



## Second round of break-out sessions: The SD dimension of IIAs Public policy exceptions<sup>1</sup>

**Chair: Mr. Mustaqeem de Gama**

South Africa

**Kick-off speaker: Mr. Yonjie Li**

China

**Kick-off speaker: Ms. Sanya Reid-Smith**

Third World Network (TWN)

**Rapporteur: Mr. Stephan W. Schill**

Professor

University of Amsterdam, The Netherlands

The discussion on public policy exceptions delved into different types of exceptions. It covered not only so-called general exception clauses, but also balance-of-payments exceptions, security clauses, exceptions for taxation measures and for financial crises. There was wide agreement among the experts that governments' right to regulate needed to be preserved in international investment law. At the same time it was stressed that it was crucial to achieve the right balance between investment protection and the furtherance of public interests. Public policy clauses should ensure that legitimate regulation of the activity of foreign investors was possible; they should not however permit (unreasonable or unjustified) discrimination.

A first set of comments centered around the question whether, in order to protect the right to regulate, public policy exceptions should be included in the first place. Concerns were expressed about the uncertainty such clauses create for the business sector by giving governments too much power. Furthermore, the inclusion of exception clauses should not be an excuse for 'lazy drafting' of the substantive standards of treatment. Instead, it was important that the standards were drafted in a way that made clear that governments' exercise of their legitimate right to regulate was not in breach of the substantive standards of treatment and did not require a justification under an exception clause. Exception clauses should, in other words, not give the wrong impression that the exercise of the right to regulate was unlawful. Finally, one expert pointed out that a policy exception clause may not be needed given that customary international law already provided for a number of possibilities to justify unlawful behaviour.

In contrast, several other experts considered that public policy exceptions were an important tool to safeguard public policy interests and the governments' right to regulate provided they serve as a safety-net or fall-back to protect public interests. Furthermore, it was pointed out that exception clauses would give governments additional comfort that investment treaty disciplines were not reducing a government's right to regulate in order to protect public interests, in particular in times, such as the present ones, were

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<sup>1</sup> The opinions expressed in this paper are those of the author and do not necessarily reflect the views of the UNCTAD Secretariat or its Member States.

there was wide-spread criticism of international investment law and an increasing number of investor-State arbitrations.

A second set of comments focused on the question of how exception clauses should look like in order to strike the right balance between policy space, on the one hand, and the protection of investor interests, on the other. First, in this context, the objectives the formulation exception clauses should fulfill were discussed. There was wide agreement on the need to prevent abuse of public policy exceptions, including in the form of unreasonable discrimination, and to create more certainty for both States and investors as to the scope and application of exceptions. The view was expressed that exceptions could be formulated in a