure or series of measures is so severe in light of its purpose'. In *Eco Oro,* the tribunal indicated that this phrase did not require a determination of bad faith or disproportionality, and that adoption of a measure in good faith would likely not place it into the rare circumstance proviso.[50] However, the tribunal held that the phrase is multifactorial in nature. In analysing whether the impugned regulatory conduct was, in fact, 'so severe in light of its purpose that it appear[ed] to be in bad faith', the tribunal considered the following factors: the design and application of the measures,[51] whether the regulatory measures were proportional to their purpose,[52] whether the regulatory conduct complied with national and international obligations,[53] and whether the regulatory conduct amounted to interference with distinct, reasonable, investment-backed expectations (a criterion taken from Annex 811(2)(a)(ii) of the Canada-Colombia FTA, which was the treaty applicable to that dispute).[54]

54. **Note 2B – 'manifestly excessive':** To our knowledge, the phrase 'manifestly excessive' has not yet been interpreted by an arbitral tribunal in the context of an indirect expropriation carve-out. Moreover, existing arbitral practice and academic authority do not provide clear guidance as to how the phrase will be interpreted in the future. This is the case in particular with the term 'manifestly', as it is not clear how much of a margin of appreciation it actually accords to the host state, and correspondingly, how broad of a standard of review it allows

[49] Italy Model BIT (2022) Annex II [3].

[50] *Eco Oro* [643].

[51] *Eco Oro* [644]-[645].

[52] *Eco Oro* [646]-[656].

[53] *Eco Oro* [657]-[680].

[54] *Eco Oro* [681]-[694].

tribunals. One can in fact observe different interpretations of the term in different contexts where it is applicable.

55. For example, in a context unrelated to indirect expropriation, the term 'manifest' appears in Art 57 of the ICSID Convention,[55] but has yet to receive a clear definition. Art 57 provides for disqualification of an arbitrator on account of a 'manifest' lack of the qualities required by the ICSID Convention. Several cases have defined the term 'manifest' as being so 'evident' or 'obvious' that it could be 'discerned with little effort and without deeper analysis.'[56] In particular, the appearance of dependence or bias in the eyes of a reasonable third party alone, without actual proof of dependence or bias, would be sufficient to demonstrate a 'manifest' lack of the requisite qualities.[57] However, it can be queried whether the same standard would be appropriate in the context of indirect expropriation – especially in view of Czechia's desire to provide balanced protection in its IIAs.

56. On the flipside, the term 'manifest' in the context of the phrase 'so severe in light of its purpose that it appears manifestly excessive' may be taken to have the combined effect of proportionality-style analysis. However, we recall at the outset that the *Eco Oro* tribunal equivocated as to the relevance of proportionality analysis – at one point holding that a finding of disproportionality would not disqualify the application of the carve-out, while nonetheless continuing to apply a proportionality analysis.[58]

57. Moreover, even if one is to entertain the idea of proportionality analysis, considerable uncertainty may remain. In particular, as commentators have noted, it is still not entirely clear in deploying proportionality analysis 'whether adjudicators should employ a necessity test (whether the impugned measure involves the lowest possible burden on protected investments to achieve the relevant policy aim) or some form of cost-benefit analysis, which, for example, asks if the impact on a claimant investor is "manifestly excessive" in light of the regulatory aim pursued.'[59] In other words, rather than providing concrete answers to the question of when a conduct is manifestly excessive, proportionality analysis may result in

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[55] Convention on the Settlement of Investment Disputes between States and Nationals of Other States (opened for signature 18 March 1965, entered int force 14 October 1966) 575 UNTS 159 ('ICSID Convention').

[56] *Caratube International Oil Company LLP and Devincci Salah Hourani v Republic of Kazakhstan*, ICSID Case No. ARB/13/13, Decision on the Proposal for Disqualification of Mr. Bruno Boesch (20 March 2014) ('*Caratube'),* [55]; *Blue Bank International & Trust (Barbados) Ltd. v Bolivarian Republic of Venezuela*, ICSID Case No. ARB 12/20, Award (26 April 2017), [61] ('*Blue Bank*').

[57] *Caratube* [57].

[58] See above, paragraph 53, *Eco Oro* [643]; c.f. *Eco Oro* [646].

[59] Joshua Paine, 'Autonomy to Set the Level of Regulatory Protection in International Investment Law' (2021) 70 *International & Comparative Law Quarterly* 697; citing Federico Ortino, 'Defining Indirect Expropriation: The Transatlantic Trade and Investment Partnership Approach and the (Elusive) Search for "Greater Certainty"' (2016) 43 *Legal Issues of Economic Integration* 351, 363; see also Jansen Calamita, 'The Principle of Proportionality and the Problem of Indeterminacy in International Investment Treaties' in Andrea Bjorklund (ed), *Yearbook of International Law & Policy* (Oxford University Press, 2014) 157.

the tribunal having to draw its own conclusions as to how the state's regulatory purpose and the regulatory measure undertaken should be balanced.

58. **Note 2C – 'good faith':** Other treaties do not use the standard of 'manifestly excessive'; instead opting to use the standard of 'good faith'. For instance, the indirect expropriation carve-out in the Austria-Kyrgyzstan BIT (2016) is expressed in the following terms:

> '[E]xcept in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith …'[60]

59. The standard of good faith has been broadly interpreted as a generalised prohibition on regulatory takings for a purpose that is collateral to a legitimate public policy objective. As noted by Sipiorski, the good faith standard is used to investigate whether a legitimate policy objective asserted by the host state in relation to a regulatory taking is nothing more than a 'cloak' for expropriatory conduct.[61]

60. Arbitral tribunals have consistently reiterated that the legitimate public purpose asserted pursuant to a host state's police powers must be held honestly, and that the regulatory taking cannot be for a collateral purpose. For example, in *Methanex,* the tribunal held that a ban on certain gasoline additives was not in fact an indirect expropriation. It based its reasoning on the fact that the 'policy was motivated by the honest belief, held in good faith and on reasonable scientific grounds' that the ban addressed a serious environmental issue.[62] Similarly, in *Eco Oro,* the arbitral tribunal ultimately held that the Colombian government's withdrawal of mining permits was not an indirect expropriation because it was a decision taken in good faith to protect the *páramo* ecosystem. It was based upon an environmental impact assessment and a constitutional court decision.[63]

61. Furthermore, under a good faith standard, any conduct inconsistent with the measure's alleged purpose must be of sufficient gravity before it can be demonstrated that the resultant regulatory taking was for a collateral purpose. On the facts of *Eco Oro*, and despite finding 'failings, at times significant failings, on the part of Colombian state organs and officials',[64] such as the failure to properly delimit the *páramo* area, the tribunal held that these

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[60] Austria-Kyrgyzstan BIT (2019) art 7(4).

[61] Emily Sipiorski, *Good Faith in International Investment Arbitration* (Oxford University Press, 2019), [8.21]; see also Ulf Linderfalk, 'Good Faith and the Exercise of Treaty-based Discretionary Powers', in Lorand Bartels and Federica Paddeu (eds), *Exceptions in International Law* (Oxford University Press, 2020), 271, for a conceptually similar definition of the 'good faith' standard as referring to an exercise of a treaty-based discretionary power for a particular purpose.

[62] *Methanex Corp v United States of America,* UNCITRAL, Final Award on Jurisdiction and Merits (3 August 2005), [105] ('*Methanex*').

[63] *Eco Oro* [636]-[637].

[64] *Eco Oro* [698].

bureaucratic shortcomings were not sufficient to demonstrate that the Colombian government had acted in bad faith.[65]

62. Thus, good faith appears to be a more predictable and balanced standard by providing a more concrete yardstick for adjudicating a state's actions. Overall, it seems to allow states sufficient regulatory freedom to act in response to pressing needs. The regulatory power of the state is balanced against the requirement that the state acts in good faith and not for a collateral purpose.

63. **Note 3 – 'designed and applied to protect legitimate policy objectives':** Some treaties require that a covered regulatory measure must be '*designed and applied* to protect legitimate policy objectives'.[66] There are minor variations to note in this respect: for instance, the phrase '*adopted and maintained* in good faith to protect legitimate public welfare objectives' is used in the Canada Model FIPA (2021);[67] whereas the Austria-Kyrgyzstan BIT (2019) uses the phrase '*adopted and applied*'.[68] To our knowledge, arbitral tribunals have not engaged with the differences between these different variations.

64. In *Eco Oro,* the tribunal stated that the standard of 'designed and applied' is closely connected with the listed factors to be used by tribunals in determining the existence of an indirect expropriation. To note, contemporary investment treaties, such as Annex 811(2)(a) of the Canada-Colombia FTA applicable in *Eco Oro*, typically define expropriation with relation to the following factors: (i) the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred; (ii) the extent to which the measure or series of measures interfere with distinct, reasonable investment-backed expectations; and (iii) the character of the measure or series of measures, in defining indirect expropriation.[69]

65. The tribunal stated that an analysis of limbs (ii) and (iii) of the aforesaid definition are closely connected with whether measures were 'designed and applied' for legitimate policy purposes. To quote the tribunal:

> 'An assessment of whether there has been interference *"with distinct, reasonable investment-backed measures"* and "*the character of the measure or series of measures"* (in Annex 811(2)(a)) can only take place with reference to whether those measures "*are designed and applied to protect legitimate welfare*

[65] *Eco Oro* [698]-[699].

[66] See e.g. Italy Model BIT (2022) Annex II [emphasis added].

[67] Canada Model FIPA (2021) [emphasis added].

[68] Austria-Kyrgyzstan BIT (2019) art 7(4).

[69] These factors are derived from the US decision of *Penn Central Transportation Co v New York City,* 438 US 104 (1978). Examples of treaties that use the *Penn Central* test include: the US Model BIT (2012) Annex B [4]; ACIA (2009) Annex 2 [3]; and CETA Annex 8-A [2].

> *objectives."* This is most obvious in connection to the "character" criterion but is also true of the "expectations" criterion, as investors must be taken to understand that States retain the power to regulate in the public interest.'[70] [emphases in original]

66. However, it is unclear whether that same reasoning would apply where the phrases 'adopted and applied' or 'adopted and maintained' are used instead.

67. The Oxford English Dictionary defines 'adopted' as '[t]o take up (a practice, habit, word, idea, etc.) from someone else; to embrace, espouse.'[71] In contrast, 'designed' is defined as '[t]o intend (a thing) to be or do something; to mean to serve some purpose or fulfil some plan'.[72] As the definitions of these terms suggest, 'designed' places an emphasis on the intentions of the party taking regulatory measures, which is otherwise absent in the word 'adopted'. Furthermore, the term 'designed' refers strictly to a state of mind; it does not refer to the enactment or application of any particular regulatory measure.

68. Similarly, the use of the term 'maintained' suggests a focus on continuing acts. 'Maintained' is defined as '[t]o keep up, preserve, cause to continue in being (a state of things, a condition, an activity, etc.)'.[73] In contrast, the term 'applied' is defined as '[c]hiefly of a physical force or influence: brought to bear, made effective; acting at a point or place.'[74] Treaties using the term 'maintained' may therefore suggest a greater emphasis on continuing acts of state regulation, as opposed to the mere act of applying or adopting certain regulatory measures.

69. It is also worth noting that some treaties provide examples of legitimate policy objectives that may be pursued by the state. For example, in the Italy Model BIT (2022), legitimate policy objectives include the:

> 'protection of public health, social services, public education, safety, environment including climate change, public morals, social or consumer protection, privacy and data protection, or the promotion and protection of cultural diversity.'[75]

70. Such specification clarifies what constitutes 'legitimate' policy objectives, thereby providing further guidance to arbitral tribunals. To that end, it may also serve to further strengthen a

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[70] *Eco Oro* [629].

[71] Oxford English Dictionary, 3rd edn (Oxford University Press, 2021), s.v. 'adopted' ('OED').

[72] OED, s.v. 'designed'.

[73] OED, s.v. 'maintained'.

[74] OED, s.v. 'applied'.

[75] Italy Model BIT (2022) Annex II [3].

state's argument that regulatory measures taken for such stated purposes are not indirect expropriations even when they cause harm to an investor or an investment.

### C. Assessment and drafting recommendations

71. We note at the outset that several tribunals have applied the police power doctrine (which is implied in treaty-based indirect expropriation carve-outs), even in the absence of a carve-out in the treaty, as forming part of general international law.[76] For that reason, the indirect expropriation carve-out may at first blush be considered redundant. However, exclusion of a carve-out poses two inherent risks to the host state.

72. The first risk is that, in the absence of a carve-out, tribunals may opt to apply the sole effects doctrine in determining the existence of an expropriation. The sole effects doctrine is an analytical approach towards determining the existence of an indirect expropriation that focuses solely on whether a regulatory measure had an expropriatory effect on the investment.[77] For example, from the reasoning used in *Eco Oro*, it is not clear whether the tribunal would have reached the same conclusion in the absence of the carve-out in Annex 811(2)(b) of the Canada-Colombia FTA. Indeed, in what looks like an application of the sole effects doctrine, it appears that the tribunal would have been open to the idea that Colombia's actions were expropriatory given the substantial deprivation they caused to Eco Oro's investment.[78] The *Eco Oro* decision thus demonstrates that a well drafted carve-out can effectively exclude liability, even where the tribunal applies the sole effects doctrine.

73. The second risk is that tribunals may consider a general exception clause located elsewhere in the treaty as potentially overriding the police powers doctrine existing in general international law. This risk is exemplified in the approach taken by the tribunal in *Bear Creek* and will be developed further in Section III of this Report.

74. Given the above remarks, we therefore conclude that it is **advantageous** for Czechia to include a carve-out from indirect expropriation in its IIAs. In this spirit, we make three recommendations below and further propose a model carve-out clause for Czechia's consideration **(BOX 2)**.

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[76] See e.g. *Philip Morris*; also, see *Eco Oro* [626], stating that customary international law and the police powers doctrine contained within the indirect expropriation carve-out of Annex 811(2)(b) of the Canada-Colombia FTA 'may provide some guidance (by analogy)' in interpreting and applying that provision.

[77] See e.g. *Norwegian Shipowners Case*, PCA Case No 1922-1, Award (13 October 1922) ('*Norwegian Shipowners*'), affirmed in later decisions such as: *Siemens A.G. v The Argentine Republic*, ICSID Case No ARB/02/08, Award (17 January 2007) ('*Siemens*'); *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania* ICSID Case No ARB/05/22, Award (24 July 2008) ('*Biwater Gauff*').

[78] *Eco Oro* [634]-[635].

**RECOMMENDATION 1: THE MANIFESTLY EXCESSIVE STANDARD SHOULD NOT BE EMPLOYED**

75. We would not recommend the use of the 'manifestly excessive' standard, due to an absence of clear authority on its interpretation. As noted in paragraphs 54-57 of this Report, the standard has yet to be interpreted by an arbitral tribunal in the context of an indirect expropriation carve-out. Moreover, to the extent that this standard implies a test of proportionality, an absence of certainty and clarity persists as to how exactly such a test should be operationalised in practice.

**RECOMMENDATION 2: THE GOOD FAITH STANDARD SHOULD BE EMPLOYED**

76. We would recommend the use of the good faith standard in drafting a carve-out to indirect expropriation, given the considerable body of arbitral practice having interpreted it. The standard of good faith provides balanced protection for both investors and the host state. It ensures that any regulatory taking performed by the host state cannot be a mere cloak for expropriatory conduct, yet, at the same time, it gives the host state the space to regulate in ways that may adversely affect investors' property rights or interests.

77. Further, we would also recommend adding an interpretative clarification aiming to reinforce the tendency by some tribunals to take the host state's international obligations into account when interpreting an IIA's standards of investment protection.[79] In particular, Czechia may consider specifying, either in the operative part of the carve-out, or as a footnote to it, that international sustainable development obligations assumed by Czechia would have to be considered in assessing whether a challenged measure has been 'so severe in light of its purpose' and/or adopted 'in good faith'.

**RECOMMENDATION 3: THE QUALIFIER 'RARE CIRCUMSTANCE' OR 'RARE CIRCUMSTANCES' COULD BE MAINTAINED**

78. In the first place, we would recommend the exclusion of the phrase 'except in rare circumstances' or any of its variations. As discussed in paragraphs 43-51 of this Report, this phrase does not appear to provide any clear, distinct utility to the interpretation of regulatory acts against the expropriation standard. For one, the use of the words 'rare circumstance' or 'rare circumstances' implies that covered regulatory measures can still be found to be an instance of indirect expropriation where such rare circumstances occur. Further, the use of the phrase may lead to legal uncertainty in practice given the conflicting interpretations offered on its practical effects.

79. That said, Czechia could maintain the 'rare circumstances' qualifier in the interest of providing the necessary protection to investors within the framework of a balanced IIA. We

[79] In the context of an FET claim, see, e.g. *Philip Morris,* [418]-[420], where the tribunal referred to Uruguay's compliance with the WHO Framework Convention on Tobacco Control in holding that the plain packaging legislation under challenge was enacted in good faith.

would not regard this as taking on an excessive risk since the phrase would be contextualised through the other elements contained in the carve-out, namely, the presence of a legitimate public welfare objective, good faith, severity of the measure in light of its purpose and non-discrimination (although, we do believe that these elements alone sufficiently safeguard the legitimate interests of investors).

**BOX 2: MODEL CARVE-OUT FOR INDIRECT EXPROPRIATION**

A specific carve-out clause, exemplified in relation to the indirect expropriation standard, could provide:

> Except [in the rare circumstance] when a measure or series of measures is so severe in the light of its purpose that it cannot be reasonably viewed as having been adopted in good faith,[FN] non-discriminatory measures by a Party that are designed and applied to protect legitimate public welfare objectives such as health, safety and the protection of the environment, do not constitute indirect expropriation.

[FN] Contracting parties could consider further specifying, for instance, the relevance of international sustainable development obligations assumed by them with regard to assessing whether the measures are not 'so severe' and/or adopted 'in good faith'.

| TABLE I.1: TYPOLOGY OF INDIRECT EXPROPRIATION CARVE-OUTS | | |
|---|---|---|
| **PARADIGMATIC CLAUSE**<br><br>***Italy Model BIT (2022)***<br><br>**[** For greater certainty, except in the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive **]** [PART A], **[** non- discriminatory measures by a Party that are designed and applied **]** [PART B] to protect legitimate policy objectives, such as the protection of public health, social services, public education, safety, environment including climate change, public morals, social or consumer protection, privacy and data protection, or the promotion and protection of cultural diversity do not constitute indirect expropriations. | | |
| **VARIATION NO** | **PART A: SITUATIONS WHERE CARVE-OUT CANNOT BE INVOKED** | |
| A-1 | except in the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears **manifestly excessive,** | Italy Model BIT (2022), Annex B |
| A-2 | except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in **good faith.** | Canada Model FIPA (2021), art 9(3)<br>Netherlands Model BIT (2019), art 12<br>Austria-Kyrgyz BIT (2016), art 7(4)<br>Slovakia-Iran BIT (2016), art 6(5) |
| **VARIATION NO** | **PART B: SETTING OUT LEGITIMATE MEANS<br>'adopted' – 'maintained' – 'designed'- 'applied'** | |
| B-1 | non-discriminatory measures by a Party that are **designed and applied** to protect legitimate policy objectives | Slovakia Model BIT (2019), art 7(6) |
| B-1.5 | non-discriminatory measures by a Party that are **designed and applied in good faith** to protect legitimate policy objectives | Netherlands Model BIT (2019), art 12 |
| B-2 | A non-discriminatory measure of a Party that is **adopted and maintained in good faith** to protect legitimate public welfare objectives | Canada Model FIPA (2021), art 9(3) |
| B-3 | Non-discriminatory measures adopted by a Contracting Party, **designed, applied or maintained** for the protection of public objectives | Colombia Model BIT (2017), art [##] |

## II. QUALIFICATIONS TO STANDARDS OF INVESTMENT PROTECTION

80. A drafting practice observed in more recent IIAs is the inclusion of qualifications to the scope of investment protections, which do not take the form of carve-outs as defined in Section I. Although these do not typically incorporate express references to sustainable development-oriented objectives, recent model BITs, such as the Canada Model FIPA (2021) and the BLEU Model BIT (2019) have to various degrees begun to incorporate such references in their Most Favoured Nation ('MFN') and National Treatment ('NT') clauses.

81. We examine such clauses below and subsequently consider whether the drafting approach of entering qualifications could be expanded and used in the context of other substantive standards of protection too, such as FET.

### A. Qualifications to provisions on non-discrimination

82. A frequently used method to qualify the scope of investment protection in relation to non-discriminatory treatment is to specify that differences in treatment between investors or investments are not less favourable unless such differences are between investors or investments in 'like circumstances'. In this regard, there are three different drafting approaches taken in practice, each more detailed than the one before **(BOX 3)**:

(a) Stating that the obligation only applies to investors/investments in 'like circumstances' (e.g. Italy Model BIT (2022));
(b) Further elaborating on the definition of 'like circumstances', as depending on the 'totality of circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public policy objectives' (e.g. Canada Model FIPA (2021)); and
(c) Taking the approach in (b) further, by incorporating express reference to sustainable development-related considerations (e.g. BLEU Model BIT (2019)).

**BOX 3: DRAFTING APPROACHES TO NON-DISCRIMINATORY TREATMENT CLAUSES IN MODEL IIAs**

***The obligation applies in 'like circumstances'***

1. Each Party shall accord to investors of the other Party and to covered investments treatment no less favourable than that it accords, in like situations, to its own investors and to their investments, with respect to operation in its territory.

2. Each Party shall accord to investors of the other Party and to covered investments treatment no less favourable than that it accords, in like situations, to investors of a third country and to their investments, with respect to operation in its territory.

Source: Italy Model BIT (2022) art 5.

***Elaborating on the definition of 'like circumstances'***

1. Each Party shall accord to an investor of the other Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of an investment in its territory.

[...]

4. Whether treatment is accorded in like circumstances depends on the totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public policy objectives.

Source: Canada Model FIPA (2021) art 5.

***Express reference to sustainable development-related considerations***

3. For greater certainty, a determination of whether an investment or an investor is in comparable situations for the purposes of paragraphs 1. and 2. of this Article shall be made based on an assessment of the totality of circumstances related to the investor or the investment, including:

a. the effect of the investment on

(i) the local community where investment is located;

(ii) the environment, including effects that relate to the cumulative impact of all investments within a jurisdiction[.]

Source: BLEU Model BIT (2019) art 6(3).

83. In relation to IIAs, such as the Italy Model BIT (2022), which do not provide further clarifications on the definition of 'like circumstances', there will generally be more space for tribunals to apply their own methods of interpretation to the term. This is not to say that tribunals may not take legitimate public policy rationales of the host state into consideration, including those related to the environmental or other sustainable development-oriented goals; but rather that, doing so, may depend on how a tribunal chooses to construe the overall object and purpose of an IIA. By way of example, contrast the cases of *SD Myers v Canada* and *Occidental Petroleum v Ecuador*.

84. In *SD Myers v Canada,* the tribunal stated that:

> '[T]he interpretation of the phrase "like circumstances" in Article 1102 NAFTA must take into account the general principles that emerge from the legal context of the NAFTA, including both its concern with the environment and the need to avoid trade distortions that are not justified by environmental concerns. The assessment of "like circumstances" must also take into account circumstances that would justify governmental regulations that treat them differently in order to

> protect the public interest. The concept of "like circumstances" invites an examination of whether a non-national investor complaining of less favourable treatment is in the same "sector" as the national investor … [T]he word "sector" has a wide connotation that includes the concepts of "economic sector" and "business sector".'[80]

Additionally, other tribunals having interpreted Art 1102 NAFTA[81] have also accepted that government regulatory actions that distinguish between investors for legitimate public policy objectives form part of the relevant 'circumstances'.[82]

85. By contrast, in *Occidental Exploration v Ecuador,* the host state had denied a tax rebate to companies operating in the petroleum industry, but not to other companies (in particular, the horticulture, mining and seafood industries). The investor, a petroleum company, argued that this constituted a breach of, among other things, the IIA's NT obligation.[83] The tribunal concluded that the NT obligation had been breached. In so doing, it rejected Ecuador's argument that all oil companies in the country, domestic and foreign, were denied the tax rebate. The tribunal held that this was irrelevant, because the qualifier 'like circumstances' did not address 'exclusively the sector in which that particular activity was taken'.[84] The *Occidental* case therefore demonstrates that, in the absence of further guidance, tribunals may ignore the regulatory purpose of states in their differential treatment towards investors.

86. Since sector-specific regulation for a legitimate purpose, such as environmental protection or climate change mitigation, may be deemed to be breach a non-discrimination obligation, it appears that the Canada Model FIPA (2021) and BLEU Model BIT (2019) offer sounder drafting approaches insofar as they give more guidance to tribunals on the relevant factors in determining the presence of 'like circumstances'. In this respect, the BLEU Model BIT (2019) is worth mentioning in greater detail here, as it provides enhanced clarification on what circumstances are relevant for the purposes of determining 'whether an investment or an investor is in comparable situations' and, in so doing, more clearly stipulates the kinds of sustainable development considerations that are relevant.

87. The BLEU Model's reference to the effect 'of the investment on the local community where investment is located' is a noteworthy addition as it reflects the growing number of ISDS cases demonstrating the tension between a state's obligations to safeguard the rights of local and indigenous communities, on the one hand, and its obligation to provide investment

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[80] *SD Myers v Canada*, UNCITRAL, Partial Award (13 November 2000) ('*SD Myers*'), [250].

[81] North American Free Trade Agreement (opened for signature 17 December 1992, entered into force 1 January 1994, terminated 1 July 2020) 32 ILM 289 (1993).

[82] See e.g. *Pope & Talbot v Canada*, UNCITRAL, Merits of Phase 2 (10 April 2001), [78]-[79]; *GAMI Investments v United Mexican States*, UNCITRAL, Award (15 November 2004), [111]-[115].

[83] *Occidental Exploration and Production Company v Republic of Ecuador*, LCIA Case No UN 3467, Final Award (1 July 2004), [171] ('*Occidental Exploration*').

[84] *Occidental Exploration* [173].

protection, on the other.[85] Moreover, the reference in the BLEU Model to the 'cumulative impacts of all investments in a jurisdiction' is also noteworthy as it suggests that governments can take into consideration not only the effects directly caused by any particular investor/investment. The concept of cumulative impacts has been utilised in other instruments, such as the World Bank's Policy and Performance Standards on Environmental and Social Sustainability,[86] and refers to impacts 'that result from the successive, incremental, and/or combined effects of an action, project, or activity … when added to other existing, planned, and/or reasonably anticipated future ones.'[87]

88. It should be noted that cumulative impacts can also be cross-sectoral in nature. For example, in a recent study conducted in the Mekong region, social and environmental degradation was attributed to the cumulative impacts of agri-business and hydropower projects in the region.[88] From the host state's point of view, attempting to regulate such a situation in the absence of a provision similar to that of the BLEU Model may cause tension

[85] Local and indigenous communities may come into conflict with a foreign investor that is operating on their land and whom they do not trust. This may lead to social unrest or government intervention that makes it impossible for the investor to operate their investment. Consider the following examples:

(a) In *Bear Creek*, the concessionaires of a silver mine in the Puno region of Peru came into conflict with the local community, causing significant social unrest. The government eventually stepped in and cancelled the investor's mining permit;

(b) In *Alvarez y Marin Corporacion S.A. and others v Republic of Panama*, ICSID Case No ARB/15/14, Award (12 October 2018) ('*Alvarez y Marin*'), the investors had purchased a set of four farms, two of which were located within the territorial bounds of an indigenous protected reservation. Per Panamanian law, indigenous reservations may only be owned by a third party subject to a right of first refusal by the indigenous communities in the area, which was not obtained. This led to the farms located within the reservation being occupied by the local Comarca people, forcing the investor to abandon their investment. The government eventually issued a report stating that the part of the investment located in the Comarca's reservation was obtained illegally;

(c) In *South American Silver Limited (Bermuda) v The Plurinational State of Bolivia*, PCA Case No 2013-15, Award (November 22 2018) ('*South American Silver*'), the investor operated a mine on indigenous land. The indigenous people had accused the investor of having condoned 'abuse of authority, contaminated, disrespected the indigenous authorities, deceived, threatened community members and [being] responsible for the rape of women from the community' (see [114]). This led to violent clashes between the local community and the investor, and eventually led the Bolivian government to cancel the investor's mining permit.

[86] Performance Standard 1 requires Borrowers from the World Bank to commit to Environmental and Social Impact Assessments ('ESIA') – a cumulative impact assessment is a part of good ESIA practice, though it is not uniformly required by all organisations. See specifically, World Bank, *Environmental and Social Framework.* (World Bank Group, 2017), [23] et seq. <https://thedocs.worldbank.org/en/doc/837721522762050108-0290022018/original/ESFFramework.pdf>.

[87] International Financial Corporation, *Good Practice Handbook. Cumulative Impact Assessment and Management: Guidance for the Private Sector in Emerging Markets.* (IFC.org, 2013), 19 <https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/publications/publications_handbook_cumulativeimpactassessment>.

[88] See Ian Baird and Keith Barney, 'The Political Ecology of Cross-Sectoral Cumulative Impacts: Modern Landscapes, Large Hydropower Dams and Industrial Tree Plantations in Laos and Cambodia' (2017) 44(4) *Journal of Peasant Studies* 769.

with definitions of 'like circumstances' that refer to sameness of business or economic sector.[89]

## B. Potential for expansion to other protection standards: FET

89. We also note that states have increasingly adopted the drafting approach of qualifications in connection to other standards of protection too. In this part, we focus on the FET obligation in particular. We take the view that qualifying language referring to states' sustainable development-oriented goals and objectives could be incorporated in the FET clauses of future IIAs.

90. There are two main drafting approaches to qualifying the FET obligation currently, which may be combined in practice. The first approach is to refer to an exhaustive or indicative list of circumstances that constitute a breach of the FET obligation.[90] The second approach is to incorporate by reference the minimum standard of treatment of aliens ('MST') under CIL to the content of the FET obligation.[91] What bears noting for present purposes is that the circumstances listed in FET definition in IIAs, as well as in definitions of the CIL MST,[92] tend to refer to circumstances related to the regularity of the host state's conduct often referencing elements, such as, denial of justice, manifest arbitrariness, fundamental lack of due process, targeted discrimination, harassment, coercion, abuse of power or bad faith.

91. At the same time, there is some uncertainty in the current jurisprudence on the meaning of FET (even under the CIL MST) generated by contradictory arbitral practice, especially as it relates to the pursuance of sustainable development objectives of the host state. By way of example, contrast the following three ISDS cases.

92. In *Lone Pine*, the tribunal adopted an approach that gave considerable deference to the host state's democratic process and public policy choices. A claim was brought by a fracking permit holder over the revocation of its permit under a law introduced by Canada to limit fracking activities with the objective of environmental preservation. Finding no violation of Art 1105 of the NAFTA, an FET clause with a reference to the CIL MST, the tribunal held that:

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[89] See e.g. *SD Myers* [250].

[90] See e.g. Hungary-Cabo Verde BIT (2019) art 2 (exhaustive list); United Kingdom-New Zealand FTA (2022) art 14.11 (indicative list).

[91] See e.g. Australia-Japan EPA (2014) art 14.5; see also Japan-Oman BIT (2015) art 5, using the, arguably, functionally equivalent phrase '… in accordance with international law, including fair and equitable treatment …'. We use the qualifier 'arguably' in the latter example since there do exist cases where similar phrasing has been found to introduce an autonomous FET clause. See e.g. *Infinito Gold Ltd. v Costa Rica*, ICSID Case No. ARB/14/5, Award (3 June 2021), [331], [334] and [350] ('*Infinito Gold*').

[92] For an influential definition, see *Waste Management, Inc. v United Mexican States ("Number 2")*, ICSID Case No. ARB(AF)/00/3, Award (30 April 2004), [98] ('*Waste Management II*').

> 'To establish a breach of the customary international law rule on the minimum standard of treatment under NAFTA Article 1105, a high threshold must be met. In general, arbitral tribunals must grant significant deference to the host state's democratic process and public policy choices and may not substitute their own judgement for that of the host state whilst assessing whether NAFTA Article 1105 has been breached in a particular case. In other words, arbitral tribunals may not substitute their own judgement for that of state legislators.'[93]

93. In *Al Tamimi*, the IIA's FET standard was also circumscribed by the CIL MST. The tribunal observed this to mean a relatively high bar for breach,[94] and found no violation.[95] It is important to note that the tribunal read the presence of a general exception clause[96] and a recognition and commitment clause[97] in the Oman-US FTA (2006) as providing a significant margin of discretion to Oman in the enforcement of its environmental laws.[98] However, the Award does not provide insight on the value attached to the presence of these environment-related clauses in the treaty. It is therefore not clear whether the tribunal would have decided differently in the absence of such clauses.

94. Whereas the decisions in *Lone Pine* and *Al Tamimi* indicate that the presence of the narrower CIL MST can afford the host state regulatory space to take sustainable development-related measures, the decision in *Eco Oro* shows the opposite, namely, that the interpretation of the CIL MST, as well the degree of deference accorded to governments under it, may vary.

95. In *Eco Oro,* Colombia was obligated to delimit and acquire the *páramo* area under various international conventions and its domestic law, but had repeatedly failed to do so. The tribunal held that the Colombian government had breached the CIL MST by acting contrary to the legitimate expectations of the investor. The tribunal considered that Eco Oro was entitled to expect that Colombia would treat the investment in an even-handed and just manner to ensure a predictable business environment, while also ensuring the enhancement and enforcement of its environmental laws and regulations.[99] Ultimately, however, the tribunal held that the Colombian government had acted inconsistently, because it had issued a mining concession despite being fully aware that it had an obligation

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[93] *Lone Pine Resources Inc. v The Government of Canada*, ICSID Case No. UNCT/15/2, Award (21 November 2022), [623] ('*Lone Pine*').

[94] *Adel A Hamadi Al Tamimi v Sultanate of Oman*, ICSID Case No. ARB/11/33, Award (3 November 2015), [382] and [386] ('*Al Tamimi*').

[95] Ibid [431].

[96] Oman-United States FTA (2006) art 10.10.

[97] Oman-United States FTA (2006) art 17.2.1.

[98] *Al Tamimi* [389].

[99] *Eco Oro* [748].

to protect the *páramo* ecosystem.[100] Moreover, the government's subsequent refusal to delimit the *páramo* ecosystem and provide further certainty to the status of the mining concession was in such circumstances a breach of the investor's legitimate expectations.[101]

96. Looking beyond the particular circumstances of Eco Oro's case and into the tribunal's more abstract statements of principle vis-à-vis the treaty's FET clause and the CIL MST, *Eco Oro* may have potentially given an expanded content to the CIL MST including in it, for instance, expectations of transparency, stability and a predictable business environment as part of the standard.[102] It has been observed by some commentators that such an expectation imports an unrealistically high standard for governments to meet,[103] which may preclude states from pursuing sustainable development-oriented objectives.

97. Given the above, the inclusion of a list of circumstances constituting a breach of FET may be a safer drafting approach for states to follow. At the same time, such an approach could be accompanied by the use of qualifying language clarifying that conduct by a state aimed to achieve sustainable development objectives under international law (e.g. the Paris Agreement) may not be construed as being contrary to an investor's expectations.

### C. Assessment and drafting recommendations

98. Insofar as clarifications to the protection against non-discriminatory treatment is concerned, it is **advantageous** for Czechia to include further qualifiers on the relevant considerations when determining the existence of 'like circumstances' among investors or investments. Such qualifiers should mention sustainable development considerations that may be of importance to Czechia and its IIA counter-party in each case, thus providing useful guidance to tribunals.

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[100] Ibid [806ff].

[101] Ibid.

[102] Ibid [743ff]. See also the definition at [754]:

> '[C]oncepts such as transparency, stability and the protection of the investor's legitimate expectations play a central role in defining the FET standard, as does procedural or judicial propriety and due process and fairness, refraining from taking arbitrary or discriminatory measures, or from frustrating the investor's reasonable expectations with respect to the legal framework affecting the investment. Unjust or idiosyncratic actions, a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith have all been found to be in breach of FET. A state may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.'

[103] See e.g. Simon Lester, 'The Eco Oro Minerals v Colombia Award: More Evidence that the MST/FET Can't be Salvaged' *International Economic Law and Policy Blog* (19 September 2021) <https://ielp.worldtradelaw.net/2021/09/the-eco-oro-minerals-v-colombia-award-more-evidence-mst-fet-cant-be-salvaged.html> accessed 31 March 2023; c.f. also Zachary Douglas, 'Nothing if Not Critical for Investment Treaty Arbitration: Occidental, Eureko and Methanex' (2006) 22 *Arbitration International* 27, 28, noting that '[t]he Tecmed "standard" is actually not a standard at all; it is rather a description of perfect public regulation in a perfect world, to which all states should aspire but very few (if any) will ever attain.'

99. At the same time, clarifying language of this kind could be adopted with regard to other standards of investment protection too. It is in our view **advantageous** for Czechia to thus expand the practice of qualifying language in its future IIAs. This is especially so for those standards that are not self-explanatory, such as the FET standard.

100. We take each of these recommendations in turn.

**RECOMMENDATION 1: INCLUDE FURTHER ELABORATION ON THE DEFINITION OF 'LIKE CIRCUMSTANCES' IN NON-DISCRIMINATION CLAUSES**

101. We recommend the inclusion of a further elaboration on the definition of 'like circumstances' in MFN and NT clauses. Though, while defining 'like circumstances', some arbitral tribunals have adopted a wide-ranging definition that embraces environmental and other concerns, it will nonetheless be useful to clarify that 'like circumstances' extend beyond mere economic circumstances.[104] Such elaboration may be included in the IIA itself, in the form of a list of factors to be considered. The Canada Model FIPA (2021) and the BLEU Model BIT (2019) provide good points of reference in this respect.

102. Art 5 of the Canada Model FIPA (2021) provides a useful drafting precedent because it incorporates the existing understanding of 'like circumstances' as requiring an analysis of the 'totality of the circumstances'. It also reflects the understanding, derived from NAFTA jurisprudence, that relevant circumstances include distinctions between investors or investments for legitimate public policy objectives. Art 6(3) of the BLEU Model BIT (2019) builds on this approach. It provides specific factors to be considered when determining 'like circumstances', such as, the effect of the investment on local communities and the environment (including any cumulative environmental impact of all investments within the state). The presence of such factors may serve to further refine and guide the interpretative process of tribunals.

103. What is more, in view of the dynamic nature of states' obligations under other multilateral treaties, such as the Paris Agreement, future IIAs may also provide for an exchange of interpretative notes between the parties on the constituents of such a list of factors. This approach could be particularly helpful in clarifying the meaning of phrases such as 'the cumulative impact of all investments' found in the BLEU Model BIT (2019), should such language be chosen.

[104] See *SD Myers* [250]. As noted above, the tribunal in *SD Myers* premised its findings on 'the general principles that emerge from the legal context of NAFTA, including both its concern with the environment and the need to avoid trade distortions that are not justified by environmental concerns' (ibid). For that reason, it is not immediately clear that other arbitral tribunals would reach the same conclusion when considering other treaties, which may have a different legal context.

**RECOMMENDATION 2: ADOPT AN FET CLAUSE WITH REFERENCE TO LIST OF CIRCUMSTANCES**

104. The MST under CIL, though helpful, may lead to varying and uncertain results, especially if it is the sole legal benchmark that an FET clause contains. Therefore, a reference to the CIL MST, in isolation, is in our view not advisable.

105. Instead, we would recommend adopting an FET clause that includes a reference to a list of circumstances constituting an FET breach, which may accompany a reference to the CIL MST. In making this recommendation, we take note of the fact that no tribunal so far appears to have interpreted an FET clause containing a list of circumstances constituting an FET breach. Yet, because such drafting approach seeks to define the FET standard, it is in our view better placed to reduce the scope of arbitral interpretative discretion.

106. At the same time, such an approach to drafting FET clauses could be accompanied by the use of qualifying language clarifying that conduct by a state aimed to achieve sustainable development objectives under international law (e.g. the Paris Agreement) may not be construed as being contrary to an investor's expectations.

## III. GENERAL EXCEPTION CLAUSE

**BOX 4: ITALY MODEL GENERAL EXCEPTION CLAUSE**

1. Subject to the requirement that such measures are not applied in a manner that would constitute [arbitrary or unjustifiable][NOTE 4] discrimination between investments or between investors, [Articles (Non-Discriminatory Treatment) and (Transfers)][NOTE 1] shall not be construed to prevent a Party from adopting or enforcing measures [necessary][NOTE 3]:

[…]

[(b) to protect human, animal or plant life or health][NOTE 2]

[…]

3. The Parties understand that the measures referred to in subparagraph (b) include environmental measures necessary to protect human, animal or plant life or health.

Source: Italy Model BIT (2022) art 15.

### A. Definition and effect of a general exception clause

107. For the purposes of this Report, general exception clauses seek to preserve the right of the state to regulate in certain defined areas. As noted by Henckels, general exception clauses typically share a set of common features:

> '[Such clauses] typically use language such as "nothing in this Agreement shall be construed to prevent the adoption of . . . ", then impose some restrictions on the design of the measure by specifying a required nexus between the measure and the permissible objective or objectives, such as "necessary to" or "designed and applied for". Increasingly, investment agreements contain exceptions that incorporate by reference or are modelled on the general exceptions in Article XX of the General Agreement on Tariffs and Trade (GATT) and Article XIV of the General Agreement on Trade in Services (GATS), which both contain an additional requirement that measures not be applied in an arbitrary or discriminatory way'.[105]

108. The way in which general exception clauses operate in practice is presently a matter of some controversy. We note two such points of controversy in particular: (i) whether general exception clauses are effective in excluding wrongfulness and the duty to pay compensation; and (ii) the relationship between general exception clauses and the police powers doctrine in indirect expropriation carve-outs and under CIL.

[105] Caroline Henckels, 'Should Investment Treaties Contain Public Policy Exceptions?' (2018) 59(8) *Boston College Law Review* 2825, 2828 ('Henckels II').

i. Whether general exception clauses are effective in excluding wrongfulness and the duty to pay compensation

109. At the outset, it is worth noting that the lack of clarity with respect to the effect of general exception clauses may be due, in part, to the fact that states themselves do not always plead these clauses even if they are present in the IIA. For example, in the decisions of *Gold Reserve,*[106] and *Crystallex*,[107] the tribunal did not examine the general exception clause at all. These cases were brought under the Canada-Venezuela BIT (1996) and concerned the revocation and refusal of mining permits, ostensibly for environmental reasons. The FTA at Annex II.10(b) contained a general exception for environmental measures. However, Venezuela, did not rely upon the general exception clause. Instead, it claimed that the measure was taken under its domestic environmental laws.[108]

110. Given this, our assessment of the effectiveness on general exception clauses relies on the few available cases interpreting such clauses, as well as on tribunals' approaches to the construal of exceptions clauses in general (i.e. also including essential security exception clauses). We begin by examining the latter first.

111. One line of arbitral authority arising out of the series of cases filed against Argentina following its financial crisis in the late-1990s had suggested that exceptions clauses operate to excuse the host state's liability following a breach of a primary obligation. For example, in *LG&E v Argentina,* the tribunal interpreted a security exception contained in Art XI of the Argentina-United States BIT (1991) in such a manner when stating that:

> '[T]he Tribunal must determine whether the measures implemented by Argentina were necessary to maintain public order or to protect its essential security interests, albeit in violation of the Treaty'; and
>
> 'Thus, Argentina is excused under Article XI from liability for any breaches of the Treaty …'[109]

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[106] *Gold Reserve Inc. v Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/09/1, Award (22 September 2014) ('*Gold Reserve*').

[107] *Crystallex International Corporation v Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2, Award (4 April 2016) ('*Crystallex*').

[108] *Gold Reserve* [557]; *Crystallex* [527].

[109] *LG&E Energy Corp and Ors v Argentine Republic*, ICSID Case No ARB/02/01, Decision on Liability (3 Oct 2006) ('*LG&E v Argentina*'), [205], [229]. However, it does not appear that the *LG&E* tribunal held that view consistently throughout the decision. For example, at [261], the tribunal described Art XI as a 'ground for exclusion from *wrongfulness* of an act of the state' [emphasis added].

This approach was echoed in other decisions, such as *CMS v Argentina,*[110] *Enron v Argentina,*[111] and *Sempra v Argentina*.[112] Similarly, the tribunal in the more recent *Bear Creek v Peru* case in essence also observed that a general exception operated to excuse a breach of a primary treaty obligation.[113]

112. However, such an approach has been criticised by other tribunals. This alternative line of authority instead argues that an exceptions clause is a 'threshold requirement' in the sense that, if found applicable, then no wrongful act would have been committed by the host state.[114] In other words, where a general exception clause applies, conduct is considered justified rather than excused, since there is no breach of a primary treaty obligation to begin with. This approach, first expressed by the annulment committee in *CMS v Argentina*, was subsequently followed by the annulment committee in *Sempra v Argentina,*[115] and other tribunals such as *Continental Casualty v Argentina*,[116] *Deutsche Telekom v India,*[117] and *Devas v India*.[118]

113. Yet other, recent, decisions, such as the one in *Eco Oro*, have seemingly run against the grain of both of these lines of jurisprudence. The *Eco Oro* decision departs from the view that exceptions clauses have the effect of justifying conduct making it not wrongful to begin with and seemingly renders such clauses without practical effect by describing them as permissions to undertake the covered regulatory conduct which, however, do not exclude liability to pay compensation.

114. In *Eco Oro,* the arbitral tribunal appeared to align its analytical approach with cases such as *Deutsche Telekom* and *Devas* in holding that a general exception clause permitted the

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[110] *CMS Gas Transmission v Argentine Republic,* ICSID Case No ARB/01/08, Award (12 May 2005).

[111] *Enron Corporation Ponderosa Assets LP v Argentine Republic,* ICSID Case No ARB/01/03, Award (22 May 2007).

[112] *Sempra Energy International v Argentina,* ICSID Case No ARB/02/16, Award (17 September 2007) ('*Sempra*').

[113] *Bear Creek* [477]. Note that the tribunal already in a way foreshadowed the *Eco Oro* decision, discussed below, by stating that, even assuming that the general exception clause applied, 'since the [general] exception ... does not offer any waiver from the obligation ... to compensate for the expropriation, Respondent has also failed to explain why it was necessary for the protection of human life not to offer compensation to Claimant'.

[114] *CMS v Argentina*, Decision of the Ad-Hoc Committee on the Application for Annulment of the Argentine Republic (25 September 2007), [129] ('*CMS Annulment'*).

[115] *Sempra,* Decision on the Argentine Republic's Application for Annulment of the Award (29 June 2010), [200].

[116] *Continental Casualty v Argentina*, ICSID Case No ARB/03/09, Award (5 September 2008), [168] ('*Continental'*).

[117] *Deutsche Telekom v India,* PCA Case No 2014-10, Interim Award (13 December 2017), [227] ('*Deutsche Telekom').*

[118] *CC Devas v India*, PCA Case No 2013-09, Decision on Jurisdiction and Merits (25 July 2016), [293] ('*Devas*').

state to undertake covered regulatory actions. However, the tribunal further suggested that the fact that such actions were permitted did not mean that the state's liability to pay compensation was excluded.[119] The majority of the tribunal supported their reasoning with the argument that, if the parties had intended this provision to exclude liability for compensation, they would have drafted the provision in similar terms as Annex 811 of the applicable IIA, which included a carve-out from indirect expropriation.[120] The majority also referred to the International Law Commission Draft Articles on Internationally Wrongful Acts ('ARSIWA'),[121] and, in particular, Arts 27(b) (not excluding a duty to compensate for material loss suffered even when a circumstance precluding wrongfulness has been rightfully invoked) and 36(1) (duty to compensate following the commission of an internationally wrongful act).[122]

115. Commentators have criticised this decision.[123] To analyse the general exception clause as merely 'permissive' fails to take into account that general exception clauses in IIAs are generally modelled after Art XX GATT, which clearly excludes wrongfulness, with the expectation of performing a similar function. The decision may contribute to the fragmentation of international investment law. If the very same IIA allows for a specific behaviour in a general exception clause, have the contracting parties really intended for it still to be compensable? Moreover, the tribunal's reference to the ARSIWA seems misplaced if one construes the general exception clause as already justifying and therefore excluding a breach. Despite such criticisms, the *Eco Oro* construal of general exception clauses poses a potential risk which will be prudent for states to address in their IIAs.

116. Lastly, a further cause for the absence of clarity vis-à-vis the effects of general exception clauses may at times be due to equivocal drafting. For instance, in *Infinito Gold*, Annex I, Section III(1) of the Canada-Costa Rica BIT (2002) contained the following:

> 'Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining or enforcing any measure otherwise consistent with this Agreement that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.'

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[119] *Eco Oro* [829]-[835].

[120] Ibid.

[121] International Law Commission, 'Draft Articles on Responsibility of States for Internationally Wrongful Acts, with commentaries' (2001) UN Doc A/56/10 ('ARSIWA').

[122] *Eco Oro* [835].

[123] See e.g. Roopa Mathews and Dilber Divitre, 'New Generation Investment Treaties and Environmental Exceptions: A Case Study of Treaty Interpretation in Eco Oro Minerals Corp. v. Colombia' *Kluwer Arbitration Blog* (April 11 2022) <https://arbitrationblog.kluwerarbitration.com/2022/04/11/new-generation-investment-treaties-and-environmental-exceptions-a-case-study-of-treaty-interpretation-in-eco-oro-minerals-corp-v-colombia/> accessed 31 March 2023.

In referencing the general rule of interpretation of Art 31 VCLT, the tribunal held that this provision could not outright exclude the state's liability for measures relevant to substantive protection standards, notably because of the wording 'any measure otherwise consistent with this Agreement'.[124] The tribunal concluded that the clause was 'not a carve-out from the BIT's protections, but rather a reaffirmation of the state's right to regulate'.[125] In the tribunal's view, the purpose of inserting such general clauses in a BIT would be to emphasise the idea that environmental and investment protection should be reconciled.[126]

ii. The unclear relationship between general exception clauses and the police powers doctrine

117. Even though general exception clauses are typically written in a comprehensive manner, using them could still have the effect of unintentionally limiting a host state's regulatory power. This may be due to a number of reasons. For instance, even comprehensive drafting might pose the risk of becoming outdated as a government's regulatory priorities evolve over time.[127] More critically for present purposes, general exception clauses may in some cases produce limiting effects by tribunals that interpret the comprehensive manner of drafting in these clauses as being exhaustive of all other defences that may available to the host state, either treaty-based or under CIL.

118. For example, in *Bear Creek*, the tribunal declined to apply the police powers doctrine because of the presence of a general exception clause in the applicable IIA.[128] The tribunal noted that because the general exception clause did not use any language indicating that the exceptions contained therein were merely exemplative (instead, they were clearly drafted as exhaustive), then 'no other exceptions from general international law or otherwise' could be applicable.[129] The dissenting arbitrator, Philippe Sands, agreed that other exceptions contained in general international law would be excluded by the presence of a general exception clause. However, he suggested that the necessity defence under CIL, as codified in Art 25 ARSIWA, would remain applicable in principle, save that it was not applicable on the facts at hand.[130]

119. We would note here that the tribunal's reasoning seems to carry force on the assumption that the police powers doctrine itself operates as an exception. But it may carry less force if the police power doctrine is conceptualised as an inherent part of a primary obligation, such

[124] *Infinito Gold* [771]-[773].

[125] *Infinito Gold* [777].

[126] *Infinito Gold* [778].

[127] Henckels II (n. 105), 2836-2837.

[128] *Bear Creek* [477].

[129] Ibid.

[130] *Bear Creek*, Partial Dissenting Opinion of Philippe Sands, [41].

as, for instance, in an indirect expropriation carve-out. At any rate, given the *Bear Creek* decision, it may be prudent for states to clarify the interaction between general exception clauses and the police powers doctrine in their IIAs.

## B. Variations in the scope and content of the legal obligation

120. Given the similarities between general exception clauses in IIAs and the general exception in the GATT/GATS, academic authority has suggested that WTO law could be relevant in interpreting general exception clauses as they appear in IIAs. For instance, Mitchell, Munro, and Voon suggest that WTO law may be relevant in the interpretation of an IIA in the following way:

> 'Where an IIA incorporates the WTO provisions by reference, WTO caselaw could conceivably be relevant in determining the "ordinary meaning" of terms within the WTO general exceptions, pursuant to VCLT Article 31(1). WTO caselaw might also be regarded as relevant to interpretation of general exceptions in IIAs either as a subsidiary means of identifying the relevant rules of international law applicable between the IIA parties pursuant to Article 31(3)(c) of the VCLT and Article 38(1)(d) of the ICJ Statute, or as a supplementary means of interpretation pursuant to VCLT Article 32.'[131]

121. In our analysis under this section, we will prioritise arguments and interpretations emerging within international investment law. However, we will look at WTO case law interpreting general exceptions under GATT/GATS in instances where elements of general exception clauses found in IIAs have not been subject to interpretation by arbitral tribunals.

122. **Note 1 – Scope of application of the exception:** Recent treaties, such as the EU's IPAs with Singapore (2018) and Vietnam (2019), as well as CETA (2016), confine the scope of their general exception clause to provisions on non-discriminatory treatment and transfers. However, in other treaties, the general exception clause has general application, and often uses language reflecting this general scope, such as '[n]othing in this Agreement shall...'.[132]

123. **Note 2 – 'to protect human, animal, or plant life or health'/'the conservation of exhaustible natural resources':** As stated, general exception clauses provide an exhaustive enumeration of the regulatory purposes for which the exception can be activated. Regulatory purposes having a link with sustainable development-oriented considerations in general exception clauses typically include: the protection of human, animal, or plant life or health (the use of this phraseology broadly follows the structure of

[131] Andrew Mitchell, James Munro, and Tania Voon, 'Importing WTO General Exceptions into International Investment Agreements' in Lisa Sachs, Lise Johnson, and Jesse Coleman (eds) *Yearbook on International Investment Law & Policy 2017* (Oxford University Press, 2019) 36.

[132] See, e.g. Rwanda-Turkey BIT (2016) art 5(1); Nigeria-Singapore BIT (2016) art 28(1); Burkina Faso-Turkey BIT (2019) art 5(1).

Art XIV GATS); and the 'conservation of exhaustible natural resources' (see, e.g., Art 4.6 EU-Viet Nam IPA (2019)). At the same time, the Italy Model general exception clause includes a footnote clarifying the contracting parties' understanding that measures 'necessary to protect human, animal or plant life or health' include environmental measures necessary to protect human, animal or plant life or health. Similar clarifications are also found in the general exception clauses of IIAs drafted by non-EU countries, such as the Israel-Japan BIT (2017) and the Hong Kong SAR-China CEPA (2017).[133]

124. Arbitral practice suggests that states should expressly allude to the regulatory purpose pursued when undertaking the measures or the conduct in question, if they wish to rely on a general exception clause. For example, in *Bear Creek,* the Peruvian government had cancelled a mining concession belonging to the investor. At the time that the concession was cancelled, the government made no mention to the protection of human life or health as the reason animating its decision. Instead, it merely referred to the emergence of 'new circumstances' and social unrest. While the tribunal did not expressly state that the government was precluded from relying on the general exception clause for this reason, it nevertheless took note of the fact that the government had failed to mention human life or health at that initial stage.[134]

125. **Note 3 – Nexus requirement:** To benefit from a general exception clause, it is not sufficient for the host state to merely mention the pursuance of a regulatory purpose enumerated in the clause itself. Rather, the actions taken must bear a rational link of some kind to the regulatory purpose(s) pursued. This is sometimes referred to as the nexus requirement. There are three different drafting options on this point that Czechia may wish to consider in this respect: (i) the regulatory measures must be 'necessary' for a legitimate policy objective; (ii) the regulatory measures must be 'relating to' or 'designed and applied for' a legitimate policy objective; and (iii) the regulatory measures must be 'deemed necessary' by the host state for the pursuance of a legitimate policy objective, in essence turning the state's determination into a so-called 'self-judging' one.

126. **Note 3A – 'Necessary':** Some treaties require that regulatory measures taken must be 'necessary' to achieve the stated legitimate policy objectives.[135] Arbitral tribunals have over the years applied varying standards of necessity when examining analogous exceptions clauses in IIAs for the protection of the host state's essential security interests.

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[133] See Israel-Japan BIT (2017) art 15; Hong Kong SAR-China CEPA (2017) art 22. The same clarification also appeared in the now terminated NAFTA, article 1106(6)(b) of which stated:

> 'Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in paragraph 1(b) or (c) or 3(a) or (b) shall be construed to prevent any Party from adopting or maintaining measures, including environmental measures…'.

[134] *Bear Creek* [475].

[135] See, e.g. Italy Model BIT (2022) art 15(1); Iran-Slovakia BIT (2016) art 11(1); Canada-Guinea BIT (2015) art 18(1).

127. Under one tranche of the series of cases against Argentina mentioned previously, notably *CMS, Enron* and *Sempra*, a very high standard for necessity was used by directly borrowing the definition of the necessity defence at CIL, as codified in Art 25 ARSIWA. As noted by the tribunal in *Sempra*:

> '["Necessary" in the context of a non precluded measures clause ("NPM clause")] is inseparable from the customary law standard insofar as the definition of necessity and the conditions for its operation are concerned, given that it is under customary law that such elements have been defined'.[136]

Under Art 25 ARSIWA, necessity would preclude the wrongfulness of a measure if the measure at issue was the only way for the state to safeguard an essential interest from a grave and imminent peril, and did not seriously impair an essential interest of the state towards which the breached obligation existed (or of the international community as a whole). Additionally, the breached obligation in question must not itself exclude the possibility of invoking necessity, and the state invoking necessity must not have contributed to the situation of necessity to begin with.[137]

128. An entirely different approach to giving meaning to the term 'necessary' was followed by the tribunal in *Continental v Argentina*, by relying heavily on how a similar term had been interpreted in the context of Art XX GATT. In particular, the tribunal affirmed the WTO Appellate Body's interpretation of the term in the *Korea-Beef* case,[138] pointing out that state action could fall on a spectrum, from being indispensable to merely making a contribution to certain policy goals, and that necessity fell closer to the side of indispensability while not fully embodying that standard.[139] Thus, according to the tribunal, a non-indispensable measure may still be considered to be necessary for a policy goal if it can be shown to be so after weighing various factors, such as 'the relative importance of interests or values furthered by the challenged measures, the contribution of the measure to the realization of the ends pursued by it and the restrictive impact of the measure on international commerce'.[140] That said, a regulatory measure would nonetheless not be considered to be 'necessary' if there was an alternative measure that was 'treaty consistent' or 'less treaty

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[136] *Sempra* [376].

[137] ARSIWA art 25. Other tribunals, for example in *LG&E v Argentina*, still followed the same interpretative approach of borrowing elements from the necessity defence under CIL, yet adopted a more lenient interpretation of it. In particular, the *LG&E* tribunal held that the economic recovery package implemented by the Argentine government was 'necessary' within the meaning of the NPM clause, as well as CIL, at least for a time, notwithstanding that 'there may have been a number of ways to draft the recovery plan' (*LG&E* [258]).

[138] *Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R (adopted 10 January 2001).

[139] *Continental* [193].

[140] *Continental* [194].

inconsistent'.[141] The *Continental* approach may thus be described as proportionality-style analysis with heavy influence from WTO law.[142]

129. A similar interpretative approach, albeit without any reference to WTO law, was followed by the tribunal in *Deutsche Telekom v India*. The tribunal, at the outset, recognised a margin of deference to the host state's determination of the necessity of a measure, considering the state's proximity to the situation, expertise and competence.[143] Given this, an arbitral tribunal's review should involve neither a *de novo* second-guessing of the state's determination nor a requirement that the state must prove the measure's indispensability.[144] The ultimate test of necessity followed by the tribunal is summarised in the following passage from the decision:

> 'To assess the necessity of the measures … the Tribunal will thus determine whether the measure was principally targeted to protect [the interests] at stake and was objectively required in order to achieve that protection, taking into account whether the state had reasonable alternatives, less in conflict or more compliant with its international obligations'.[145]

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[141] *Continental* [195].

[142] For instance, c.f. the following passage from *Brazil - Retreaded Tyres*, WT/DS332/AB/R (adopted 12 March 2007), [156] ('*Brazil-Retreaded Tyres')*:

> '[I]n order to determine whether a measure is "necessary" within the meaning of Article XX(b) of the GATT 1994, a panel must assess all the relevant factors, particularly the extent of the contribution to the achievement of a measure's objective and its trade restrictiveness, in the light of the importance of the interests or values at stake. If this analysis yields a preliminary conclusion that the measure is necessary, this result must be confirmed by comparing the measure with its possible alternatives, which may be less trade restrictive while providing an equivalent contribution to the achievement of the objective pursued. It rests upon the complaining Member to identify possible alternatives to the measure at issue that the responding Member could have taken. As the Appellate Body indicated in *US - Gambling*, while the responding Member must show that a measure is necessary, it does not have to "show, in the first instance, that there are *no* reasonably available alternatives to achieve its objectives."' [emphasis in original, footnotes omitted]

To note, the wholesale transposition of WTO law into international investment law, specifically in the context of the necessity standard, has been criticised by commentators. For instance, Mitchell, Munro and Voon (n. 131), 37, point out that an ISDS tribunal may apply WTO law without recognizing or applying the nuances of WTO law in the same way that the Appellate Body does in practice (e.g. investment tribunals might fail to adopt a broad, evolutionary interpretation of the exhaustive list of objectives in the general exceptions or undertake an independent process of ranking the importance of different policy objectives in place of the respondent state). Alvarez also criticises the *Continental* decision's wholesale transposition of WTO jurisprudence, among others, on the ground that it failed to take into account the different object and purpose served by international trade and international investment law (see e.g. José E. Alvarez, 'Beware: Boundary Crossings – A Critical Appraisal of Public Law Approaches to International Investment Law' (2016) 17 *Journal of World Investment and Trade* 171, 195-203).

[143] *Deutsche Telekom* [238].

[144] Ibid.

[145] *Deutsche Telekom* [239].

130. **Note 3B – 'related to'/'designed and applied for':** A less demanding nexus requirement between a measure and its regulatory purpose is followed by treaties that use terms such as 'related to' or 'designed and applied for'.[146] It is moreover not uncommon to see such lower threshold standards coexisting with the higher threshold necessity standard in the same general exception clause, albeit in relation to different regulatory purposes. This can be seen, for instance, in Art 4.6 of the EU-Viet Nam IPA (2019).

131. In the context of WTO law, the term 'related to', found in Art XX(g) GATT ('relating to the conservation of exhaustible natural resources'), has been interpreted by the Appellate Body as denoting that there must be 'a close and genuine connection between means and ends'.[147] Determining such a connection may require a review of the design and structure of the measure at issue, although not necessarily an evaluation of its actual effects in practice.[148] In the investment context, the tribunal in *Devas v India* had to interpret an essential security exception in the India-Mauritius BIT (1998) which contained the equivalent term 'directed to' as a nexus requirement. The tribunal did not clearly spell out a defining test but, rather, clarified that the phrase could be interpreted neither as denoting indispensability nor as being entirely self-judging.[149] From reading the tribunal's lengthy analysis of the facts of the case, one may glean that the tribunal likely endorsed a means/ends formula.[150]

132. Lastly, the phrase 'designed and applied for' has been previously examined in Section I, in connection with its use in carve-outs from indirect expropriation. For present purposes, we consider that the meaning of 'designed and applied for' is equivalent to the phrases 'relating to' or 'directed to'.

133. **Note 3C – Self-judging standards:** Yet other treaties employ an essentially self-judging nexus requirement. In order for the nexus requirement to be interpreted as self-judging, there must exist precise language in the treaty explicitly giving the state the power to make a subjective determination.[151] That said, there appears to exist no uniform term denoting the self-judging character of a nexus requirement. Observable drafting variations include:

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[146] See e.g. Ghana-Turkey BIT (2016) art 7(1); Canada-Hong Kong China SAR BIT (2016) art 17(1)(c).

[147] See *China - Measures Related to the Exportation of Various Raw Materials*, WT/DS394/AB/R, WT/DS395/AB/R, WT/DS398/AB/R (adopted 22 February 2012), [355] ('*China-Raw Materials')*; referring to *United States - Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R (adopted 6 November 1998), [136] ('*US-Shrimp*').

[148] See *China - Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum*, WT/DS431/R, WT/DS432/R, WT/DS433/R (adopted 29 August 2014), [7.290], [7.379] ('*China-Rare Earths*'); with *China - Rare Earths*, WT/DS431/AB/R, WT/DS432/AB/R, WT/DS433/AB/R (adopted 29 August 2014), [5.114].

[149] *Devas* [242]-[243].

[150] *Devas* [315]-[374].

[151] Andrew Newcombe and Luis Paradell Truis, *The Law and Practice of Investment Treaties* (Kluwer Law International, 2009), 492; *Devas* [219]; *Enron* [336].

the phrases 'it considers necessary', or sometimes 'it considers appropriate', where 'it' refers to a contacting party to the treaty;[152] 'deems necessary';[153] or simply, 'any measure appropriate to'.[154]

134. That said, the use of 'self-judging' language does not necessarily insulate the host state from the possibility of arbitral review or from a potential finding of liability. It has been recognised by some tribunals that, even in the presence of a clearly self-judging clause, states are still subject to the overriding requirement that their actions must be in good faith.[155]

135. **Note 4 – 'arbitrary or unjustifiable discrimination'/'disguised restriction on trade or investment':** The treaties examined almost uniformly preclude reliance on their general exception clause when the measures complained of are discriminatory in character. For example, in the Burkina Faso-Turkey BIT (2019),[156] and the Cambodia-Turkey BIT (2018),[157] the chapeau to the general exception clause states:

> 'Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining or applying non-discriminatory legal measures.'

136. Several of the treaties examined further qualify that requirement by using the phrase 'arbitrary or unjustifiable discrimination between investors and investments'.[158] This formulation can be subject to minor variations. For example, the Colombia Model BIT (2017) uses the formulation 'arbitrary and discriminatory treatment against a Covered Investor or Investment'.[159] Yet other treaties, such as the Hong Kong-China CEPA (2017), specify that, in addition to not being 'arbitrary or unjustifiable', the covered measure must also not constitute a 'disguised restriction on trade or investment'.[160]

137. The standards of arbitrariness and justifiability are often discussed together in international investment law. In particular, the two terms are often used in an interchangeable fashion.[161]

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[152] See e.g. Morocco-Nigeria BIT (2016) art 13(4); Colombia-UAE BIT (2013) art 10(1) (exception-style clause applying in relation to environmental and labour measures in particular).

[153] See e.g. Colombia Model BIT (2017), art [##] on general exceptions.

[154] See e.g. Colombia-UAE BIT (2013) art 11 (general exception clause).

[155] *LG&E* [214]; *Enron* [324], [339].

[156] Burkina Faso-Turkey BIT (2019) art 5(1).

[157] Cambodia-Turkey BIT (2018) art 4(1).

[158] See e.g. Italy Model BIT (2022) art 15(1).

[159] Colombia Model BIT (2017), art [##] on general exceptions.

[160] Hong Kong-China CEPA (2017) art 22(1).

[161] Rudolf Dolzer, Ursula Kriebaum, and Christoph Schreuer, *Principles of International Investment Law*, 3rd edn (Oxford University Press, 2022), 240.

But, the fact that both terms are used in general exception clauses should give one cause to consider whether each term seeks to capture a different situation.

138. **Note 4A – 'arbitrary':** The standard reference for the meaning of arbitrariness is the following passage from the ICJ's decision in *ELSI*:

> 'Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. ... It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety'.[162]

Referencing decisions by other tribunals, the tribunal in *Philip Morris v Uruguay* alluded to a definition of arbitrariness as involving the exercise of discretionary sovereign action made irrationally, in bad faith, or exhibiting a manifest lack of reasons.[163]

139. Beyond these general statements of principle, other tribunals have affirmed that arbitrary conduct is exemplified in:

(a) a measure that inflicts damage on the investor without serving any apparent legitimate purpose;

(b) a measure that is not based on legal standards but on discretion, prejudice or personal preference;

(c) a measure taken for reasons that are different from those put forward by the decision maker and, in particular, when a public interest is put forward as a pretext to take measures that are designed to harm the investor;

(d) a measure taken in wilful disregard of due process and proper procedure.[164]

140. **Note 4B – 'unjustifiable':** Compared to arbitrariness, the ordinary meaning of unjustifiability seems to denote a broader concept with a lower threshold than arbitrariness in the manner in which a measure is applied to a particular investor. That is to say, arbitrary conduct is by definition unjustifiable. But not all unjustifiable conduct is necessarily arbitrary. Determining unjustifiability may thus involve a substantive examination by a tribunal which may replicate elements of a tribunal's analysis on the nexus requirement.

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[162] *Elettronica Sicula SpA v United States of America*, (1989) ICJ Rep 15, [128] ('*ELSI'*), cited with approval in *Azurix v Argentina* ICSID Case No ARB/01/12, Award (14 July 2006)*,* [392] ('*Azurix*'); *Joseph Charles Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability (14 January 2010), [262] ('*Lemire*'); *Philip Morris* [390].

[163] *Philip Morris* [399]; citing: *Electrabel S.A. v Republic of Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicability and Liability (30 November 2012), [8.35] ('*Electrabel*'); *Saluka* [272]-[273]; *Frontier Petroleum Services Ltd. v Czech Republic,* UNCITRAL, Final Award (12 November 2010), [527] ('*Frontier Petroleum*'); *Glamis Gold, Ltd. v United States of America*, UNCITRAL, Award (8 June 2008), [805] ('*Glamis*').

[164] See *Lemire* [262]; quoting *EDF (Services) Limited v Romania*, ICSID Case No. ARB/05/13, Award (8 October 2009), [303] ('*EDF*'), where the tribunal accepted this definition delivered in an expert opinion by Professor Schreuer.

141. Indeed, looking at the context of WTO law, the meaning of 'unjustifiable' discrimination was considered in *Brazil - Retreaded Tyres*, where the Appellate Body stated:

> '[A]nalyzing whether discrimination is "unjustifiable" will usually involve an analysis that relates primarily to the cause or the rationale of the discrimination… [I]n certain cases the effects of the discrimination may be a relevant factor, among others, for determining whether the cause or rationale of the discrimination is acceptable or defensible and, ultimately, whether the discrimination is justifiable.'[165]

142. And, in *US - Tuna II*, the Appellate Body considered 'arbitrary or unjustifiable' discrimination in a similar fashion, without, however, neatly differentiating between the two terms:

> '[T]he analysis of whether discrimination is arbitrary or unjustifiable "should focus on the cause of the discrimination, or the rationale put forward to explain its existence"...Thus, "[o]ne of the most important factors" in the assessment of arbitrary or unjustifiable discrimination is the question of whether the discrimination can be reconciled with, or is rationally related to, the policy objective with respect to which the measure has been provisionally justified under one of the subparagraphs of Article XX.'[166]

143. **Note 4C – 'disguised restriction on trade or investment':** The term 'disguised restriction on trade or investment' refers to situations where a measure ostensibly taken for a public purpose is actually, in its purpose and effect, a barrier to trade or investment.[167] Given this, the term should not be read in isolation but together with the standards of 'arbitrary' and 'unjustifiable' discrimination.[168]

### C. Assessment and drafting recommendations

144. As seen, recent arbitral practice has generated significant uncertainty with respect to the interpretation of a general exception clause. In response to such uncertainty, Czechia may wish to bear in mind two possible drafting approaches going forward.

145. The first possible approach is to *not* rely exclusively or principally on a general exception clause. This is in line with emerging drafting practice, as seen in the USMCA (2018) and

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[165] *Brazil - Retreaded Tyres* [229]-[230].

[166] *United States - Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products (Art 21.5: Mexico)*, WT/DS381/AB/RW (adopted 16 May 2017), [7.316] ('*US-Tuna II*').

[167] See *SD Myers,* Separate Opinion of Bryan Schwartz on the Partial Award, [174].

[168] See, e.g. in the context of WTO law, *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R (adopted 20 May 1996), [25] (*'US-Gasoline'*): '"Arbitrary discrimination", "unjustifiable discrimination" and "disguised restriction" on international trade may, accordingly, be read side-by-side; they impart meaning to one another.'

the Canada Model FIPA (2021). These IIAs either eschew the use of a general exception clause or couple the use of a general exception with further clarifications of the primary obligations created under the treaty.[169]

146. A second possible approach is to continue relying on general exception clauses as the principal safeguard of regulatory interests. In this case, Czechia may wish to consider the addition of treaty language to address the uncertainties alluded to earlier. We set out two recommendations for Czechia's consideration below. It is our opinion that if these recommendations are observed, a general exception clause can be effective in reliably preserving the state's regulatory freedom in the context of a balanced treaty.

**RECOMMENDATION 1: CLARIFY THE NATURE AND EFFECT OF GENERAL EXCEPTION CLAUSES**

147. Where a general exception clause is relied on, we recommend that an interpretative note should be included confirming its nature as a clause precluding wrongfulness, rather than as being merely 'permissive'. This would be a prudent course of action addressing the reasoning of *Eco Oro* in future treaty drafting. In particular, the envisaged interpretative note should clarify that the general exception clause has the effect of justifying the host state's conduct, thus rendering it non-wrongful to begin with, and therefore, non-compensable.

148. We further recommend that a general exception clause, if included, should specify its relationship with other legal sources that might be used to exclude liability. In particular, it should be clarified that a general exception clause will apply notwithstanding other quasi-defensive clauses that may be found in the treaty, such as carve-outs.

149. Regarding the relationship of general exception clauses to general international law, and notably the police powers doctrine, Czechia may assess whether it prefers a general exception clause that explicitly excludes the application of the general police powers doctrine, or the regulatory flexibility that comes with a general exception clause that explicitly leaves room for the application of the police powers doctrine.

**RECOMMENDATION 2: DEFINE THE SCOPE AND CONTENT OF GENERAL EXCEPTION CLAUSES**

**RECOMMENDATION 2A: HAVE THE CLAUSE APPLY TO THE ENTIRE IIA**

150. As mentioned above, some treaties confine the application of the general exception clause to certain protection standards, while other treaties make the clause applicable to the entire IIA or investment chapter. In our view, there is no reason not to conceive the general exception clause as applying to the entire IIA or investment chapter, thus ensuring that states conserve their freedom to regulate in a reasonable manner regarding all investment protection standards, including, for instance, the FET standard.

[169] For further commentary, see Mitchell, Munro, and Voon (n. 131), 46-50.

**RECOMMENDATION 2B: USE AN EXEMPLATIVE, RATHER THAN EXHAUSTIVE, LIST OF REGULATORY PURPOSES**

151. Czechia may consider using exemplative rather than exhaustive language in enumerating the permissible regulatory purposes for which its general exception clauses may be invoked. The purpose of such a drafting choice would be to exclude *Bear Creek*-style reasoning that deems a general exception clause to be exhaustive of all the defences available to the host state. The utility of such an approach can also be apprehended when looking at the Italy Model general exception clause, which does not mention regulatory objectives related to social policy, such as labour or consumer protection. The danger of adopting an exhaustive list is to inadvertently exclude legitimate public policy objectives whose relevance might only become apparent once the treaty has already been concluded and ratified.

152. In making this recommendation, we do note two potential drawbacks First, it departs from existing and clearly established drafting practice which may make it difficult to garner the agreement of other states. Second, it would tend to give the host state significant flexibility to raise a range of regulatory purposes as reasons to preclude wrongfulness and may thus create a less balanced treaty.

**RECOMMENDATION 2C: USE ADDITIONAL CRITERIA TO FINE-TUNE THE CLAUSE**

153. A series of additional drafting changes can be made to general exception clauses to bring them more in line with Czechia's preferred IIA policy.

154. Regarding the nexus requirement, and in the interest of a balanced IIA, we recommend incorporating into the general exception clause that measures must be 'necessary' to achieve a certain regulatory purpose. Given the different interpretative approaches, we recommend that a footnote clarifies the meaning to be ascribed to the term 'necessary'. In our view, it would seem reasonable to adopt a definition that mirrors the one adopted in *Deutsche Telekom v India* discussed above. This would involve specifying that 'necessary' in this context refers to the fact that the measure was principally targeted to protect the regulatory interests at stake and was objectively required in order to achieve that protection, taking into account whether the state had reasonable alternatives, less in conflict or more compliant with its international obligations. Doing so would mean that the standard can clearly be distinguished both from the one in Art 25 ARSIWA, which would be too burdensome, and from entirely self-judging standards, which would accord the state too much discretion vis-à-vis the legitimate interests of the investor.

155. In order to achieve a balanced treaty that also protects the investor's legal position, it is further recommended to maintain the requirement that measure taken under a general exception clause must not constitute discrimination among investors or investments. In this regard, it seems to be sufficient to just refer to unjustifiable discrimination, since the term seems capacious enough to cover instances of arbitrary conduct too. Conversely, if the goal

is to retain more flexibility for the host state, only arbitrary discrimination may be mentioned instead, as this term seems to imply a generally higher threshold of breach.

**BOX 5: SUMMARY OF RECOMMENDATIONS IN RELATION TO GENERAL EXCEPTION CLAUSES**

If employed, general exception clauses should specify:

**1. Their relationship to the other standards of protection and the consequences of their application:**

(a) Are general exception clauses intended to operate as a defence to the IIA's standards of protection or are they simply to be weighed in a balancing exercise against them? This depends on Czechia's needs. But, for more predictable ISDS outcomes, we recommend specifying that general exception clauses, when validly invoked, exclude acts as a defence.

(b) Do general exception clauses preclude wrongfulness and therefore the duty to pay compensation? We recommend specifying that where a general exception clause applies, no compensation shall be due because no internationally wrongful act had been committed by the state to begin with.

**2. Their relationship to specific carve-outs, if any, from the standards of protection:** How will general exception clauses interact with specific carve-outs with respect to investor protections that may be included in the IIA? We recommend specifying that general exception clauses apply in addition to/notwithstanding any carve-outs.

**3. Their relationship to general international law**: Do general exception clauses exclude the application of the police powers doctrine under CIL? We remain agnostic on this point as this relates to a state's views regarding sources of international law.

**4. Their scope and requirements:**

(a) Do general exception clauses apply to the entire IIA? We recommend not to limit the clause's scope to only certain protection standards.

(b) Should general exception clauses use exemplative or exhaustive lists of regulatory purposes? We recommend using an exemplative list, although we do note the potential drawbacks of this choice.

(c) What should be the nexus requirement used and should safeguards against discrimination be included? We recommend using the term 'necessary' as a nexus, albeit with a clarificatory note. We also recommend specifying that measures that constitute unjustifiable discrimination are not covered by the clause.

## TABLE III.1: TYPOLOGY OF GENERAL EXCEPTION CLAUSES

### PARADIGMATIC CLAUSE

***Italy Model BIT (2022)***

**[** Subject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors **]** PART A , [ Articles [Non-Discriminatory Treatment] and [Transfers] **]** PART B **[** shall not be construed to prevent a Party from adopting or enforcing measures necessary **]**: PART C

(a) to protect public security or public morals or to maintain public order [1];

(b) to protect human, animal or plant life or health [2];

(c) to ensure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to:

(i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on contracts;

(ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;

(iii) safety.

[1] The public security and public order exceptions may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.
[2] The Parties understand that the measures referred to in subparagraph (b) include environmental measures necessary to protect human, animal or plant life or health.

| VARIATION NO | PART A: STANDARD OF DISCRIMINATION<br>'arbitrary or unjustifiable discrimination' – 'arbitrary and discriminatory' – 'arbitrary or unjustifiable' – 'non-discriminatory' | |
|---|---|---|
| A-1 | Subject to the requirement that such measures are not applied in a manner that would constitute **arbitrary or unjustifiable discrimination** between investments or between investors | Italy Model BIT (2022), art 15(1) |

| | | |
|---|---|---|
| A-1.5 | Provided that such measures are not applied in an **arbitrary or unjustifiable manner, or do not constitute a disguised restriction on trade or investment** | Hong Kong-China CEPA, art 22(1)<br>Israel-Japan BIT, art 15(1)<br>ASEAN-Hong Kong Investment Agreement, art 9(1) |
| A-2 | Provided that such Measures are not applied in a manner that would constitute means of **arbitrary and discriminatory** treatment against a Covered Investor or Investment | Colombia Model BIT (2017), art [##] |
| A-3 | Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining or applying **non-discriminatory** legal measures | Burkina Faso-Turkey BIT (2019), art 5(1)<br>Turkey-Cambodia BIT (2018), art 4(1) |
| *Some treaties include an additional definition clause, defining measures as 'including environmental measures'* | | Hong Kong-China CEPA, art 22(1)<br>Italy Model BIT, art 15(1)<br>Israel-Japan BIT, art 15(1) |
| **VARIATION NO** | **PART B: SCOPE OF APPLICATION** | |
| B-1 | Nothing in this Agreement/Treaty… | Norway Model BIT (2015), art 24<br>Slovakia-Iran BIT (2016), art 11(1)<br>Hong Kong-Chile BIT (2016), art 18 |
| B-2 | Scope limited to non-discriminatory treatment and transfers | Italy Model BIT (2022), art 15(1) |

| VARIATION NO | PART C: NEXUS REQUIREMENT | |
|---|---|---|
| C-1 | shall not be construed to prevent a Party from adopting or enforcing **measures necessary** | Italy Model BIT (2022), art 15(1) |
| C-2 | shall preclude a Contracting Party from adopting, maintaining or enforcing Measures that such Contracting Party **deems necessary** | Colombia Model BIT (2017), art [##] |
| C-3 | Refers to measures 'designed and applied for' / 'related to' | Burkina Faso-Turkey BIT (2019), art 5(1)<br>Turkey-Cambodia BIT (2018), art 4(1)<br>Rwanda-Turkey BIT (2016), art 5 |

## IV. RIGHT TO REGULATE CLAUSES

**BOX 6: ITALY MODEL RIGHT TO REGULATE CLAUSE**

1.The Parties [reaffirm][NOTE 1] the right to regulate within their territories [to achieve][NOTE 3] [legitimate policy objectives, such as the protection of public health, social services, public education, safety, the environment including climate change, public morals, social or consumer protection, privacy and data protection, or the promotion and protection of cultural diversity.][NOTE 2]

2. [For greater certainty, the provisions of this Agreement 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.][NOTE 4]

[...]

Source: Italy Model BIT (2022) art 6.

### A. Definition of a 'right to regulate clause'

156. The 'right to regulate' is defined generally as a state's sovereign power to adopt regulatory measures within its own territory. In IIAs, the right to regulate is typically protected through various means, such as general exception clauses, essential security exceptions, preambular references, carve-outs, as well as standalone clauses that purport to preserve a state's regulate capacity.[170] This section focuses on the latter type of standalone treaty clauses that make express reference to a 'right to regulate'. The content of such clauses is exemplified in the paradigmatic example set out in **BOX 6.** Standalone right to regulate clause are typically found in more recent IIAs.[171]

157. At present, it is unclear whether standalone right to regulate clauses have the effect of excluding state liability that may be incurred under the substantive standards of protection contained in the IIA. There are two divergent interpretations in this respect.

158. Some scholars argue that the inclusion of a right to regulate clause does not have, in and of itself, any direct effect on a state's liability to pay compensation in ISDS. This argument

[170] Ted Gleason and Catharine Titi, 'The Right to Regulate' (2022) *Academic Forum on ISDS Concept Paper* 2022/2, 2.

[171] Examples include: CETA (2016) art 8.9; Indonesia-Switzerland BIT (2022) art 12; Colombia-Spain BIT (2021) art 14; Hungary-Kyrgyzstan BIT (2020) art 3; Hungary-Cabo Verde BIT (2019) art 3; Belarus-Hungary (2019) art 3; EU-Singapore IPA (2018) art 2.2; Lithuania-Turkey BIT (2018) art 3; Argentina-Chile FTA (2017) arts 8.2(4) and 8.4.

interprets the right to regulate as encompassing and declaring only the state's general regulatory freedom recognised at general international law. This includes the state's power to voluntarily subject aspects of its own right to regulate to the investment protections contained in an IIA. Therefore, a general reference to the right to regulate in an IIA does not in and of itself serve to exclude a state's liability to pay compensation if its regulatory actions are found to be in breach of an obligation contained in an IIA.[172] Under this view, standalone right to regulate clauses in IIAs serve to provide interpretative guidance to arbitral tribunals on how they should approach their interpretative task rather than mandating any particular conclusion.

159. Other scholars see the right to regulate clause as having direct, substantive effects on the liability to pay compensation in ISDS. This argument interprets the right to regulate in wider terms, as including a right to regulate in derogation of the commitments assumed by a state under the terms of an IIA. The practical implication of this interpretation is that, if a regulatory measure falls within the right to regulate clause, then there is no liability to pay compensation notwithstanding that the regulatory measure may in other circumstances have been regarded as breaching the state's obligations under the relevant IIA.[173] Such an understanding of the effects of standalone right to regulate clauses seems to treat such clauses as being closer to exceptions.

## B. Variations in the scope and level of legal obligations

160. **Note 1 – 'reaffirm':** A large number of the treaties analysed, 'reaffirm' a state's pre-existing right to regulate.[174] The word 'reaffirm' necessarily presupposes a pre-existing right that the standalone clause in essence merely recalls or repeats. The term 'reaffirms' may therefore suggest that the 'right' referred to in the clause is simply the state's general, sovereign power to take regulatory action, as presently recognised at general international law, and not the wider definition of it as a derogation from the state's IIA obligations. This then implies that the right to regulate clause is not intended to have substantive effect in the context of ISDS.[175] In this respect, we note that if standalone right to regulate clauses merely reiterate the state's right to regulate at general international law, then their inclusion as operative clauses, as opposed to preambular statements, may appear to be somewhat superfluous.

161. At the same time, in our review we observed that some treaties do not use the language of 'reaffirm' but, rather, use language reminiscent of exceptions clauses and may therefore

[172] Gleason and Titi (n. 170), 2. See also Charalampos Giannakopoulos, 'The Right to Regulate in International Investment Law and the Law of State Responsibility: A Hohfeldian Approach' in Photini Pazartzis and Panos Merkouris (eds), *Permutations of Responsibility in International Law* (Brill, 2019) 148.

[173] Ibid., 3.

[174] Italy Model BIT (2022) art 6(1); CETA (2016) art 8.9; EU-Singapore IPA (2018) art 2.2(1).

[175] Gleason and Titi (n. 170), 3.

avoid some of the above-mentioned issues, at least in principle. For example, Art 12 of the Czechia Model BIT (2016) states:

> 'Nothing in this Agreement shall be construed to affect the right of the Contracting Parties to regulate within their territories through measures necessary to achieve legitimate policy objectives, such as […]'

162. However, we also note that, as seen in the preceding Section III, drafting variations of this kind have at times been interpreted as merely 'reaffirming the right to regulate' and, therefore, as not having a substantive effect. We recall here the tribunal in *Infinito Gold*, which stated that:

> '[clauses identical to the one above] must be viewed as acknowledging and reminding interpreters that these two objectives – environment and investment protection – should, if possible, be reconciled so that they are mutually supportive and reinforcing.'[176]

This statement suggests that references to the right to regulate clause may not be seen as having substantive effects even if the word 'reaffirming' is not used.

163. **Note 2 – 'legitimate policy objectives':** Standalone right to regulate clauses frame the right to regulate in connection to the achievement of *'*legitimate policy objectives*'*,[177] thus requiring some kind of balancing between regulatory means and legitimate ends.[178] Most of the treaties reviewed, however, do not specify or indicate the kinds of legitimate policy objectives that may be covered.[179] In this respect, the Italy Model's (2022) right to regulate

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[176] *Infinito Gold* [778]

[177] See e.g. Italy Model BIT (2022) art 6(1); EU-Singapore IPA (2018) art 2.2(1); EU-Vietnam IPA (2019) art 2.2(1).

[178] See *Saluka* [302]-[306]:

> 'It is now established in international law that states are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare. ... The determination of a breach of [the FET standard] by the Czech Republic ... requires a weighing of the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interests on the other.'

And, for a similar statement, see *United Utilities (Tallinn) B.V. and Aktsiaselts Tallinna Vesi v Republic of Estonia*, ICSID Case No. ARB/14/24, Award (21 June 2019), [767] (*'United Utilities*').

[179] Indeed, as noted by Paul Barker, 'Legitimate Regulatory Interests: Case Law and Developments in IIA Practice' in Andreas Kulick (ed), *Reassertion of Control over the Investment Treaty Regime* (Cambridge University Press, 2017) 230, 239:

> 'Most IIAs do not, however, expressly state what constitutes a legitimate regulatory interest or a non-compensable regulatory measure. Tribunals must therefore not only decide as a substantive matter whether there is a legitimate regulatory interest to which the measure is genuinely addressed but also from a more procedural or due-process

clause is an exception in that it provides an illustrative list of examples of legitimate regulatory objectives that the host state may pursue.

164. Tribunals have generally had little difficulty accepting and taking into account a state's legitimate interests in pursuing certain public welfare objectives, including in the context of sustainable development, such as, *inter alia,* environmental regulations controlling dangerous chemicals,[180] tobacco control,[181] and the protection of cultural heritage.[182] However, this has not always been the case. For example, in *Occidental Exploration v Ecuador,* the tribunal declined to consider whether tax policy objectives may have had a bearing on the acceptability of differential treatment under the NT standard.[183] For this reason, the addition of treaty language clarifying through an illustrative list the scope of legitimate regulatory interests that a state may choose to pursue appears to be a sound and useful drafting practice to follow.

165. **Note 3 – 'to achieve'/'necessary':** While some treaties, such as the Italy Model BIT (2022), state that the exercise of the right to regulate must be directed 'to achieve' legitimate policy goals, other treaties incorporate a higher bar by subjecting the exercise of the right to regulate to the requirement of necessity. For example, the Netherlands and Czechia Model BITs reaffirm the state's 'right to regulate within their territories **necessary to achieve** legitimate policy objectives' [emphasis added].[184] In this respect, we refer to our remarks in paragraphs 125-134 of this Report.

166. **Note 4 – Savings clause:** Most standalone right to regulate clauses also contain a savings clause of some type, 'for greater certainty'. Three main drafting variations of a savings clause can be observed, although the practical effect of all seems rather similar.

167. The **first variation** operates on regulatory actions taken by states. It clarifies that acts of regulation may include 'modification to [a state's] laws, in a manner which negatively affects an investment or interferes with an investor's expectation of profits'. For example, the savings clause in the Netherlands Model BIT (2022) states:

> 'The mere fact that a Contracting Party regulates, including through a modification to its laws, in a manner which negatively affects an investment or

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perspective on whether the way in which the measure was implemented conforms to the standards of protection in the IIA.'

[180] *Methanex; Chemtura.*

[181] *Philip Morris*.

[182] *Southern Pacific Properties v Arab Republic of Egypt,* ICSID Case No ARB/84/3, Award (20 May 1992) ('*SPP*').

[183] *Occidental Exploration* [167ff].

[184] Netherlands Model BIT (2019) art 2(2); Czechia Model BIT (2016) art 12(1).

> interferes with an investor's expectations of profits, is not a breach of an obligation under this Agreement.'[185]

168. The **second variation** is largely similar, save that the word 'regulates' is replaced with the phrase 'adoption, modification or enforcement of a Measure'. For example, the savings clause in the Colombia Model BIT (2017) is phrased in the following terms:

> 'For greater certainty, the mere fact that the adoption, modification or enforcement of a Measure negatively affects a Covered Investment or interferes with a Covered Investor's expectations, including its expectation of profits, does not amount to a breach of any obligation under this Agreement.'[186]

169. Lastly, the **third variation** operates directly on the legitimate expectations of the investor. Art 12(2) of the Czechia Model BIT (2016) and Art 6(2) of the Italy Model BIT (2022) right to regulate clause both contain the following:

> 'For greater certainty, the provisions of this Agreement 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.'

This clarificatory clause appears to largely reiterate a principle emerging in the context of jurisprudence interpreting the FET standard to the effect that, in the absence of an express agreement stating otherwise, investors do not have a legitimate expectation that a host state will not change its laws over time.[187] In view of the expansion of the concept of legitimate expectations in the context of arbitral decisions, such as *Eco Oro,* we recommend that such a savings clause should be retained.

### C. Assessment and drafting recommendations

170. Considering the dearth of authorities interpreting standalone right to regulate clauses, offering an assessment of its practical effects may appear speculative at this stage. Given this, we note that the right to regulate is presently already enshrined in CIL. However, it is

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[185] Netherlands Model BIT (2019) art 2(2).

[186] Colombia Model BIT (2017) article [##] on right to regulate.

[187] See *Philip Morris* [421]-[427]; also *Parkerings-Compagniet AS v Republic of Lithuania*, ICSID Case No. ARB/05/8, Award (11 September 2007), [332] ('*Parkerings v Lithuania'*):

> '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. Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time.'

still unclear whether even an explicit reference to it in an IIA will have any substantive effect in excluding liability.

171. Therefore, if a right to regulate clause is to be included, our overall recommendation would be that it should be used in combination with other strategies to exclude liability, such as carve-outs, qualifications to investment protections, or a general exception clause. In terms of drafting a standalone right to regulate clause, we offer three recommendations in particular.

**RECOMMENDATION 1: ADOPT PHRASING THAT CLARIFIES THAT THE RIGHT TO REGULATE CLAUSE HAS SUBSTANTIVE EFFECT**

**RECOMMENDATION 1A: EXPLICITLY CLARIFY WHETHER THE RIGHT TO REGULATE CLAUSE HAS SUBSTANTIVE EFFECT**

172. We recommend that an explanatory note should be added to a right to regulate clause to clarify whether the clause is intended to have substantive effect or not.

173. The general impression that emerges from the authorities examined is that it is unclear whether right to regulate clauses have a substantive effect in excluding liability to pay compensation. Therefore, depending on the precise policy objectives of Czechia, it may be possible to include an explanatory note indicating in which sense the 'right to regulate' is being used. For instance, if the right to regulate is to be seen as purely declaratory in nature, an explanatory note could read:

> 'Note: For the purposes of Art [XX], the "right to regulate" does not include the right of a Contracting Party to regulate in derogation of any of the provisions of this Treaty.'

174. But if it is sought to make the right to regulate an operative provision having substantive force, as a defence to regulate in derogation of the other terms of the IIA, then the explanatory note could be framed in the following terms:

> 'Note: For the purposes of Art [XX], the "right to regulate" includes the right of a Contracting Party to regulate without being liable to pay compensation, and includes the right of a Contracting Party to regulate in derogation of any of the provisions of this Treaty.'

**RECOMMENDATION 1B: RETAIN THE WORDING 'NOTHING … NECESSARY TO'**

175. If, however, Recommendation 1A above represents a substantial departure from contemporary drafting practice, an alternative would be to retain the formulation used in Art 12 of Czechia's 2016 Model BIT, i.e.:

'Nothing in this Agreement shall be construed to affect the right of the Contracting Parties to regulate within their territories through measures necessary to achieve legitimate policy objectives, such as [...]'.

176. As mentioned above, this wording seems to suggest more practical effects than the mere 'reaffirming' of the right to regulate. A limitation of this wording is that the host state would have to prove the necessity of the relevant measure. For this purpose, and similarly to what was previously suggested in the context of general exception clauses, an explanatory note may be included clarifying what kind of test is implied by the standard 'necessary'.

**RECOMMENDATION 2: ADOPT A LIST OF EXAMPLES OF LEGITIMATE POLICY OBJECTIVES**

177. An illustrative list of examples of 'legitimate policy objectives' could be added to any standalone right to regulate clause. In this connection, the Italy Model's (2022) right to regulate clause provides a useful drafting precedent.

**RECOMMENDATION 3: RETAIN THE SAVINGS CLAUSE**

178. We recommend that the savings clause in right to regulate provisions of the Czechia Model BIT (2016) and the Italy Model BIT (2022) should be retained to provide interpretative guidance to tribunals against construing the IIA's provisions, in particular FET, as an implied stabilisation clause.

**BOX 7: SUMMARY OF RECOMMENDATIONS ON RIGHT TO REGULATE CLAUSES**

In negotiating a standalone right to regulate clause, Czechia may consider:

1. Clarifying whether it is intended to have substantive effects on the host state's liability and the duty to pay compensation. This should preferably be done by way of an explicit statement, or, in the alternative, by retaining the drafting approach followed in Czechia's Model BIT (2016);
2. Adopting an illustrative list of 'legitimate policy objectives' that the host state may choose to pursue;
3. Including a savings clause to clarify that the right to regulate clause does not create a legitimate expectation of regulatory stability.

On the whole, the right to regulate clauses in Czechia's Model BIT (2016) and the Italy Model BIT (2022) appear to offer sound drafting precedents.

| TABLE IV.1: TYPOLOGY OF RIGHT TO REGULATE CLAUSES | | |
|---|---|---|
| **PARADIGMATIC CLAUSE**<br><br>***Italy Model BIT (2022)***<br><br>**[** The Parties reaffirm the right to regulate within their territories **]** **PART A** **[** to achieve legitimate policy objectives, such as the protection of public health, social services, public education, safety, the environment including climate change, public morals, social or consumer protection, privacy and data protection, or the promotion and protection of cultural diversity. **]** **PART B**<br><br>**[** For greater certainty, the provisions of this Agreement 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.**]** **PART C** | | |
| **VARIATION NO** | **PART A: AFFIRMING THE RIGHT TO REGULATE**<br>***'Reaffirm the right' - 'shall not affect the right' - 'Nothing in this agreement shall affect the inherent right'*** | |
| A-1 | The Parties <u>reaffirm the right to regulate within their territories</u> | Italy Model BIT (2022), art 6(1)<br>Canada Model BIT (2021), art 3<br>EU-Singapore IPA (2018), art 2.2<br>EU-Vietnam IPA (2019), art 3.2<br>Slovakia Model BIT (2019), art 4(1) |
| A-2 | The provisions of this Agreement <u>shall not affect the right</u> of the Contracting Parties to regulate within their territories | Netherlands Model BIT (2019), art 2(2)<br>Cape Verde-Hungary BIT (2019), art 3(1) |
| A-3 | <u>None of the provisions of this Agreement shall affect the **inherent** right</u> of the Contracting Parties to regulate within their territories | Colombia Model BIT (2017), art [##] |

| VARIATION NO | PART B: STANDARD OF NECESSITY (WHEN INCORPORATED)<br>*'to achieve legitimate policy objectives' – 'necessary to achieve legitimate policy objectives'* | |
|---|---|---|
| B-1 | … right to regulate within their territories to achieve legitimate policy objectives | Italy Model BIT (2022), art 6(1)<br>Canada Model BIT (2021), art 3<br>EU-Singapore IPA (2018), art 2(2)<br>EU-Vietnam IPA (2019), art 2(2) |
| B-2 | … right of the Contracting Parties to regulate within their territories necessary to achieve legitimate policy objectives | Netherlands Model BIT (2019), art 2(2)<br>Cape Verde-Hungary BIT (2019), art 3(1)<br>Czech Republic Model BIT (2016), art 12(1) |
| **VARIATION NO** | **PART C: SAVINGS CLAUSE** | |
| C-1 | For greater certainty, the mere fact that a Party regulates, including through a modification to its laws, in a manner which negatively affects an investment or interferes with an investor's expectations of profits, does not amount to a breach of an obligation under this Agreement | Netherlands Model BIT (2019), art 2(2)<br>EU-Singapore IPA (2018), art 2(2)<br>EU-Vietnam IPA (2019), art 2(2)<br>Slovakia Model BIT (2019), art 4(1)<br>Cape Verde-Hungary (2019), art 3(1) |
| C-2 | For greater certainty, the mere fact that the adoption, modification or enforcement of a Measure negatively affects a Covered Investment or interferes with a Covered Investor's expectations, including its expectation of profits, does not amount to a breach of any obligation under this Agreement. | Colombia Model BIT (2017), art [##] |
| C-3 | For greater certainty, the provisions of this Agreement 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. | Czech Model BIT (2016), art 3(1)<br>Italy Model BIT (2022), art 6(1) |

## V. CLAUSES ADDRESSING DOMESTIC LEVELS OF SUSTAINABLE DEVELOPMENT STANDARDS

### A. General remarks

179. This section addresses five types of clauses that broadly address states' domestic levels of sustainable development standards.[188]

180. Three of the five types of clauses can be grouped together thematically since they have negative objectives and seek to provide safeguards against certain types of actions or inactions undertaken by states. They are as follows:

(a) **'Non-lowering' clauses:** They seek to discourage states from *prospectively* lowering their domestic standards to gain a comparative advantage to attract or encourage investment (Subsection B);

(b) **'Non-derogation' clauses:** They discourage states from waiving, or derogating from, *existing* applicable domestic measures in an effort to encourage investment (Subsection C); and

(c) **'Effective enforcement' clauses:** They address a state's failure to effectively enforce *existing* domestic laws as an encouragement of investment (Subsection D).

181. We term the fourth type of clauses **'ensuring levels of protection clauses'**. They pursue a positive objective, since they aim to ensure adequate levels of protection in domestic laws and policies (Subsection E).

182. We term the fifth type of clauses **'consultation mechanism clauses'**. They either offer or mandate consultations between the contracting parties to an IIA, upon one party's non-compliance with a 'non-derogation' or a 'non-lowering' clause (Subsection F).

183. Notably, all clauses addressed in this section create inter-state obligations only. They do not directly address investors, nor do they impliedly refer to investors as third-party beneficiaries. This has certain implications in relation to the practical effects of these clauses in the context of ISDS, which shall be examined in Subsection G.

[188] See, generally, Kathryn Gordon, Joachim Pohl, and Marie Bouchard, 'Investment Treaty Law, Sustainable Development and Responsible Business Conduct: A Fact Finding Survey' (2014) *OECD Working Papers on International Investment* 2014/01, 16 <https://www.oecd-ilibrary.org/finance-and-investment/investment-treaty-law-sustainable-development-and-responsible-business-conduct-a-fact-finding-survey_5jz0xvgx1zlt-en> accessed 14 February 2022.

## B. Non-lowering clauses

184. Non-lowering clauses seek to discourage a state from lowering its regulatory standards as a means of gaining a comparative advantage to encourage investment. Put differently, non-lowering clauses seek to avoid a regulatory 'race to the bottom'.[189] Non-lowering clauses were first adopted in the 1992 North American Free Trade Agreement (NAFTA), alongside and non-derogation clauses (examined below).[190] Although they did not gain traction in IIAs for some time, they are much more common now, having become the 'clear preference of major economies including the United States, China, the European Union, Brazil, Canada, Japan, and Korea', as well as middle- and smaller-sized economies.[191]

185. Non-lowering clauses adopt a two-part structure. The first part mentions a type of interference with a domestic measure.[192] In most clauses, this will be described as a 'reduction', a 'lowering', or a 'relaxation'. However, there are some outliers, such as the Colombia Model BIT (2017), which uses the terms 'detract' and 'diminish' instead.[193] The second part provides the circumstances in which such interferences with domestic measures are proscribed.[194] For instance, in the Italy Model BIT (2022), such interferences are proscribed when they are undertaken 'in order to encourage investment'.[195]

**BOX 8: ITALY MODEL NON-LOWERING CLAUSE**

A Party shall not weaken or reduce the levels of protection afforded in its environmental laws in order to encourage investment.

Source: Italy Model BIT (2022) art 20(2).

[189] Chi (n. 13), 22.

[190] Andrew D. Mitchell and James Munro, 'No Retreat: An Emerging Principle of Non-Regression from Environmental Protections in International Investment Law' (2019) 50 *Georgetown Law Journal* 625, 628.

[191] Ibid.

[192] Ibid., 629.

[193] Colombia Model BIT (2017), art [##] on non-detraction from environmental, human rights and labour standards.

[194] Mitchell and Munro (n. 190), 629.

[195] Italy Model BIT (2022), art 20(2).

i. ‘Shall not’/‘Shall refrain’, ‘Shall recognise the importance’, ‘Recognise that it is inappropriate’

186. **‘Shall not’/‘Shall refrain’**: The first drafting variation is phrased in terms of ‘shall not’. An example is seen in the Italy Model BIT (2022), as referred to in **BOX 8**. The word ‘shall’ indicates that the party has a duty to undertake a certain action or inaction.[196] ‘Shall’-based obligations are hard legal rules, which are ‘norms framed in mandatory terms and with higher precision’.[197] In other words, the phrase ‘shall’ articulates an obligation in the most forceful manner possible.[198] Obligatory clauses involve the parties’ commitment to behave in a certain way or to refrain from behaving in a certain way.[199] Some IIAs, such as the Japan-Uruguay BIT (2015),[200] utilise the phrase ‘shall refrain’ instead. In terms of practical effect, the difference between this phrasing and ‘shall not’ is minimal, since both are essentially negative ‘shall’-based obligations.

187. **‘Recognise that it is inappropriate’**: The most common drafting variation of a non-lowering clause that we have observed states that the IIA parties recognise the inappropriateness of lowering or reducing standards. This variation of the non-lowering clause may be described as ‘soft law’, as it is framed in aspirational terms and is vague in its content. As such, the clause is hortatory and ‘creates, at best, weak legal obligations’.[201]

188. **‘Shall recognise the importance’**: A few IIAs, such as the Japan-Kenya BIT (2016),[202] mention that the parties ‘shall recognise the importance’ of encouraging investment without relaxing domestic standards. While this variation is also formulated in terms of a mandate, it is arguably slightly weaker than the preceding variation, insofar as the word ‘inappropriate’ used there carries a more negative connotation compared to the word ‘importance’, potentially rendering the latter less forceful.

ii. ‘Laws/Legislation’, ‘Measures’

189. **‘Laws’/‘Legislation’**: Most non-lowering clauses identified within our dataset refer to the weakening and/or reduction of levels of protection afforded in domestic ‘laws’ or domestic ‘legislation’. In using these words, the clauses target only legally binding instruments. Arbitral tribunals have interpreted ‘legislation’ to broadly mean rules and norms which are

[196] Bryan A. Garner, *Black’s Law Dictionary*, 11th edn (Thomson Reuters, 2019), s.v. ‘shall’.

[197] Mitchell and Munro (n. 190), 663.

[198] Ibid., 666.

[199] McLaughlin (n. 12), 115.

[200] Japan-Uruguay BIT (2015) art 27.

[201] Kenneth W. Abbott, Robert O. Keohane, Andrew Moravcsik, Anne-Marie Slaughter, and Duncan Snidal, ‘The Concept of Legalization’ (2000) 54 *International Organization* 401, 412.

[202] Japan-Kenya BIT (2016) art 22.

given binding effect, such as laws, regulations, and other binding instruments.[203] As such, non-binding instruments and actions or inactions by states are excluded from the scope of this variation. For instance, if a lowering of environmental standards is implemented through a non-legal instrument, such as a moratorium, then this measure would arguably not be captured by a non-lowering clause which adopts the 'laws/legislation' variation.[204]

190. **'Measures':** Other IIAs, such as the Iran-Slovakia BIT (2016),[205] refer to the relaxation of 'measures'. The term 'measure' is likely broader insofar as it could include laws, regulations, other instruments of a state, as well as actions or inactions of a state.[206] As such, this variation encompasses both binding and non-binding measures and is therefore broader in scope compared to the 'laws/legislation' variation.

191. We note that these variations are also seen in non-derogation clauses (to be addressed in the next section). Thus, the present analysis is equally applicable to non-derogation clauses. Czechia may opt to adopt either of the variations examined here with regards to its non-derogation clause.

**TABLE V.1: TYPOLOGY OF NON-LOWERING CLAUSES**

| Commitment Level | No. | Variations | Indicative Examples |
|---|---|---|---|
| ↓ | **1A.** | **shall refrain** from encouraging investment by investors of the other Contracting Party or of a non-Contracting Party by relaxing its health, safety or environmental measures or by lowering its labor standards' | Japan-Uruguay BIT (2015), art 27<br>China-Cambodia FTA (2022), art 8(4) |
| | **1B.** | **shall not** weaken or reduce the levels of protection afforded in its environmental laws in order to encourage investment | Italy Model BIT (2022), art 20(2) (Environment)<br>Italy Model BIT (2022), art 22(2) (Labour) |
| | **2.** | **recognize that it is inappropriate** to encourage investment by relaxing … measures<br><br>**recognize that it is inappropriate** to lower the levels of protection… | Netherlands Model BIT (2019), art 6(4)<br>Austria-Kyrgyzstan BIT (2016), art 4<br>Iran-Slovakia BIT (2016), art 10(1)<br>Brazil Model CFIA (2015), |

[203] *Vladislav Kim and others v Republic of Uzbekistan*, ICSID Case No. ARB/13/6, Decision on Jurisdiction (8 March 2017), [18], [371] ('*Kim*').

[204] Mitchell and Munro (n. 190), 671.

[205] Iran-Slovakia BIT (2016) art 10(1).

[206] *Saluka* [459].

| | | | |
|---|---|---|---|
| | | | art 16(2)<br>United States Model BIT (2012), art 12(2) |
| | **3.** | **shall recognise the importance** of encouraging investments … without relaxing its health, safety or environmental <u>measures</u> or by lowering its labour <u>standards</u> | Japan-Kenya BIT (2016), article 22 |
| Note: Variations under subsection (i) are in **bold.** Variations under subsection (ii) are <u>underlined</u>. | | | |

### C. Non-derogation clauses

192. Non-derogation clauses address a state's waiver, or derogation, from applicable domestic measures. They tend to be grouped together with non-lowering clauses in IIAs. Non-derogation clauses adopt the same two-part structure as non-lowering clauses.[207] In most non-derogation clauses, the type or nature of interference with a domestic measure is described in the clause's first part as a 'waiver' or a 'derogation'. Variations include the Brazil Model CFIA (2015), which uses the terms 'repeal' and 'amendment' instead.[208] The clause's second part provides the circumstances whereby such interferences with domestic measures are proscribed.[209] In the Italy Model BIT (2022), such waivers or derogations are proscribed in the same circumstances as in the non-lowering clause – that is, when they are undertaken 'in order to encourage investment in [the contracting party's] territory'.[210]

**BOX 9: ITALY MODEL NON-DEROGATION CLAUSE**

A Party shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from such legislation in order to encourage investment in its territory.

Source: Italy Model (2022) art 20(3).

[207] See paragraphs 184-185 of this Report.

[208] Brazil Model CFIA (2015) art 16(2).

[209] Mitchell and Munro (n. 190), 629.

[210] Italy Model BIT (2022) art 20(3).

i. ‘Shall not’/‘Guarantees it shall not’, ‘Should not’, ‘Recognise it is inappropriate’

193. **‘Shall not’/‘Guarantees it shall not**’: The first variation observed is phrased in terms of ‘shall not’, thereby denoting a mandatory course of conduct.[211] An example is seen in the Italy Model BIT (2022), as illustrated in **BOX 9**. Notably, the Brazil Model CFIA (2015) utilises the phrase ‘guarantees it shall not’.[212] The obligations in both variations are articulated in an equally forceful manner, as both include the phrase ‘shall not’. However, the variation of the Brazil Model arguably attributes more accountability to the parties by framing the obligation in terms of a ‘guarantee’.

194. **‘Should’**: Some IIAs frame their non-derogation clause as a ‘should’-based obligation, which is typically categorised as a softer legal commitment. According to arbitral jurisprudence, ‘should’ indicates a duty to engage in certain conduct, although it falls short of a legal obligation[213] and is less mandatory than ‘shall.’[214] In other words, the use of ‘should’, as opposed to ‘shall’, affords the parties ‘a degree of flexibility in how the duty is applied’.[215] For instance, according to some authors, a state would not violate a ‘should’-based obligation if it fails to comply with the duty on a legitimate basis, either within the framework of the duty itself or of the treaty.[216] By contrast, a ‘should’-based obligation would be breached if the state lacks any justification whatsoever, or if the justification offered is completely incompatible with the duty or the general purpose of the treaty.[217]

195. At the same time, it must be made clear that the use of ‘should’ cannot be interpreted as imposing no obligation at all. As the tribunal in *El Paso v Argentina* stated, ‘if the Parties to the BIT had intended to instil no meaning at all … they should and would have said so’.[218] It should also be noted that certain ‘should’-based non-derogation clauses are exempt from dispute settlement procedures,[219] thereby implying that such clauses do impose some duties on parties. Accordingly, a party which intends for a non-derogation clause to be merely hortatory in nature would thus have to articulate it without utilising the word ‘should’. Indeed, some IIAs do adopt this approach.[220]

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[211] See paragraph 186 of this Report.

[212] Brazil Model CFIA (2015) art 16(2).

[213] *Grand River Enters. Six Nations, Ltd. and others v United States of America*, UNCITRAL, Decision on Objections to Jurisdiction (20 July 2006), [58] (‘*Grand River*’).

[214] *Occidental Exploration* [70].

[215] Mitchell and Munro (n. 190), 664.

[216] Ibid.

[217] Ibid.

[218] *El Paso v Argentina*, ICSID Case No. ARB/03/15, Jurisdiction (27 April 2006), [110] (‘*El Paso*’).

[219] See Canada-Hong Kong SAR BIT (2016) art 20.

[220] See, e.g. China-Canada BIT (2012) art 18(3), stating that:

196. **'Recognise it is inappropriate'**: The weakest variation states that parties recognise the inappropriateness of waivers or derogations of standards. As highlighted previously, in paragraph 187, such hortatory language indicates that the clause 'creates, at best, weak legal obligations'.[221]

ii. 'Waive/Derogate/Relax', 'Change', 'Amend'

197. **'Waive'/'derogate'/'relax'**: The terms 'waive', 'derogate' and 'relax' are most commonly used in non-derogation clauses. For instance, the Italy Model BIT (2022) uses the terms 'waive' and 'derogate'.

198. **'Change'**: This variation is used in the non-derogation clause found in the BLEU-United Arab Emirates BIT (2004), which states:

> 'No Contracting Party shall change or relax its domestic environmental legislation to encourage investment, or investment maintenance or the expansion of the investment that shall be made in its territory.'

'Change' is a neutral term and could arguably encompass *any* amendment to domestic legislation (whether a weakening one or not), insofar as it is linked to an encouragement of investment.

199. **'Amend'**: Another neutral term, 'amend', is used in the non-derogation clause of the Brazil Model CFIA (2015).[222] However, the Brazilian Model's non-derogation clause also requires that the amendment 'decrease[s] [the contracting parties'] labor, environmental or health standards.' As such, Brazil's variation is ultimately similar to most of the non-derogation clauses found in other IIAs that refer to the 'weakening' of protections.

iii. '(In order) to encourage'/'As an encouragement', 'In a manner affecting investment'

200. **'In order to encourage'/'to encourage'/'as an encouragement'**: Most non-derogation clauses use either of these three phrases: 'in order to encourage';[223] 'to encourage';[224] and

> 'The Contracting Parties recognize that it is inappropriate to encourage investment by waiving, relaxing, or otherwise derogating from domestic health, safety or environmental measures.'

[221] Abbott, Keohane, Moravcsik, Slaughter, and Snidal (n. 201), 412.

[222] Brazil Model CFIA (2015) art 16(2).

[223] See Italy Model BIT (2022) art 20(3).

[224] See Brazil Model BIT (2015) art 16(2).

'as an encouragement'.[225] These variations focus on the parties' intention behind the non-enforcement of regulatory standards. Thus, the non-derogation clause would only be triggered where the derogation or waiver was done in an attempt to encourage investment.

201. **'In a manner affecting investment'/'in ways affecting investment'**: Other IIAs use phrases which focus on the effect that non-enforcement can have on investment, specifying that any derogation or lowering will only be actionable if it 'affects' investment.[226] Accordingly, intention to encourage investment is not necessary for the non-enforcement of regulatory standards to be inconsistent with the clause. However, this drafting variation arguably imposes a higher threshold for violation, as complicated evidentiary showings may be needed to establish that the non-enforcement has indeed affected investment.[227]

iv. Domestic laws v. International standards

202. **'Domestic laws'/'its laws'**: In most IIAs, non-derogation as well as non-lowering clauses are articulated with reference to the parties' domestic laws. For instance, the non-lowering clause of the China-Canada BIT (2012) mentions the levels of protection afforded by 'domestic' environmental laws,[228] whereas the non-derogation clause in the US Model BIT (2012) mentions waiver or derogation from 'its' environmental law.[229]

203. **International standards ('fundamental principles and rights at work')**: Although very uncommon, some treaties refer to international standards in addition to domestic standards. For instance, Article 12.3(5) of the EU-Singapore FTA (2018) refers to the ILO's Declaration on Fundamental Principles and Rights at Work:

> 'The Parties recognise that the violation of fundamental principles and rights at work cannot be invoked or otherwise used as a legitimate comparative advantage.'

This variation is significant as international standards may be higher than domestic standards.[230] However, two points should be noted. Firstly, thus far, such references to

[225] See US Model BIT (2012) art 12(2).

[226] Jesse Coleman, Lise J. Johnson, Ella Merrill, and Lisa E. Sachs, 'Investment Treaties and Models in 2019: (Mis)Aligned with the SDGs?' in Lisa Sachs, Lise Johnson, and Jesse Coleman (eds), *Yearbook on International Investment Law & Policy 2019* (Oxford University Press, 2021) 111, 152.

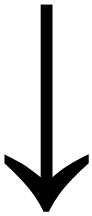
[227] Lise Johnson, Lisa Sachs, and Jesse Coleman, 'International Investment Agreements, 2014: A Review of Trends and New Approaches' in Andrea K. Bjorklund (ed), *Yearbook on International Investment Law & Policy 2014-2015* (Oxford University Press, 2016) 15, 40.

[228] China-Canada BIT (2012) art 18(3).

[229] US Model BIT (2012) art 12(2).

[230] Johnson, Sachs, and Coleman (n. 227), 39.

international standards are only made within the realm of labour standards. Secondly, clauses adopting this variation tend to be framed in weaker hortatory language, as seen in the example, where the term 'recognise' is used.

| TABLE V.2: TYPOLOGY OF NON-DEROGATION CLAUSES | | | |
|---|---|---|---|
| **Commitment Level** | **No.** | **Variations** | **Indicative Examples** |
|  | **1A.** | **guarantees it shall not** amend or repeal, nor offer the amendment or repeal of such legislation *to encourage* the establishment, maintenance or expansion of an investment in its territory, to the extent that such amendment or repeal involves decreasing **their** labor, environmental or health standards | Brazil Model CFIA (2015), art 16(2) |
| | **1B.** | **shall not** waive or otherwise derogate from, or offer to waive or otherwise derogate from such legislation ['***its*** environmental laws'] *in order to* encourage investment in its territory | Italy Model BIT (2022), art 20(3))<br>Slovakia Model BIT (2016), art 3(2) |
| | **1C.** | **shall ensure** that it does not waive or otherwise derogate from or offer to waive or otherwise derogate from **its** labour laws… | Morocco-Nigeria BIT (2016), art 15(2)<br>US Model BIT (2012), art 12(2) |
| | **1D.** | **No** Contracting Party **shall** change or relax **its** domestic environmental legislation *to encourage investment*… | BLEU-United Arab Emirates BIT (2004), art 5(2) |
| | **2.** | **should not** waive or otherwise derogate from, or offer to waive or otherwise derogate from those measures [**domestic** health, safety or environmental measures] *to encourage… investment*' | Singapore-Nigeria BIT (2016), art 10<br>Japan-Colombia BIT (2011), art 21(1) |
| | **3.** | **recognize that it is inappropriate** *to encourage investment* by waiving, relaxing, or otherwise derogating from **domestic** health, safety or environmental measures | China-Canada BIT 2012, art 18(3) |

Note: Variations under subsection (i) are in **bold**. Variations under subsection (ii) are underlined. Variations under subsection (iii) are *italicised*. Variations under subsection (iv) are in **bold and underlined**.

## D. Effective enforcement of laws clauses

204. This type of clause seeks to guard against states failing, through action or inaction, to effectively enforce their domestic laws relating to environmental and/or labour protection as a way to encourage investment. In contrast to not lowering and non-derogation clauses, only five IIAs within our dataset included an effective enforcement of laws clause. Three of those IIAs targeted environmental and labour laws, whereas the remaining two IIAs addressed only labour laws.

**BOX 10: EFFECTIVE ENFORCEMENT OF LAWS CLAUSE IN THE BLEU MODEL BIT (2019)**

A Contracting Party shall not, through a sustained or recurring course of action or inaction, fail to effectively enforce its environmental and labour laws, as an encouragement for investment.

Source: BLEU Model BIT (2019) art 15(5).

### i. 'Shall not', 'Shall ensure that it does not'

205. Contrary to non-lowering and non-derogation clauses, the effective enforcement of laws clauses we observed were all of an obligatory nature with two different types of phraseology used. The clauses stated that each contracting party either 'shall not' or 'shall ensure that it does not' fail to effectively enforce the relevant laws. The practical difference of the two variations is likely to be minimal. Both variations are fundamentally 'shall'-based obligations, thereby constituting hard law and imposing a mandatory duty on the contracting parties.[231]

### ii. 'Sustained or recurring course of action or inaction'

*206.* All five 'effective enforcement of laws' clauses in our dataset mention the phrase 'a sustained or recurring course of action or inaction'. This implies that, in order for any non-enforcement to be inconsistent with the treaty, it must occur over a period of time.[232] This may make it more difficult or cumbersome for one contracting party to enforce the obligations under this provision against the other party.[233]

[231] See paragraph 186 of this Report.

[232] Johnson, Sachs, and Coleman (n. 227), 39.

[233] Coleman, Johnson, Merrill, and Sachs (n. 226), 153.

| TABLE V.3: TYPOLOGY OF EFFECTIVE ENFORCEMENT CLAUSES | | |
|---|---|---|
| **No.** | **Variations** | **Indicative Examples** |
| **1A.** | **shall not**, through a sustained or recurring course of action or inaction, fail to effectively enforce its environmental and labour laws, as an encouragement for investment | BLEU Model BIT (2019), art 15(5)<br>EU-Canada CETA (2017), art 23.4(3) |
| **1B.** | **shall ensure that it does not** fail to effectively enforce those laws through a sustained or recurring course of action or inaction | Morocco-Nigeria BIT (2016), art 15(2)<br>US Model BIT (2012), art 12(2) |
| Note: Variations under subsection (i) are in **bold**. Variations under subsection (ii) are underlined. | | |

## E. Ensuring levels of protection in laws and policies clauses

207. This type of clause differs from the preceding three types, as it seeks to impose a positive rather than negative obligation on the contracting parties, namely, the obligation to ensure that certain levels of environmental, labour, and/or human rights protection are met in their laws and policies.

**BOX 11: ENSURING LEVELS OF PROTECTION IN LAWS AND POLICIES CLAUSE IN THE BLEU MODEL BIT (2019)**

Each Contracting Party shall ensure that its laws and policies provide for and encourage high levels of environmental and labour protection and shall strive to continue to improve those laws and policies and their underlying levels of protection.

Source: BLEU Model BIT (2019) art 15(2).

### i. 'Shall ensure … shall strive to continue to improve', 'shall strive to ensure'

208. **'Shall ensure … and shall strive to continue to improve'**: Some IIAs frame this clause as a 'shall'-based obligation,[234] thus connoting a mandatory duty of result to ensure a certain level of protection in domestic laws and policies.[235] We observed that, occasionally, this variation of the clause is subsequently buttressed by the phrase 'shall strive to continue to improve'.[236] This introduces a duty of conduct for the future alongside the duty of result.

[234] BLEU Model BIT (2019) art 15(2).

[235] See paragraph 186 of this Report.

[236] The Netherlands Model BIT (2019) art 6(2).

However, it should be noted that, when this add-on is used, the requisite 'improvement' tracks closer to a 'best efforts' commitments ('shall strive to …').

209. **'Shall strive to ensure'**: As highlighted in the preceding paragraph, the phrase 'shall strive' indicates that a 'best efforts' approach is required. Being hortatory, 'best efforts' clauses create weaker legal obligations and may be overridden in some situations.[237] For example, although it appears clear that a party who undertakes action that manifestly undermines or subverts the commitment would not have 'strived' to implement the clause, it is less clear if the same conclusion should follow for less egregious actions by a party.[238]

ii. 'High levels', 'High levels appropriate to its economic and social situation', 'appropriate levels'

210. **'High levels':** On one end of the spectrum, some IIAs, such as the Netherlands Model BIT (2019),[239] refer to 'high levels' of protection, albeit without defining what 'high levels' entails. Although what constitutes 'high levels' can be subject to interpretation, the lack of any qualifying language may also make it possible to make a contextual interpretation linking the term to internationally recognised standards.

211. **'High levels appropriate to its economic and social situation':** Another variant of the 'high levels' approach was observed in the Morocco-Nigeria BIT (2016), which utilises the phrase 'high levels **appropriate** *to* [each contracting party's] **economic and social situation**'.[240] Arguably, these qualifications grant more flexibility to the IIA parties to contend that they cannot uphold excessively high standards due to their potential status as developing or least-developed economies. Conversely, this provision may be invoked against developed economies to produce the opposite outcome. Since the threshold is determined by the economic and social situation in each state, this variation may be disadvantageous for a developed economy such as Czechia.

*212.* **'Appropriate levels':** At the opposite end of the spectrum, there are IIAs, such as the Iran-Slovakia BIT (2016), that employ the phrase 'appropriate levels' instead. Given that this variation is significantly more contextual, the obligation it imposes is arguably weaker than in the preceding variations. That is, in determining what would qualify as 'appropriate levels' of protection, a number of *prima facie* legitimate considerations could in principle be taken into account, including, *inter alia*, level of economic development, social situation, technical capacity, the political salience of an issue and the state's overall policy strategy. Consequently, this approach may expand the scope of situations beyond the purely economic and social situations described earlier.

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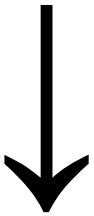
[237] Mitchell and Munro (n. 190), 666.

[238] Ibid.

[239] The Netherlands Model BIT (2019) art 6(2).

[240] Morocco-Nigeria BIT (2016) art 15(5) [emphases added].

| TABLE V.4: TYPOLOGY OF ENSURING LEVELS OF PROTECTION CLAUSES | | | |
|---|---|---|---|
| **Commitment Level** | **No.** | **Variations** | **Indicative Examples** |
|  | **1A.** | **shall ensure** that its investment laws and policies provide for and encourage high levels of environmental and labor protection and **shall strive to continue to improve** those laws and policies and their underlying levels of protection | Netherlands Model BIT (2019), art 6(2)<br>BLEU Model BIT (2019), art 15(2) |
| | **1B.** | **shall ensure** that its laws and regulations provide for high levels of labour and human rights protection appropriate to its economic and social situation, and **shall strive to continue to improve** these law and regulations | Morocco-Nigeria BIT (2016), art 15(5) |
| | **2.** | **shall strive** actively to ensure that its laws and policies provide for and encourage high levels of environmental protection | Republic of Korea-New Zealand FTA (2015), art 16.2(1) |
| | **3.** | **shall ensure** that its laws and regulations provide for appropriate levels of environmental protection and shall strive to continue to improve those laws and regulations | Iran-Slovakia BIT (2016), art 10(2) |
| Note: Variations under subsection (i) are in **bold**. Variations under subsection (ii) are underlined. Variations under subsection (iii) are *italicised*. | | | |

## F. Consultation mechanism clauses

213. Clauses of this kind either offer or mandate consultations between the contracting parties, upon one party's breach of a non-derogation or non-lowering clause. Notably, the very existence of consultation mechanism clauses further highlights the soft manner of enforcement of non-lowering and non-derogation clauses.[241] Clauses on consultation mechanisms were found in only 20 IIAs within our dataset. Fifteen of these were BITs concluded by Canada, mostly with African states, and one was the Canada Model BIT (2021). It should thus be kept in mind that the consultation mechanism type of clause is not commonly adopted by states as of the time of writing.

[241] Camille Martini, 'Balancing Investors' Rights with Environmental Protection in International Investment Arbitration: An Assessment of Recent Trends in Investment Treaty Drafting' (2017) 50 *International Lawyer* 529.

**BOX 12: CONSULTATION MECHANISM CLAUSE IN THE CANADA MODEL FIPA (2021)**

If a Party considers that the other Party has offered such an encouragement [i.e. of investment, by relaxing domestic measures relating to health, safety, the environment, other regulatory objectives, or the rights of Indigenous peoples], it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.

Source: Canada Model FIPA (2021) art 4.

i. 'May request consultations … shall consult', 'will address'

214. **'May request consultations … shall consult'**: This type of clause most commonly provides the IIA parties with the option to request consultations as a right that may be exercised at their discretion. Once either party chooses to exercise this right, it becomes mandatory for both parties to engage in consultations with one another. However, it should be noted that, while the duty to participate in consultations is compulsory once the right is invoked, there is no explicit continuous obligation to maintain the consultations until a mutually satisfactory solution is reached. The lack of such a continuous duty is not unexpected since consultations are generally regarded as an informal and amicable manner of resolving disputes.

215. **'Will address':** The Brazil Model CFIA (2015) takes a different approach by stating that parties 'will address the issue through consultation'.[242] Thus, the consultation mechanism clause is formulated as a hard obligation and is moreover not dependent on one party's choice to request consultation, as in the first variation. That said, similar to the first variation, Brazil's Model also does not address whether a continuous obligation exists to participate in consultations until the matter is resolved.

ii. 'Good faith'

216. Notably, the Canada-Mali BIT (2014) states that the IIA parties 'undertake to make best efforts in good faith to resolve any dispute' during the consultations.[243] While the word 'undertake' suggests a hard obligation, it is attached to the phrase 'best efforts', meaning that the Canada-Mali treaty ultimately imposes only a weak legal obligation which is not immune to being overridden.[244]

[242] Brazil Model CFIA (2015) art 16.

[243] Canada-Mali BIT (2014) art 15(2).

[244] See paragraph 209 of this Report.

| TABLE V.5: TYPOLOGY OF CONSULTATION MECHANISM CLAUSES | | | |
|---|---|---|---|
| **Commitment Level** | **No.** | **Variations** | **Indicative Examples** |
| ↓ | **1.** | If a Party considers that another Party has offered such an encouragement, the Parties **will address** the issue through consultations | Brazil Model CFIA (2015), art 16 |
| | **2A.** | During these consultations, the Parties undertake to make best efforts in good faith to resolve any dispute regarding the application of paragraph 1 | Canada-Mali BIT (2014), art 15(2) |
| | **2B.** | If a Party considers that the other Party has offered such an encouragement, it **may request** consultations with the other Party and the two Parties **shall consult** with a view to avoiding any such encouragement | Canada Model BIT (2021), art 4<br>Canada-Mongolia BIT (2016), art 15<br>Singapore-Nigeria BIT (2016), art 10<br>Canada-Guinea BIT (2015), art 15<br>Canada-Burkina Faso BIT (2015), art 15 |
| | **2C.** | If a Party considers that the other Party has offered such encouragement, the Parties **shall consult, upon request,** with a view to avoiding any such encouragement | Peru-Republic of Korea BIT (2014), art 9.9(2) |
| Note: Variations under subsection (i) are in **bold**. Variations under subsection (ii) are underlined. | | | |

## G. Assessment and recommendations

217. Clauses that address domestic levels of sustainable development standards such as non-derogation and non-lowering clauses appear to mostly relate to the state's behaviour prior to investments being made. These clauses could therefore encourage sustainable development and discourage the adoption or maintenance of laws, regulations, policies or measures that unduly protect business interests, at least in principle. At the same time, the practical relevance of these clauses in the context of ISDS seems limited, for two reasons.

218. Firstly, in most contemporary IIAs that include these clauses, the arbitration clause does not cover them. In other words, an ISDS tribunal has no jurisdiction to interpret and apply clauses that a state's address domestic levels of sustainable development standards.

219. The second reason is that, even if they are covered by the arbitration clause, the obligations imposed under these clauses are inter-state and there is no indication that investors are regarded as third-party beneficiaries of these obligations Therefore, the relevance of these

clauses in ISDS may be more indirect and contextual even if they may be brought within an ISDS tribunal's jurisdictional scope. We envisage two ways through which this may be done.

220. The first way might be as a 'sword' for the investor. It is not entirely inconceivable that an investor may point to a host state's failures to meet its obligations under those clauses as part of a broader argument that it was these failures that ultimately resulted in the state taking more invasive actions affecting the investor's interest in the future (e.g., a failure to maintain high environmental standards at time x resulted in the state adopting much stricter environmental regulations across the board at time x+1). However, we would not deem this risk to be too pronounced in practice, since making such an argument would require the investor to prove a difficult causal link between the state's omissions and the subsequent regulatory action taken, as well as between the omissions and the damage suffered due to the regulatory action.[245]

221. The second way might be as a 'shield' for the state. There have been cases where a tribunal has taken into account an express reference in the IIA to the state's commitment to enforce environmental laws as a contextual factor assisting in the interpretation of a substantive standard of protection. In *Al Tamimi v Oman*, and for the purposes of interpreting the MST, the tribunal made reference to Art 10.10 of the United States-Oman FTA (2006) which stated that:

> '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 concerns.'

The tribunal considered it uncontroversial that general principles of CIL must be applied in the context of the express provisions of a treaty which, in this case, put 'a high premium on environmental protection'.[246] To buttress this statement, the tribunal made reference to Chapter 17 ('Environment') of the FTA which included provisions for the enforcement of environmental laws and provisions allowing state discretion regarding regulatory matters and the allocation of resources.[247] It concluded that not every minor misapplication of a state's laws and regulations would amount to a breach of the MST, especially 'in a context such as the US-Oman FTA, where the impugned conduct concerns the good-faith application or enforcement of a state's laws or regulations relating to the protection of its environment.'[248]

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[245] See, in this regard, the investor's failed attempt in *Eudoro Armando Olguín v Republic of Paraguay*, ICSID Case No. ARB 98/5, Award (26 July 2001), [65] ('*Olguin*'), to argue that liability resulted from the Paraguayan authorities' unlawful omissions in supervising the financial institution, in which the claimant had deposited money, causing that institution to go bankrupt.

[246] *Al-Tamimi* [387].

[247] *Al-Tamimi* [388].

[248] *Al-Tamimi* [390].

**RECOMMENDATION: CLAUSES ADDRESSING DOMESTIC LEVELS OF SUSTAINABLE DEVELOPMENT STANDARDS SHOULD BE RETAINED**

222. The insertion of clauses addressing domestic levels of sustainable development standards are likely to have the effect of enhancing a host state's ability to ensure sustainable development in its legal framework without incurring liability. The associated risks for the host state are not very high.

223. However, since a lot will depend on the precise weight a tribunal is willing to accord to references to sustainable development-related commitments in the IIA, it may be a safer drafting strategy to also explicitly exclude liability for reasonable and proportionate sustainable development measures in the operative standards of investment protection. To this end, states should make use of the drafting techniques discussed earlier in this Report, such as carve-outs and general exception clauses.

## VI. RECOGNITION, COMMITMENT AND IMPLEMENTATION CLAUSES

224. Recognition and commitment ('RC') clauses seek to recognise and affirm the contracting parties' commitment to international agreements, instruments and standards within the following five regulatory areas: (i) environmental protection; (ii) combating climate change; (iii) labour protection; (iv) human rights protection; and (v) ensuring corporate social responsibility. Implementation clauses go a step further in seeking to ensure the contracting parties' commitment to implement international agreements and instruments within the five aforementioned areas.

225. International agreements, instruments, and standards that are frequently mentioned in the context of RC and implementation clauses include the ILO Conventions, the 2015 Paris Agreement, the UN Guiding Principles on Business and Human Rights, and the OECD Guidelines for Multinational Enterprises, including related due diligence guidance.

226. In this section, we separately analyse RC clauses and implementation clauses under each of the five regulatory areas identified. We regard these clauses as modular, meaning that Czechia may choose to combine and adopt different variations of these two types of clauses, as it deems fit. An element to flag at the outset is that some RC and implementation clauses also impose obligations upon investors alongside the inter-state obligations. This is contrasted with clauses that address states' domestic levels of sustainable development standards, which, as seen above, contain exclusively inter-state obligations.

### A. Environmental protection

227. RC and implementation clauses within the realm of environmental protection are 'probably the most frequently seen' category of sustainable development provision in modern investment agreements.[249]

#### i. Recognition and commitment clauses

**BOX 13: ENVIRONMENTAL PROTECTION RC CLAUSE IN THE BLEU MODEL BIT (2019)**

The Contracting Parties reaffirm their commitments under the multilateral environmental agreements.

Source: BLEU Model BIT (2019) art 17(1).

[249] Chi (n. 13), 18.

*a. 'Reaffirm', 'Recognise'*

228. All of the environmental protection RC clauses identified within our dataset are framed as 'reaffirmations' and 'recognitions'. As such, they are merely hortatory and declaratory. They do not impose any hard obligations and are thus weak in terms of practical effectiveness.[250] The majority of them mention 'reaffirmations' of 'obligations'[251] or 'commitments'.[252] The difference in practical effect of the two phrases is minimal. Some IIAs, such as the Morocco-Nigeria BIT (2016), state that the parties 'recognise' that the environmental instruments 'play an important role in protecting the environment'.[253] This language is slightly weaker as it does not mention the parties' obligations or commitments.

*b. General reference to multilateral environmental agreements v. specific examples of multilateral environmental agreements*

229. Most environmental protection RC clauses refer to 'multilateral environmental agreements' ('MEAs') in general. However, in some IIAs, the environmental protection RC clause gives examples of MEAs to which the IIA parties are party, thereby enhancing the specificity of the clause's scope. For instance, Art 6(6) of the Netherlands Model BIT (2019) mentions the Paris Agreement, stating that:

> '6. Within the scope and application of this Agreement, the Contracting Parties reaffirm their obligations under the multilateral agreements in the field of environmental protection, labour standards and the protection of human rights to which they are party, **such as the Paris Agreement**, the fundamental ILO Conventions and the Universal Declaration of Human Rights.' [emphasis added]

[250] Ibid., 24.

[251] See Netherlands Model BIT (2019) art 6(6).

[252] See BLEU Model BIT (2019) art 17(1).

[253] Morocco-Nigeria BIT (2016) art 13(1).

| TABLE VI.1: TYPOLOGY OF RC CLAUSES ON ENVIRONMENTAL PROTECTION | | | |
|---|---|---|---|
| **Commitment Level** | **No.** | **Variations** | **Indicative Examples** |
| ↓ | **1A.** | **reaffirm their obligations** under the multilateral agreements in the field of environmental protection ... to which they are party, such as the Paris Agreement | Netherlands Model BIT (2019), art 6(6) |
| | **1B.** | **reaffirm their commitments** under the multilateral environmental agreements. | BLEU Model BIT (2019), art 17(1) |
| | **2.** | **recognize** that their respective environmental laws policies and multilateral environmental agreements to which they are both party, **play an important role in protecting the environment** | Morocco-Nigeria BIT (2016), art 13(1)<br>US Model BIT (2012), art 12(1) |
| Note: Variations under subsection (a) are in **bold**. Variations under subsection (b) are underlined. | | | |

ii. Implementation clauses

**BOX 14: ITALY MODEL ENVIRONMENTAL PROTECTION IMPLEMENTATION CLAUSE**

Each Party shall effectively implement the multilateral environmental agreements (MEAs), protocols and amendments that it has ratified.

Source: Italy Model BIT (2022) art 20(4).

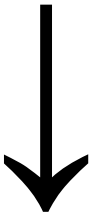
230. Two variations of implementation clauses addressing environmental protection have been identified within our dataset. The first variation frames the clause as an obligation by using the term 'shall'. As mentioned previously, 'shall'-based obligations are hard legal rules which obligate the parties to either behave in a particular way or refrain from behaving in a particular way.[254] The second variation uses the phrase 'shall strive', thus only mandating a

[254] McLaughlin (n. 12), 115.

'best efforts' approach. 'Best efforts' clauses create weak legal obligations that may be overridden.[255]

231. Notably, some clauses refer to the implementation of MEAs, protocols and amendments that each of the contracting parties to the IIA 'has ratified'.[256] This implies that states are not obligated to ratify or accede to any particular MEA or international environmental instrument.

**TABLE VI.2: TYPOLOGY OF IMPLEMENTATION CLAUSES ON ENVIRONMENTAL PROTECTION**

| Commitment Level | No. | Variations | Indicative Examples |
|---|---|---|---|
|  | **1A.** | levels, laws and policies **shall be consistent** with each Party's commitment to internationally recognised standards and agreements on environmental protection | Italy Model BIT (2022), art 20(1) |
| | **1B.** | … **shall effectively implement** the multilateral environmental agreements (MEAs), protocols and amendments that it has ratified … | Italy Model BIT (2022), art 20(4) |
| | **2.** | … **shall strive to ensure** that such commitments [under the multilateral environmental agreements] are fully recognised and implemented by their domestic legislation and **shall strive to continue to improve** those laws and regulations | BLEU Model BIT (2019), art 17(1) |

## B. Climate change

232. There are clauses through which contracting parties recognise, commit to, or implement international agreements, instruments, and/or standards in the area of climate change protection. RC and implementation clauses addressing climate change are a very recent and, as such, as of yet limited development. In our dataset, we have observed such clauses only in the Italy Model BIT (2022) and the BLEU Model BIT (2019). Two international instruments are directly referenced in the observed clauses, namely, the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement.

### i. Recognition and commitment clauses

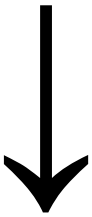
233. Two variations of climate change RC clauses have been identified. The language used in both variations is equally hortatory, merely using the phrase 'recognise the importance'.

[255] See paragraph 209 of this Report.

[256] See Italy Model BIT (2022) art 20(4).

Rather, the difference among the clauses observed lies in the international instruments to which they refer. The Italy Model BIT (2022) mentions the UNFCCC, Paris Agreement, and 'other MEAs and multilateral instruments in the area of climate change.' The BLEU Model BIT (2019) refers only to the UNFCCC.

234. Additionally, the Italy Model mention a specific action, that is, 'taking urgent action to combat climate change and its impacts'. In contrast, the BLEU Model uses broader language and merely mentions 'pursuing the objectives' of the specified instruments/agreements. Owing to the vagueness in content, the variation of the BLEU Model is 'softer' and its practical effect is therefore further reduced.[257]

| TABLE VI.3: TYPOLOGY OF RC CLAUSES ON CLIMATE CHANGE | | | |
|---|---|---|---|
| **Commitment Level** | **No.** | **Variations** | **Examples** |
|  | **1.** | **recognise the importance** of taking urgent action to combat climate change and its impacts, and the role of investment in pursuing this objective, consistent with the *United Nations Framework Convention on Climate Change* (UNFCCC) and the purpose and goals of the *Paris Agreement* adopted by the Conference of the Parties to the UNFCCC at its 21st session (the Paris Agreement), and with *other MEAs and multilateral instruments in the area of climate change* | Italy Model BIT (2022), art 21(1) |
| | **2.** | **recognise the importance** of pursuing the objectives of the *United Nations Framework Convention on Climate Change (UNFCCC)* in order to address the threat of climate change | BLEU Model BIT (2019), art 17(2) |

ii. Implementation clauses

235. Only one variation of a climate change implementation clause has been identified in our dataset. This variation is found in Art 21(2) of the Italy Model BIT (2022). It is framed as a 'shall'-based obligation to implement the UNFCCC and the Paris Agreement, thus denoting a mandatory course of conduct. As such, the practical effectiveness of this implementation clause appears to be strong.

[257] Abbott, Keohane, Moravcsik, Slaughter, and Snidal (n. 201), 412.

| TABLE VI.4: TYPOLOGY OF IMPLEMENTATION CLAUSES ON CLIMATE CHANGE | | |
|---|---|---|
| **1.** | Each Party **shall: (a) effectively implement** the *UNFCCC and the Paris Agreement* adopted thereunder, including its commitments with regard to its Nationally Determined Contributions | Italy Model BIT (2022), art 21(2) |

## C. Labour protection

236. The international instruments most commonly referred to in RC and implementation clauses related to labour protection are the ILO Conventions and ILO Declarations. The number of RC and implementation clauses within the realm of labour protection has increased in recent years, although less so than the number of clauses related to environmental protection.[258]

### i. Recognition and commitment clauses

**BOX 15: ITALY MODEL LABOUR RC CLAUSE**

In accordance with the ILO Constitution and the ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up, as amended in 2022, each Party shall respect, promote and effectively implement throughout its territory the internationally recognised core labour standards as defined in the fundamental ILO Conventions.

Source: Italy Model BIT (2022) art 22(4).

#### *a. 'Shall', 'reaffirm/recall'*

237. Most IIAs adopt weaker language in their labour RC clauses, using phrases such as 'reaffirm its commitment to respect',[259] 'reaffirm their obligations and commitments',[260] and 'recall the obligations'[261]. Such drafting is indicative of an obligation of a hortatory nature.

[258] Rodrigo Polanco, 'Sustainable Development in Chilean International Investment Agreements' (2022) *WTI Working Paper No. 07/2022*, 13 <https://boris.unibe.ch/175098/1/WTI_Working_Paper_07_2022_Sustainable_Development_in_Chilean_International_Investment_Agreements.pdf> accessed 6 February 2023.

[259] See BLEU Model BIT (2019) art 16(2).

[260] See Morocco-Nigeria BIT (2016) art 15(1).

[261] See EU-Vietnam FTA (2020) art 12.7(1),(2).

However, some IIAs, like the Italy Model BIT (2022), state that the parties 'shall' respect labour standards,[262] thereby articulating a mandatory duty.[263]

*b. Instrument or agreement referenced*

238. Most IIAs refer to the fundamental ILO Conventions or the ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up.

**TABLE VI.5: TYPOLOGY OF RC CLAUSES ON LABOUR PROTECTION**

| Commitment Levels | No. | Variations | Indicative Examples |
|---|---|---|---|
| ↓ | **1.** | In accordance with the ILO Constitution and the ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up, as amended in 2022, each Party **shall respect, promote and effectively implement** throughout its territory the internationally recognised core labour standards as defined in the fundamental ILO Conventions | Italy Model BIT (2022), art 22(4) |
| | **2.** | **reaffirms its commitment to respect**, promote and implement in its law and practices in its whole territory core labour standards as embodied in the fundamental ILO Conventions that it has ratified | BLEU Model BIT (2019), art 16(2) |
| | **3A.** | **reaffirm** their respective obligations as members of the International Labour Organization (ILO) and their commitments under the ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up | Morocco-Nigeria BIT (2016), art 15(1)<br>US Model BIT (2012), art 13(1)) |
| | **3B.** | **reaffirm** their obligations under the multilateral agreements in the field of … labor standards … to which they are party, such as … the fundamental ILO Conventions | Netherlands Model BIT (2019), art 6(6) |

Note: Variations under subsection (a) are in **bold**. Variations under subsection (b) are underlined.

[262] See Italy Model BIT (2022) art 22(4).

[263] See paragraph 186 of this Report.

ii. Implementation clauses

*a. 'Shall', 'shall strive', 'reaffirms its commitment'*

239. **'Shall':** The labour implementation clauses in the Italy Model BIT (2022) use the term 'shall' ('shall effectively implement', 'shall be consistent'), thereby articulating a mandatory duty.[264]

240. **'Shall strive':** Some IIAs use the phrase 'shall strive' instead and thus formulate their implementation clauses as best efforts commitments to adopt laws consistent with labour standards. While 'shall strive'-based obligations are soft law and 'hortatory',[265] they are still substantive commitments creating legal obligations which can be, however, potentially overridden.[266]

241. **'Reaffirms its commitment to implement':** Some labour implementation clauses are phrased as mere 'reaffirmations of commitments to implement'.[267] As such, they are hortatory in nature and may be unlikely to impose concrete legal obligations.

*b. Variations in the standards and agreements referred to*

242. **'Fundamental ILO Conventions that it has ratified':** This variation has the narrowest scope. It is limited to the 11 fundamental ILO Conventions that currently exist. Additionally, only those which have been ratified by each contracting party are relevant to the provision. This variation is adopted by the BLEU Model BIT (2019).[268]

243. **'Core labour standards as defined in the fundamental ILO Conventions':** Similarly to the preceding variation, this variation is also limited to the 11 fundamental ILO conventions. However, this variation is slightly broader in scope, as it may be thought to capture those fundamental ILO conventions which have not been ratified by the contracting parties.

244. **'ILO Conventions it has ratified':** This variation expands the scope beyond the 11 fundamental ILO conventions and captures other ILO conventions ratified by the contracting parties. An example of this variation is seen in Art 22(5) of the Italy Model BIT (2022).

245. **'Internationally recognised labour standards and agreements':** The scope of this variation is much wider than the other variations, as it captures internationally recognised labour standards and agreements in general, including both ILO and non-ILO labour instruments.

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[264] See paragraph 186 of this Report.

[265] Abbott, Keohane, Moravcsik, Slaughter, and Snidal (n. 201), 412.

[266] Mitchell and Munro (n. 190), 666.

[267] See BLEU Model BIT (2019) art 16(2).

[268] Ibid.

*c. 'Levels, laws and policies', 'laws, regulations, policies and practices', 'domestic law'*

246. Among labour implementation clauses there are also drafting variations as to the subject to which implementation applies. In some IIAs, such as the Italy Model BIT (2022), the labour implementation clause makes reference to 'levels, laws and policies'.[269] In contrast, IIAs like the United States-Singapore FTA (2003) just refer to 'domestic law'.[270] The former option would seem to broaden the scope beyond domestic laws, capturing non-binding instruments and other conduct attributable to the state.[271]

*d. Ratification add-on*

247. It should also be noted that, occasionally, implementation clauses are followed by clauses requiring parties to make efforts towards the ratification of the ILO Conventions. For instance, Art 22(5) of the Italy Model BIT (2022) states that:

> 'Each Party shall effectively implement the ILO Conventions it has ratified and to [sic] make sustained efforts towards ratifying, to the extent that it has not yet done so, the fundamental ILO Conventions.'

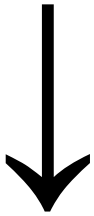
**TABLE VI.6: TYPOLOGY OF IMPLEMENTATION CLAUSES ON LABOUR PROTECTION**

| Commitment Level | No. | Variations | Indicative Examples |
|---|---|---|---|
| | **1.** | Such *levels, laws and policies* **shall be consistent** with each Party's commitments to internationally recognised labour standards and agreements<br><br>'**shall** respect, promote and **effectively implement** throughout its territory the internationally recognised core labour standards as defined in the fundamental ILO Conventions<br><br>…**shall effectively implement** the ILO Conventions it has ratified | Italy Model BIT (2022), arts 22(1), 22(4), 22(5) |

[269] Italy Model BIT (2022) art 22(1).

[270] United States-Singapore FTA (2003) art 17.1(1).

[271] Mitchell and Munro (n. 190), 671.

| | | | |
|---|---|---|---|
|  | **2A.** | **shall strive** to adopt and maintain in its *laws, regulations, policies and practices* thereunder, the following principles embodied in the ILO Declaration … | Republic of Korea-New Zealand FTA (2015), art 15.2(1) |
| | **3.** | **reaffirms its commitment** to respect, promote and **implement** in *its law* and practices in its whole territory core labour standards as embodied in the <u>fundamental ILO Conventions that it has ratified</u> | BLEU Model BIT (2019), art 16(2) |
| Note: Variations under subsection (a) are in **bold**. Variations under subsection (b) are <u>underlined</u>. Variations under subsection (c) are *italicised*. | | | |

## D. Human rights protection

248. The international agreements and/or instruments that are most commonly referred to in connection to RC and implementation clauses addressing the protection of human rights are the Universal Declaration of Human Rights and the UN Guiding Principles on Business and Human Rights.

### i. Recognition and commitment clauses

249. Although it has become relatively common in recent years to find RC clauses in IIAs which reaffirm states' multilateral environmental obligations, RC clauses which reaffirm states' international human rights obligations are still novel.[272] Within our dataset, only two articulations of human rights RC clauses have been found and both were in the Netherlands Model BIT (2019). While both are formulated in aspirational terms ('reaffirm their obligations', 'express their commitment'), one targets 'multilateral agreements' in the field of human rights, whereas the other targets the 'international framework on Business and Human Rights'.

[272] Jesse Coleman, Lise J. Johnson, Nathan Lobel, and Lise E. Sachs, 'International Investment Agreements 2018: A Review of Trends and New Approaches' in Lisa Sachs, Lise Johnson, and Jesse Coleman (eds), *Yearbook on International Investment Law & Policy 2018* (Oxford University Press, 2019) 107.

| TABLE VI.7: TYPOLOGY OF RC CLAUSES ON HUMAN RIGHTS PROTECTION | | |
|---|---|---|
| **No.** | **Variations** | **Examples** |
| **1A.** | **reaffirm their obligations** under the multilateral agreements in the field of … the protection of human rights to which they are party, such as … the Universal Declaration of Human Rights | Netherlands Model BIT (2019), art 6(6) |
| **1B.** | **express their commitment** to the international framework on Business and Human Rights, such as the United Nations Guiding Principles on Business and Human Rights and … **commit to strengthen** this framework | Netherlands Model BIT (2019), art 7(5) |

ii. Implementation clauses

250. Some of the human rights implementation clauses observed are addressed to states only while others are also addressed to investors and their investments in addition to the states-parties to the IIA. The former approach is followed in the Italy Model BIT (2022) whereas the latter approach has been adopted, for example, by the Morocco-Nigeria BIT (2016). This is a notable difference considering that most other types of clauses examined in Section V as well as in the present section are directed towards states only. Czechia may thus opt to include both state-addressed and investor-addressed human rights implementation clauses.

*a. State-addressed human rights implementation clauses*

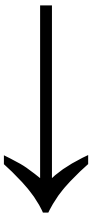
**BOX 16: ITALY MODEL HUMAN RIGHTS IMPLEMENTATION CLAUSE**

The Parties shall support the dissemination and use of relevant internationally agreed instruments that have been endorsed or are supported by the Parties, such as the UN Global Compact, the UN Guiding Principles on Business and Human Rights, the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, and the OECD Guidelines for Multinational Enterprises and related due diligence guidance.

Source: Italy Model BIT (2022) art 19(2).

251. An example of a state-addressed human rights implementation clause is seen in the Italy Model BIT (2022) (**BOX 16**). Within our dataset, two state-addressed human rights implementation clauses have been identified. Both provisions are formulated as 'shall'-based obligations, thereby connoting a mandatory course of action. The difference between the two provisions lies in the international instrument mentioned. One variation merely refers to the 'international human rights agreements' to which the IIA contracting parties are party

to. The other variation goes a step further and identifies an example of an 'internationally agreed instrument … endorsed or supported by the Parties', such as the 'UN Guiding Principles on Business and Human Rights'.

| TABLE VI.8: TYPOLOGY OF IMPLEMENTATION CLAUSES ON HUMAN RIGHTS PROTECTION – ADDRESSED TO STATES | | | |
|---|---|---|---|
| **Commitment Level** | **No.** | **Variations** | **Examples** |
|  | **1A.** | All parties **shall ensure** that their laws, policies and actions are **consistent** with the *international human rights agreements to which they are a Party*. | Morocco-Nigeria BIT (2016), art 15(6) |
| | **1B.** | The parties **shall support** the dissemination and **use of** relevant *internationally agreed instruments that have been endorsed or are supported* by the Parties, such as the ... *UN Guiding Principles on Business and Human Rights* | Italy Model BIT (2022), art 19(2) |

*b. Investor-addressed human rights implementation clauses*

252. Three variations of investor-addressed human rights implementation clauses have been identified.

253. The first and second variations are both formulated as 'shall'-based obligations ('shall respect',[273] 'shall not manage or operate'[274]). As such, they both connote mandatory duties. The difference between the two variations lies in their scope. One variation frames a positive obligation for investors to 'respect the prohibitions' in international human rights agreements in general terms, whereas the other variation introduces a negative obligation directed only towards investors' 'management or operation of the investments'. As such, the latter variation has a narrower scope of application.

254. The third variation is drafted as a weak 'best efforts' provision, owing to two characteristics. Firstly, this variation employs phrases such as 'shall develop their best efforts'[275] and 'shall endeavour'.[276] Secondly, the principles and standards with which investors shall endeavour to comply are labelled as 'voluntary'. Thus, there is no degree of mandatoriness or

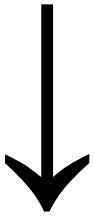
[273] See Colombia Model BIT (2017) art [##] on investors' social responsibility.

[274] See Morocco-Nigeria BIT (2016) art 18(4).

[275] See Brazil-Malawi Investment Cooperation and Facilitation Agreement (2015) art 9(2)(b).

[276] See Brazil Model CFIA (2015) art 14(2)(b).

compulsion within the provision. Additionally, the scope of the provision is itself limited, as it only mentions respecting the 'human rights of those involved in the companies' activities'.

| TABLE VI.9: TYPOLOGY OF IMPLEMENTATION CLAUSES ON HUMAN RIGHTS PROTECTION – ADDRESSED TO INVESTORS | | | |
|---|---|---|---|
| **Commitment Level** | **No.** | **Variations** | **Examples** |
|  | **1.** | Claimant Investors **shall respect** the prohibitions established in *international instruments, to which any Contracting Party is or becomes a party*, pertaining to human rights | Colombia Model BIT (2017), art [##]-Investors' Social Responsibility |
| | **2.** | Investors and investments **shall not** manage or operate the **investments** in a manner that circumvents … *human rights obligations* to which the *host state and/or home state are Parties* | Morocco-Nigeria BIT (2016), art 18(4) |
| | **3A.** | The investors and their investment **shall develop their best efforts** to comply with the following voluntary principles and standards: …<br>(b) Respect the human rights of **those involved in the companies' activities**, consistent with the *international obligations and commitments of the Host Party* | Brazil-Malawi CFIA (2015), art 9(2)(b) |
| | **3B.** | 2. The **investors and their investment shall endeavour** to comply with the following voluntary principles and standards for a responsible business conduct and consistent with the laws adopted by the host state receiving the investment: …<br>b) Respect the *internationally recognized human right*s of those involved in the companies' activities | Brazil Model CFIA (2015), art 14(2)(b) |

255. To note, most treaties within our dataset do not include any provisions clarifying the consequences of non-compliance with investor-addressed human rights implementation clauses. This further reduces the already limited practical effectiveness of these clauses.[277] That said, two treaties within our dataset include what can be described as an 'enforcement add-on'. These treaties are the Colombia Model BIT (2017) and the Netherlands Model BIT (2019). Three key differences between the provisions in these two models can be observed.

256. Firstly, the consequences which follow from non-compliance with international human rights instruments are different in each variation. The variation appearing in a draft article of the Colombia Model BIT (2017) addressing investors' social responsibility provides that a foreign investor's compliance with the human rights provisions of international instruments

[277] Coleman, Johnson, Lobel, and Sachs (n. 272).

to which the host state is a party, throughout the making of the investment, is a prerequisite for access to arbitration. By contrast, the variation appearing in Art 23 of the Netherlands Model BIT (2019) allows arbitral tribunals to take into consideration a foreign investor's failure to respect human rights when determining the amount of compensation due. Between the two variations, completely preventing a claimant investor from submitting a claim to a court or an arbitral tribunal is arguably a stronger deterrent than merely directing a tribunal to take non-compliance into account when assessing compensation.

257. Secondly, the variation in the Colombia model is framed in stronger language. It uses the word 'shall' to connote a mandatory course of action directed at the investor. Contrarily, the variation in the Netherlands model uses the less mandatory term 'expected'. Thus, tribunals are expected, but arguably not required, to take the investor's non-compliance into account when determining compensation.[278]

258. Thirdly, the variation in the Colombia model has a broader scope of application as it refers generally to 'international instruments… pertaining to human rights'.[279] The variation in the Netherlands model is much narrower in scope, as it only mentions non-compliance with commitments under two specific international human rights instruments: the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises. The provision would thus not be triggered if an investor's conduct is inconsistent with other international human rights instruments.

[278] Ibid. Notably, the October 2018 draft version of the Netherlands Model BIT stated that the tribunal 'may' take non-compliance into account when determining compensation, which would have imposed an even laxer standard on the tribunal.

[279] Colombia Model BIT (2017) art [##] on investors' social responsibility.

| TABLE VI.10: TYPOLOGY OF ENFORCEMENT ADD-ON TO INVESTOR-ADDRESSED IMPLEMENTATION CLAUSES ON HUMAN RIGHTS PROTECTION | | | |
|---|---|---|---|
| **Commitment Level** | **No.** | **Variations** | **Examples** |
| ↓ | **1.** | A Claimant Investor **shall accept** the aforementioned prohibitions [i.e. established in international instruments, pertaining to human rights] as mandatory throughout the making of its investment and its operation in the Host Party's Territory **in order to submit a claim to a Court or an Arbitral Tribunal** pursuant to SECTION [DD]-INVESTOR-STATE DISPUTE SETTLEMENT | Colombia Model BIT (2017), art [##]-Investors' Social Responsibility |
| | **2.** | [A] Tribunal, in deciding on the amount of **compensation**, is **expected** to take into account non-compliance by the investor with its commitments under the *UN Guiding Principles on Business and Human Rights, and the OECD Guidelines for Multinational Enterprises* | Netherlands Model BIT (2019), art 23 |

## E. Corporate social responsibility incorporation clauses

259. In recent years, it has become increasingly common for IIAs to include provisions on the voluntary incorporation of corporate social responsibility ('CSR') standards.[280] These provisions are principally addressed to states and, less commonly, to investors too.

### *a. State-addressed CSR incorporation clauses*

**BOX 17: ITALY MODEL CSR INCORPORATION CLAUSE**

The Parties shall promote the uptake by enterprises and investors of corporate social responsibility or responsible business practices with a view to contributing to sustainable development and responsible investment.

Source: Italy Model BIT (2022) art 19(1).

260. The Italy Model BIT (2022) offers an example of state-addressed CSR incorporation clause (**BOX 17**). In our review of such clauses, we have observed four drafting variations which diverge in terms of the forcefulness of language used. The first variation employs the term 'shall', with some IIAs additionally articulating the objective of such incorporation as

[280] Coleman, Johnson, Merrill and Sachs (n. 226), 123.

'contributing to sustainable development and responsible investment'.[281] The other three variations use the phrases 'is to', 'should', and 'reaffirm the importance'.

261. It should also be noted that there are IIAs where contracting parties have assumed different levels of obligations in relation to CSR standards. For instance, in the Singapore-Nigeria BIT (2016), Singapore commits to more hortatory language ('Singapore reaffirms the importance of encouraging…')[282] compared to Nigeria ('Nigeria is to encourage…')[283]. The latter language is arguably more mandatory and suggests the imposition of an obligation. Therefore, Czechia has the option to propose different variations of the CSR incorporation clause for itself and for the other contracting party in its negotiations. This would not be completely without precedent, although we note that it not a commonly followed practice.

262. Despite these variations, all clauses observed are ultimately formulated as 'encouragement' provisions that do not require states to actually implement policies on CSR. In other words, they only constitute 'best endeavours' provisions.[284] Given this, one can question their practical effectiveness. Indeed, as some authors argue, having states offer mere encouragements to investors to incorporate CSR standards 'has not worked in the past and is quite unlikely to be an effective remedy in the future'.[285]

**TABLE VI.11: TYPOLOGY OF CSR CLAUSES – ADDRESSED TO STATES**

| Commitment Level | No. | Variations | Indicative Examples |
|---|---|---|---|
| | **1A.** | **shall promote** the uptake by enterprises and investors of corporate social responsibility or responsible business practices **with a view to** contributing to sustainable development and responsible investment | Italy Model BIT (2022), art 19(1) |
| | **1B.** | **shall encourage** investors and enterprises … to voluntarily incorporate | Canada Model BIT (2021), art 16(2) |
| | **2.** | ... **is to** encourage enterprises … to voluntarily incorporate… | Nigeria-Singapore BIT (2016), art 11(2) (Applicable to |

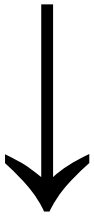
[281] See Italy Model BIT (2022) art 19(1).

[282] Nigeria-Singapore BIT (2016) art 11(1).

[283] Nigeria-Singapore BIT (2016) art 11(2).

[284] Angelos Dimopoulos, 'Standards of Responsible Investment and International Investment Law' in Panagiotis Delimatsis (ed) *The Law, Economics and Politics of International Standardisation* (Cambridge University Press, 2015) 356.

[285] Patrick Dumberry and Gabrielle D. Aubin, 'How to Impose Human Rights Obligations on Corporations under Investment Treaties? Pragmatic Guidelines for the Amendment of BITs' in Karl P. Sauvant (ed), *Yearbook on International Investment Law & Policy 2011-2012* (Oxford University Press, 2013) 569, 580.

| | | | |
|---|---|---|---|
|  | | | Nigeria) |
| | **3.** | Each party **should encourage** enterprises to voluntarily incorporate …<br><br>… **should remind** those enterprises of the **importance** of incorporating… | Canada-Mongolia BIT (2016), art 14 |
| | **4.** | **reaffirm the importance** of each Party encouraging enterprises operating within its area to voluntarily incorporate … | Netherlands Model BIT (2019),art 7<br>Belarus-India BIT (2018), art 12<br>Nigeria-Singapore BIT (2016), art 11(1) (Applicable to Singapore) |

*b. Investor-addressed CSR incorporation clauses*

263. Within our dataset, investor-addressed CSR incorporation clauses have been formulated as best efforts provisions, utilising phrases such as 'shall endeavour'[286] and 'should make efforts'.[287] There is thus no direct requirement for investors to operate according to best CSR practices. Any obligation created is weak and capable of being overridden. As such, investor-addressed CSR incorporation clauses effectively leave investors free to self-regulate which, according to some authors, has not 'ensured that investors operate in compliance with internationally accepted CSR standards'.[288]

| TABLE VI.12: TYPOLOGY OF CSR CLAUSES – ADDRESSED TO INVESTORS AND INVESTMENTS | | |
|---|---|---|
| **No.** | **Variations** | **Examples:** |
| **1A.** | Investors and their enterprises ... **shall endeavour** to voluntarily incorporate… | India Model BIT (2015), art 12 |
| **1B.** | Investors … **should make efforts** to voluntarily incorporate internationally recognized standards of [CSR] into their business policies and practices | Argentina-Qatar BIT (2016), art 12 |

[286] See India Model BIT (2015) art 12.

[287] See Argentina-Qatar BIT (2016) art 12.

[288] J Anthony VanDuzer, Penelope Simons, and Graham Mayeda, 'Integrating Sustainable Development into International Investment Agreements: A Guide for Developing Countries' (Commonwealth Secretariat 2013), 303-304.

## F. Assessment and recommendations

264. RC and implementation clauses face similar practical issues as clauses addressing domestic levels of sustainable development. That is, they may fall outside the direct jurisdictional scope of ISDS and often-times are not directly addressed to investors. As discussed in the preceding section, although investors may attempt to use such clauses as a sword, the likelihood of success appears low and thus so does the risk for states in including them in their IIA. Conversely, as we explain below, it is more likely that states may be able to use RC and implementation clauses in their favour. Hence, our recommendation to Czechia is to retain these clauses in its future IIAs.

**RECOMMENDATION: CLAUSES ADDRESSING THE RECOGNITION, COMMITMENT, AND IMPLEMENTATION OF INTERNATIONAL SUSTAINABLE DEVELOPMENT STANDARDS SHOULD BE RETAINED**

265. We identify three principal ways in which states might use RC and implementation clauses in their favour.

266. Firstly, such clauses might inform the scope of the IIA's investment protection standards. There is some case law supporting this. In *Al Warraq v Indonesia*, and in determining whether there was a breach of the due process (denial of justice) dimension of the FET standard, the tribunal took into account provisions of the International Covenant on Civil and Political Rights ('ICCPR')[289] which were binding on Indonesia.[290] The tribunal did not make explicit reference to any rule of interpretation, such as Art 31(3)(c) VCLT, but rather suggested that the ICCPR's standards are part of an 'International Bill of Rights' informing the FET standard.[291] In a similar vein, the annulment committee in *Tulip Real Estate v Turkey* stressed the importance of systemic integration (this time mentioning Art 31(3)(c) VCLT) as a principle to harmonise divergent international norms, ultimately concluding that:

> 'Provisions in human rights instruments dealing with the right to a fair trial and any judicial practice thereto are relevant to the interpretation of the concept of a fundamental rule of procedure as used in Article 52(1)(d) of the ICSID Convention.'[292]

267. Secondly, RC and implementation clauses might serve the host state as a defence. There have been cases in which tribunals have accepted international obligations as quasi-defences to the alleged violation of investment protection standards. For example, in

[289] International Covenant on Civil and Political Rights (opened for signature 16 December 1966, entered into force 23 March 1976) 999 UNTS 171.

[290] *Hesham T. M. Al Warraq v Republic of Indonesia,* UNCITRAL, Final Award (15 December 2014), [561] ('*Al Warraq*').

[291] *Al Warraq* [557].

[292] *Tulip Real Estate and Development Netherlands B.V. v Republic of Turkey*, ICSID Case No. ARB/11/28, Decision on Annulment (30 December 2015), [86]-[92] (quote at [92]) ('*Tulip Real Estate'*).

*Chemtura v Canada,* when assessing the violation of the MST under Art 1105(1) NAFTA, the tribunal took into account Canada's international obligations under the Aarhus Protocol[293] to conclude that Canada's actions (the review and termination of lindane products) were not undertaken in bad faith, but rather to comply with these obligations.[294] Similarly, in *Philip Morris v Uruguay,* the tribunal found that there was no violation of the FET standard, as the regulations restricting the marketing and advertising of cigarettes in that case were adopted in a reasonable manner, within Uruguay's margin of discretion to pursue public policy objectives, and in compliance with an international obligation (i.e. the WHO Framework Convention on Tobacco Control).[295]

268. Considering that often arbitrators take divergent views on the margin of appreciation and discretion they recognise to states (see, e.g. the disagreement on this ground between the majority and the dissent in *Philip Morris* vis-à-vis the investor's allegation of FET breach), facilitating the reliance on other international instrument to which the host state may be party, through the use of RC and implementation clauses, could result in more deference being paid by tribunals to the state's regulatory margin of discretion.[296]

269. Thirdly, host states could potentially use RC and implementation clauses as a legal basis for counterclaims. In respect of investor-addressed RC and implementation clauses, those containing mandatory, 'shall', obligations and to some degree also those containing 'best efforts' obligations may afford host states the opportunity to use them as a legal basis for a counterclaim. To bring a counterclaim, states must satisfy certain criteria: (i) the counterclaim must fall within the jurisdictional scope of the tribunal;[297] (ii) there must be a close connection between the counterclaim and the primary claim in response to which it is made,[298] meaning that primary claim and counterclaim must be interdependent in that they

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[293] Protocol to the 1979 Convention on Long-Range Transboundary Air Pollution on Persistent Organic Pollutants (opened for signature 24 June 1998) 2161 UNTS 199.

[294] *Chemtura Corporation v Canada*, UNCITRAL, Award (2 August 2010), [137]-[143] ('*Chemtura'*).

[295] *Philip Morris* [418]-[420].

[296] In this respect, we note that there have been cases, still pending as of the time of writing, where states have made first attempts to rely on the 2015 Paris Agreement to exclude liability for investment-adverse measures. For example, in the Respondent's Counter-Memorial of 5 September 2022 in the case of *RWE AG and RWE Eemshaven Holding II BV v Kingdom of the Netherlands*, ICSID Case No. ARB/21/4, the Netherlands makes the case that the challenged measures (a phasing out of coal power production until 2030) were 'adopted to achieve $CO_2$ emissions reductions so as to meet the Netherlands' obligations under the Paris Agreement' ([85]). The Netherlands argue that as adherence to the Paris Agreement would imply a proportionate exercise of its police powers, this measure did not constitute indirect expropriation ([782]) and was a reasonable and proportionate measure within the meaning of the third sentence of Article 10(1) ECT ([983]).

[297] *Saluka Investments B.V. v The Czech Republic*, UNCITRAL, Decision on Jurisdiction over the Czech Republic's Counterclaim (7 May 2004), [60] (*'Saluka Counterclaim'*).

[298] *Saluka Counterclaim* [61, 76]. See also *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v The Argentine Republic,* ICSID Case No. ARB/07/26, Award (8 December 2016), [1151] (*'Urbaser'*).

share 'a common origin, identical sources, operational unity';[299] (iii) there must exist sameness or identity between the parties to the primary claim and the counterclaim;[300] (iv) the counterclaim must be based upon a law that is applicable to the investor and imposes obligations upon the investor.[301]

270. Provided that the applicable arbitration rules permit for the filing of counterclaims and that the RC or implementation clause on the basis of which the counterclaim is raised is within the tribunal's jurisdictional scope (thus satisfying criterion (i) above), the remaining three criteria would be fulfilled. In particular, the incorporation of investor-addressed obligations within the IIA provides: the close connection between the investor's primary claim and the state's counterclaim; the identity of the parties involved; an applicable and imposable legal obligation upon the investor (although, in this respect we note that the largely hortatory nature of the investor obligations currently contained in IIAs may prove to be a practical obstacle for states).

271. We also note for completeness that it may be possible for a tribunal to apply the municipal laws of the host state to adjudicate counterclaims. However, this is rare in practice.[302] To obviate this uncertainty, it is advisable to incorporate investor-addressed obligations within the IIA itself as sounder basis for counterclaims.

[299] *Saluka Counterclaim* [79].

[300] *Saluka Counterclaim* [49].

[301] Urbaser [1206]-[1210]. See also *David Aven et al v The Republic of Costa Rica*, UNCITRAL Case No. UNCT/15/3, Final Award (18 September 2018), [743] ('*Aven*').

[302] To our knowledge this has so far only happened in the cases *Burlington v Ecuador* and *Perenco v Ecuador*, where the host state's law was applied under Article 42(1) of the ICSID Convention (when parties did not agree to an applicable law) or under applicable investment contracts. See *Burlington Resources Inc. v Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Counterclaims (7 February 2017) (*'Burlington'*); *Perenco Ecuador Limited v The Republic of Ecuador*, ICSID Case No. ARB/08/6, Interim Decision on the Environmental Counterclaim (11 August 2015) (*'Perenco'*).

## VII. NOVEL CLAUSES

272. In our review of IIAs we have also noted a number of SDPs that appear in singular treaties. We have called these: 'novel clauses'. We briefly set them out here for Czechia's consideration.

### A. Clauses on impact assessments

273. In Art 14 of the Morocco-Nigeria BIT (2016), an obligation is placed upon investors and investments to comply with regulations requiring environmental or social impact assessments. The full provision states:

> '1) Investors or the investment shall comply with environmental assessment screening and assessment processes applicable to their proposed investments prior to their establishment, as required by the laws of the host state for such an investment or the laws of the home state for such an investment, whichever is more rigorous in relation to the investment in question.
>
> 2) Investors or the investment shall conduct a social impact assessment of the potential investment. The Parties shall adopt standards for this purpose at the meeting of the Joint Committee.
>
> 3) Investors, their investment and host state authorities shall apply the precautionary principle to their environmental impact assessment and to decisions taken in relation to a proposed investment, including any necessary mitigation or alternative approaches of the precautionary principle by investors and investments shall be described in the environmental impact assessment they undertake.'

274. The enforcement of such investor obligations in practice is an open question, considering that an investment treaty is an inter-state document which must rely on inter-state means of enforcement. That said, the obligations contained in the above example could form a sound basis for a state counterclaim, provided that the requirements mentioned in Section VI above are met.

### B. Clauses on gender protections

275. Art 6(3) of the Netherlands Model BIT (2019) recognises gender equality as a key component of achieving economic growth and sustainable development. The relevant clause is replicated below:

> 'The Contracting Parties emphasize the important contribution by women to economic growth through their participation in economic activity, including in

international investment. They acknowledge the importance of incorporating a gender perspective into the promotion of inclusive economic growth. This includes removing barriers to women's participation in the economy and the key role that gender-responsive policies play in achieving sustainable development. The Contracting Parties commit to promote equal opportunities and participation for women and men in the economy. Where beneficial, the Contracting Parties shall carry out cooperation activities to improve the participation of women in the economy, including in international investment.'

276. As with the majority of the clauses discussed in Sections V and VI, it is likely that this clause may be used by host states as an interpretative aid to contextualise the scope of the other standards of investment protection contained in the IIA.

## APPENDIX
## CODING GUIDE WITH VARIATIONS

### Carve-outs

| PARADIGMATIC CLAUSE | | |
|---|---|---|
| ***Italy Model BIT (2022)***<br><br>**[** For greater certainty, except in the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive **]** [PART A], **[** non- discriminatory measures by a Party that are designed and applied **]** [PART B] to protect legitimate policy objectives, such as the protection of public health, social services, public education, safety, environment including climate change, public morals, social or consumer protection, privacy and data protection, or the promotion and protection of cultural diversity do not constitute indirect expropriations | | |
| **VARIATION NO** | **PART A: SITUATIONS WHERE CARVE-OUT CANNOT BE INVOKED** | |
| A-1 | except in the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears **manifestly excessive** … | Italy Model BIT (2022) |
| A-2 | except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in **good faith** … | Canada Model BIT (2021)<br>Netherlands Model BIT (2019)<br>Austria-Kyrgyzstan BIT (2016)<br>Slovakia-Iran BIT (2016)<br>Canada-Mongolia BIT (2016) |
| **PART B: SETTING OUT LEGITIMATE MEANS**<br><br>**'adopted' – 'maintained' – 'designed' – 'applied'** | | |
| B-1 | non- discriminatory measures by a Party that are **designed and applied** to protect legitimate policy objectives | Slovakia Model BIT (2014) |

| | | |
|---|---|---|
| B-1.5 | non- discriminatory measures by a Party that are **designed and applied in good faith** to protect legitimate policy objectives | Netherlands Model BIT (2019) |
| B-2 | A non-discriminatory measure of a Party that is **adopted and maintained in good faith** to protect legitimate public welfare objectives | Canada Model FIPA (2021) |
| B-3 | Non-discriminatory Measures adopted by a Contracting Party, **designed, applied or maintained** for the protection of public objectives | Colombia Model BIT (2017) |

**General exception clauses**

**PARADIGMATIC CLAUSE**

***Italy Model BIT (2022)***

**[** Subject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors **]** PART A, [ Articles [Non-Discriminatory Treatment] and [Transfers] **]** PART B **[** shall not be construed to prevent a Party from adopting or enforcing measures necessary **]**: PART C

(a) to protect public security or public morals or to maintain public order[1];
(b) to protect human, animal or plant life or health[2];
(c) to ensure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to:
(i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on contracts;
(ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;
(iii) safety.

[1] The public security and public order exceptions may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.
[2] The Parties understand that the measures referred to in subparagraph (b) include environmental measures necessary to protect human, animal or plant life or health.

| VARIATION NO | PART A: STANDARD OF DISCRIMINATION<br>'Arbitrary or unjustifiable discrimination' – 'arbitrary and discriminatory' – 'arbitrary or unjustifiable' – 'non-discriminatory' | |
|---|---|---|
| A-1 | Subject to the requirement that such measures are not applied in a manner that would constitute **arbitrary or unjustifiable discrimination** between investments or between investors | Italy Model BIT (2022) |
| A-1.5 | Provided that such measures are not applied in an **arbitrary or unjustifiable manner, or do not constitute a disguised restriction on trade or investment** | Hong Kong-China CEPA (2017)<br>Israel-Japan BIT (2017)<br>ASEAN-Hong Kong Investment Agreement (2017) |
| A-2 | Provided that such Measures are not applied in a manner that would constitute means of **arbitrary and discriminatory** treatment against a Covered Investor or Investment | Colombia Model BIT (2017) |
| A-3 | Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining or applying **non-discriminatory** legal measures | Burkina-Faso-Turkey BIT (2019)<br>Turkey-Cambodia BIT (2019) |
| A-XX | *Some treaties include an additional clause clarifying measures as 'including environmental measures'* | Hong Kong-China CEPA (2017)<br>Italy Model BIT (2022)<br>Israel Japan BIT (2017) |
| **VARIATION NO** | **PART B: SCOPE OF APPLICATION** | |
| B-1 | Nothing in this Agreement/Treaty… | Norway Model BIT (2015)<br>Slovakia-Iran BIT (2016)<br>Hong Kong-Chile BIT (2016) |
| B-2 | *Limited to Non-Discriminatory Treatment and Transfers* | Italy Model BIT (2022)<br>Netherlands Model BIT (2019) |

| VARIATION NO | PART C: NEXUS REQUIREMENT | |
|---|---|---|
| C-1 | Shall not be construed to prevent a Party from adopting or enforcing **measures necessary** | Italy Model BIT (2022) |
| C-2 | Shall not preclude a Contracting Party from adopting, maintaining or enforcing Measures that such Contracting Party **deems necessary** | Colombia Model BIT (2017) |
| C-3 | Measures 'designed and applied for' / 'related to'<br><br>*(no requirement of necessity; instead standard of rational relation applies)* | Burkina Faso-Turkey BIT (2019)<br>Turkey-Cambodia BIT (2018)<br>Rwanda-Turkey BIT (2016) |

**Right to regulate clauses**

**PARADIGMATIC CLAUSE**

***Italy Model BIT (2022)***

**[** The Parties reaffirm the right to regulate within their territories **]** [PART A] **[** to achieve legitimate policy objectives, such as the protection of public health, social services, public education, safety, the environment including climate change, public morals, social or consumer protection, privacy and data protection, or the promotion and protection of cultural diversity. **]** [PART B]
**[** For greater certainty, the provisions of this Agreement 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**]**[PART C]

| VARIATION NO | PART A: AFFIRMING RIGHT TO REGULATE<br>*'Reaffirm the right' – 'shall not affect the right' – 'Nothing in this agreement shall affect the inherent right'* | |
|---|---|---|
| A-1 | The Parties reaffirm the right to regulate within their territories | Italy Model BIT (2022)<br>Canada Model BIT (2021)<br>EU-Singapore IPA (2018) |

| | | |
|---|---|---|
| | | EU-Vietnam IPA (2019)<br>Slovakia Model BIT (2019) |
| A-2 | The provisions of this Agreement shall not affect the right of the Contracting Parties to regulate within their territories … | Netherlands Model BIT (2019)<br>Cape Verde-Hungary BIT (2019) |
| A-3 | None of the provisions of this Agreement shall affect the **inherent** right of the Contracting Parties to regulate within their territories | Argentina-Qatar BIT (2016) |
| **VARIATION NO** | **PART B: STANDARD OF NECESSITY (WHETHER INCORPORATED)**<br>***'To achieve legitimate policy objectives' – 'necessary to achieve legitimate policy objectives'*** | |
| B-1 | … right to regulate within their territories to achieve legitimate policy objectives | Italy Model BIT (2022)<br>Canada Model BIT (2021)<br>EU-Singapore IPA (2018)<br>EU-Vietnam IPA (2019) |
| B-2 | … right of the Contracting Parties to regulate within their territories necessary to achieve legitimate policy objectives … | Netherlands Model BIT (2019)<br>Cabo Verde-Hungary BIT (2019)<br>Czech Republic Model BIT (2016)<br>Argentina-Qatar BIT (2016) |
| **VARIATION NO** | **PART C: SAVINGS CLAUSE** | |
| C-1 | For greater certainty, the mere fact that a Party regulates, including through a modification to its laws, in a manner which negatively affects an investment or interferes with an investor's expectations of profits, does not amount to a breach of an obligation under this Agreement | Netherlands Model BIT (2019)<br>EU-Singapore IPA (2018)<br>EU-Vietnam IPA (2019)<br>Slovakia Model BIT (2019)<br>Cabo Verde-Hungary (2016) |
| C-2 | For greater certainty, the mere fact that the adoption, modification or enforcement of a Measure negatively affects a Covered Investment or interferes with a Covered Investor's expectations, including its expectation of profits, does not amount to a breach of any obligation under this Agreement | Colombia Model BIT (2017) |

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| C-3 | For greater certainty, the provisions of this Agreement 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 | Czech Model BIT (2016)<br>Italy Model BIT (2022) |

**Clauses addressing levels of sustainable development standards**

**A. Non-lowering clauses**

| VARIATION NO | NON-LOWERING CLAUSES | |
|---|---|---|
| 1A | A Party shall not weaken or reduce the levels of protection afforded in its environmental laws in order to encourage investment | Italy Model BIT (2022) |
| 1B | Each Contracting Party shall refrain from encouraging investment by investors of the other Contracting Party or of a non-Contracting Party by relaxing its health, safety or environmental measures or by lowering its labor standards | Netherlands Model BIT (2019)<br>Canada-Mongolia BIT (2016)<br>Austria-Kyrgyzstan BIT (2016)<br>Nigeria-Singapore BIT (2016)<br>Chile-Hong Kong BIT (2016)<br>Iran-Slovakia BIT (2016)<br>Morocco-Nigeria BIT (2016)<br>Brazil Model CFIA (2015)<br>Japan-Uruguay BIT (2015) |
| 2 | The Contracting Parties recognize that it is inappropriate to lower the levels of protection afforded by domestic environmental or labor laws in order to encourage investment | Czech Model BIT (2016)<br>Italy Model BIT (2022) |
| 3 | Each Contracting Party shall recognise the importance of encouraging investments by investors of the other Contracting Party or of a non-Contracting Party without relaxing its health, safety or environmental measures or by lowering its labour standards | Japan-Kenya BIT (2016) |

## B. Non-derogation / waiver clauses

| VARIATION NO | NON-DEROGATION/WAIVER CLAUSES | |
|---|---|---|
| 1A | Therefore, each Party guarantees it shall not amend or repeal, nor offer the amendment or repeal of such legislation to encourage the establishment, maintenance or expansion of an investment in its territory, to the extent that such amendment or repeal involves decreasing their labor, environmental or health standards. If a Party considers that another Party has offered such an encouragement, the Parties will address the issue through consultations | Brazil Model CFIA (2015) |
| 1B | A Party shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from such legislation in order to encourage investment in its territory | Italy Model BIT (2022)<br>Iran-Slovakia BIT (2016)<br>Slovakia Model BIT (2016) |
| 1C | Accordingly, each Party shall ensure that it does not waive or otherwise derogate from or offer to waive or otherwise derogate from its labour laws where the waiver or derogation would be inconsistent with the labour rights conferred by domestic laws and intemational labour instruments in which both are parties are signatories, or fail to effectively enforce its labour laws through a sustained or recurring course o f action or inaction | Morocco-Nigeria BIT (2016)<br>United States Model BIT (2012) |
| 1D | No Contracting Party shall change or relax its domestic environmental legislation to encourage investment | BLEU-United Arab Emirates BIT (2004) |
| 2 | Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from those measures to encourage the establishment, acquisition, expansion or retention in its territory of an investment of an investor | China-Cambodia FTA (2022)<br>Singapore-Nigeria BIT (2016)<br>Japan-Colombia BIT (2011) |
| 3 | The Contracting Parties recognize that it is inappropriate to encourage investment by waiving, relaxing, or otherwise derogating from domestic health, safety or environmental measures | China-Canada BIT (2012) |

### C. Failure to effectively enforce laws clauses

| VARIATION NO | FAILURE TO EFFECTIVELY ENFORCE LAWS | |
|---|---|---|
| 1A | A Contracting Party shall not, through a sustained or recurring course of action or inaction, fail to effectively enforce its environmental and labour laws, as an encouragement for investment | BLEU Model BIT (2019)<br>EU-Canada CETA (2016) |
| 1B | The parties recognize that it is inappropriate to encourage investment by weakening or reducing the protection accorded in domestic labour laws. Accordingly, each Party shall ensure that it does not waive or otherwise derogate from or offer to waive or otherwise derogate from its labour laws where the waiver or derogation would be inconsistent with the labour rights conferred by domestic laws and international labour instruments in which both are parties are signatories, or fail to effectively enforce its labour laws through a sustained or recurring course of action or inaction | Morocco-Nigeria BIT (2016)<br>United States Model BIT (2012) |

### D. Levels of protection in laws and policies clauses

| VARIATION NO | LEVELS OF PROTECTION IN LAWS AND POLICIES | |
|---|---|---|
| 1A | Each Contracting Party shall ensure that its investment laws and policies provide for and encourage high levels of environmental and labor protection and shall strive to continue to improve those laws and policies and their underlying levels of protection | Netherlands Model BIT (2019)<br>BLEU Model BIT (2019) |
| 1B | Each Party shall ensure that its laws and regulations provide for high levels of labour and human rights protection appropriate to its economic and social situation, and shall strive to continue to improve these law and regulations | Morocco-Nigeria BIT (2016) |
| 2 | Each Party shall strive actively to ensure that its laws and policies provide for and encourage high levels of environmental protection and promote the sustainable management of natural and infrastructure resources | Republic of Korea-New Zealand FTA (2015) |

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| 3 | Recognizing the right of each Contracting Party to establish its own level of environmental protection and its own sustainable development policies and priorities, and to adopt or modify its environmental laws and regulations, each Contracting Party shall ensure that its laws and regulations provide for appropriate levels of environmental protection and shall strive to continue to improve those laws and regulations | Iran-Slovakia BIT (2016) |

### E. Consultation mechanism clauses

| VARIATION NO | CONSULTATION MECHANISM | |
|---|---|---|
| 1 | The Parties recognize that it is inappropriate to encourage investment by lowering the standards of their labor and environmental legislation or measures of health. Therefore, each Party guarantees it shall not amend or repeal, nor offer the amendment or repeal of such legislation to encourage the establishment, maintenance or expansion of an investment in its territory, to the extent that such amendment or repeal involves decreasing their labor, environmental or health standards. If a Party considers that another Party has offered such an encouragement, the Parties will address the issue through consultations | Brazil Model CFIA (2015) |
| 2A | If a Party considers that the other Party has offered such an encouragement, it may request consultations with the other Party and the Parties shall consult with a view to avoiding any such encouragement. During these consultations, the Parties undertake to make best efforts in good faith to resolve any dispute regarding the application of paragraph 1 | Canada-Mali BIT (2014) |
| 2B | The Parties recognize that it is not appropriate to encourage investment by relaxing domestic measures relating to health, safety, the environment, other regulatory objectives, or the rights of Indigenous peoples. Accordingly, no Party shall relax, waive or otherwise derogate from, or offer to relax, waive or otherwise derogate from, such measures in order to encourage the establishment, acquisition, expansion or management of the investment of an investor in its territory. If a Party considers that the other Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding the encouragement | Canada Model BIT (2021)<br>Canada-Mongolia BIT (2016)<br>Canada-Hong Kong BIT (2016)<br>Singapore-Nigeria BIT (2016)<br>Canada-Guinea BIT (2015)<br>Canada-Burkina Faso BIT (2015)<br>Canada-Côte d'Ivoire BIT (2014)<br>Canada-Moldova BIT (2014)<br>Canada-Senegal BIT (2014)<br>Canada-Serbia BIT (2014)<br>Canada-Cameroon BIT (2014)<br>Guatemala-Trinidad and Tobago |

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| | | BIT (2013)<br>Canada-Tanzania BIT (2013)<br>Canada-Benin BIT (2013)<br>Canada-Kuwait BIT (2011) |
| 2C | If a Party considers that the other Party has offered such encouragement, the Parties shall consult, upon request, with a view to avoiding any such encouragement | Peru-Republic of Korea BIT (2014) |
| 2D | If a Party considers that the other Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult, or it may request the establishment of an arbitral panel pursuant to Section D (State-to-State Dispute Settlement Procedures), both with a view to avoiding the encouragement | Canada-Nigeria BIT (2014) |

**Recognition, commitment and implementation clauses**

**A. Environmental protection clauses**

| VARIATION NO | ENVIRONMENTAL PROTECTION – RECOGNITION & COMMITMENT | |
|---|---|---|
| 1A | Within the scope and application of this Agreement, the Contracting Parties reaffirm their obligations under the multilateral agreements in the field of environmental protection, labor standards and the protection of human rights to which they are party, such as the Paris Agreement, the fundamental ILO Conventions and the Universal Declaration of Human Rights. Furthermore, each Contracting Party shall continue to make sustained efforts towards ratifying the fundamental ILO Conventions that it has not yet ratified | Netherlands Model BIT (2019) |
| 1B | The Contracting Parties reaffirm their commitments under the multilateral environmental agreements.<br><br>They shall strive to ensure that such commitments are fully recognised and implemented by their domestic legislation and shall strive to continue to improve those laws and regulations | BLEU Model BIT (2019) |
| 2 | The Parties recognize that their respective environmental laws policies and multilateral environmental agreements to which they are both party, play an important role in protecting | Morocco-Nigeria BIT (2016)<br>US Model BIT (2012) |

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| | the environment | |
| **VARIATION NO** | **ENVIRONMENTAL PROTECTION – IMPLEMENTATION** | |
| 1A | The Parties recognise the right of each Party to determine its sustainable development policies and priorities, to establish the levels of domestic environmental protection it deems appropriate, and to adopt or modify its environmental laws and policies. Such levels, laws and policies shall be consistent with each Party's commitment to internationally recognised standards and agreements on environmental protection<br><br>Each Party shall effectively implement the multilateral environmental agreements (MEAs), protocols and amendments that it has ratified. The Parties affirm their commitment to promote the development of investment in a way that is conducive to a high level of environmental protection | Italy Model BIT (2022) |
| 1B | Each Party shall effectively implement the multilateral environmental agreements (MEAs), protocols and amendments that it has ratified. The Parties affirm their commitment to promote the development of investment in a way that is conducive to a high level of environmental protection | Italy Model BIT (2022) |
| 2 | They shall strive to ensure that such commitments are fully recognised and implemented by their domestic legislation and shall strive to continue to improve those laws and regulations | BLEU Model BIT (2019) |

**B. Climate change**

| **VARIATION NO** | **CLIMATE CHANGE – RECOGNITION & COMMITMENT** | |
|---|---|---|
| 1 | The Parties recognise the importance of taking urgent action to combat climate change and its impacts, and the role of investment in pursuing this objective, consistent with the United Nations Framework Convention on Climate Change (UNFCCC) and the purpose and goals of the Paris Agreement adopted by the Conference of the Parties to the UNFCCC at its 21st session (the Paris Agreement), and with other MEAs and multilateral instruments in the area of climate change | Italy Model BIT (2022) |

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| 2 | The Contracting Parties recognise the importance of pursuing the objectives of the United Nations Framework Convention on Climate Change (UNFCCC) in order to address the threat of climate change | BLEU Model BIT (2019) |
| **VARIATION NO** | **CLIMATE CHANGE – IMPLEMENTATION** | |
| 1 | Each Party shall: (a) effectively implement the UNFCCC and the Paris Agreement adopted thereunder, including its commitments with regard to its Nationally Determined Contributions | Italy Model BIT (2022) |

**C. Labour**

| VARIATION NO | LABOUR – RECOGNITION & COMMITMENT | |
|---|---|---|
| 1 | In accordance with the ILO Constitution and the ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up, as amended in 2022, each Party shall respect, promote and effectively implement throughout its territory the internationally recognised core labour standards as defined in the fundamental ILO Conventions | Italy Model BIT (2022) |
| 2 | Each Contracting Party reaffirms its commitment to respect, promote and implement in its law and practices in its whole territory core labour standards as embodied in the fundamental ILO Conventions that it has ratified. The Parties shall make continued and sustained efforts to ratify the fundamental ILO Conventions if they have not yet done so | BLEU Model BIT (2019) |
| 3A | The Parties reaffirm their respective obligations as members of the International Labour Organization (ILO) and their commitments under the ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up | Morocco-Nigeria BIT (2016)<br>United States Model BIT (2012) |
| 3B | Within the scope and application of this Agreement, the Contracting Parties reaffirm their obligations under the multilateral agreements in the field of environmental protection, labor standards and the protection of human rights to which they are party, such as the Paris Agreement, the fundamental ILO Conventions and the Universal Declaration of Human | Netherlands Model BIT (2019) |

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| | Rights. Furthermore, each Contracting Party shall continue to make sustained efforts towards ratifying the fundamental ILO Conventions that it has not yet ratified | |
| **VARIATION NO** | **LABOUR – IMPLEMENTATION** | |
| 1 | In accordance with the ILO Constitution and the ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up, as amended in 2022, each Party shall respect, promote and effectively implement throughout its territory the internationally recognised core labour standards as defined in the fundamental ILO Conventions | Italy Model BIT (2022) |
| 2 | Each Contracting Party reaffirms its commitment to respect, promote and implement in its law and practices in its whole territory core labour standards as embodied in the fundamental ILO Conventions that it has ratified. The Parties shall make continued and sustained efforts to ratify the fundamental ILO Conventions if they have not yet done so | BLEU Model BIT (2019) |
| 3A | The Parties reaffirm their respective obligations as members of the International Labour Organization (ILO) and their commitments under the ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up | Morocco-Nigeria BIT (2016)<br>United States Model BIT (2012) |
| 3B | Within the scope and application of this Agreement, the Contracting Parties reaffirm their obligations under the multilateral agreements in the field of environmental protection, labor standards and the protection of human rights to which they are party, such as the Paris Agreement, the fundamental ILO Conventions and the Universal Declaration of Human Rights. Furthermore, each Contracting Party shall continue to make sustained efforts towards ratifying the fundamental ILO Conventions that it has not yet ratified | Netherlands Model BIT (2019) |

## D. Human Rights

| VARIATION NO | HUMAN RIGHTS – RECOGNITION & COMMITMENT | |
|---|---|---|
| 1A | Within the scope and application of this Agreement, the Contracting Parties reaffirm their obligations under the multilateral agreements in the field of environmental protection, labor standards and the protection of human rights to which they are party, such as the Paris Agreement, the fundamental ILO Conventions and the Universal Declaration of Human Rights. Furthermore, each Contracting Party shall continue to make sustained efforts towards ratifying the fundamental ILO Conventions that it has not yet ratified | Netherlands Model BIT (2019) |
| 1B | The Contracting Parties express their commitment to the international framework on Business and Human Rights, such as the United Nations Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises, and commit to strengthen this framework | Netherlands Model BIT (2019) |
| **VARIATION NO** | **HUMAN RIGHTS – IMPLEMENTATION (STATE-ADDRESSED)** | |
| 1A | All parties shall ensure that their laws, policies and actions are consistent with the international human rights agreements to which they are a Party | Morocco-Nigeria BIT (2016) |
| 1B | The Parties shall support the dissemination and use of relevant internationally agreed instruments that have been endorsed or are supported by the Parties, such as the UN Global Compact, the UN Guiding Principles on Business and Human Rights, the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, and the OECD Guidelines for Multinational Enterprises and related due diligence guidance | Italy Model BIT (2022) |
| **VARIATION NO** | **HUMAN RIGHTS – IMPLEMENTATION (INVESTOR-ADDRESSED)** | |
| 1 | Claimant Investors shall respect the prohibitions established in international instruments, to which any Contracting Party is or becomes a party, pertaining to human rights and the environment. A Claimant Investor shall accept the aforementioned prohibitions as mandatory throughout the making of its investment and its operation in the Host Party's Territory in order to submit a claim to a Court or an Arbitral Tribunal pursuant to SECTION [DD]-INVESTOR-STATE DISPUTE SETTLEMENT | Colombia Model BIT (2017) |

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| 2 | Investors and investments shall not manage or operate the investments in a manner that circumvents international environmental, labour and human rights obligations to which the host state and/or home state are Parties | Morocco-Nigeria BIT (2016) |
| 3A | The investors and their investment shall develop their best efforts to comply with the following voluntary principles and standards for a responsible business conduct and consistent with the laws adopted by the Host Party receiving the investment: … b) Respect the human rights of those involved in the companies' activities, consistent with the international obligations and commitments of the Host Party | Brazil-Malawi CFIA (2015) |
| 3B | The investors and their investment shall endeavour to comply with the following voluntary principles and standards for a responsible business conduct and consistent with the laws adopted by the Host State receiving the investment: … b) Respect the internationally recognized human rights of those involved in the companies' activities | Brazil Model CFIA (2015) |

## E. CSR – incorporation clauses

| VARIATION NO | CSR – INCORPORATION (STATE-ADDRESSED) | |
|---|---|---|
| 1A | The Parties shall promote the uptake by enterprises and investors of corporate social responsibility or responsible business practices with a view to contributing to sustainable development and responsible investment | Italy Model BIT (2022) |
| 1B | Each Party reaffirms the importance of internationally recognized standards, guidelines and principles of responsible business conduct that have been endorsed or are supported by that Party, including the OECD Guidelines for Multinational Enterprises and the United Nations Guiding Principles on Business and Human Rights, and shall encourage investors and enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate these standards, guidelines and principles into their business practices and internal policies. These standards, guidelines and principles address areas such as labour, environment, gender equality, human rights, community relations and anti-corruption | Canada Model BIT (2021) |
| 2 | Nigeria is to encourage enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate internationally recognised standards of corporate social responsibility in their practices and internal policies such as statements of principles that have been endorsed or | Nigeria-Singapore BIT (2016) (Applicable to Nigeria) |

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| | are supported by Nigeria | |
| 3 | Each Party should encourage enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate internationally recognized standards of corporate social responsibility in their practices and internal policies, such as statements of principle that have been endorsed or are supported by the Parties. These principles address issues such as labour, the environment, human rights, community relations and anti-corruption. The Parties should remind those enterprises of the importance of incorporating such corporate social responsibility standards in their internal policies. | Canada-Mongolia BIT (2016)<br>Canada-Burkina Faso BIT (2015)<br>Canada-Guinea BIT (2015) |
| 4 | The Contracting Parties reaffirm the importance of each Contracting Party to encourage investors operating within its territory or subject to its jurisdiction to voluntarily incorporate into their internal policies those internationally recognized Netherlands model Investment Agreement 22 March 2019 standards, guidelines and principles of corporate social responsibility that have been endorsed or are supported by that Party, such as the OECD Guidelines for Multinational Enterprises, the United Nations Guiding Principles on Business and Human Rights, and the Recommendation CM/REC(2016) of the Committee of Ministers to Member States on human rights and business | Netherlands Model BIT (2019)<br>Belarus-India BIT (2018)<br>Nigeria-Singapore BIT (2016) (Applicable to Singapore)<br>Chile-Hong Kong BIT (2016) |
| **VARIATION NO** | **CSR – INCORPORATION (INVESTOR-ADDRESSED)** | |
| 1 | Investors and their enterprises operating within its territory of each Party shall endeavour to voluntarily incorporate internationally recognized standards of corporate social responsibility in their practices and internal policies, such as statements of principle that have been endorsed or are supported by the Parties. These principles may address issues such as labour, the environment, human rights, community relations and anti-corruption | India Model BIT (2015) |
| 2 | Investors operating in the territory of the host Contracting Party should make efforts to voluntarily incorporate internationally recognized standards of corporate social responsibility into their business policies and practices | Argentina-Qatar BIT (2016) |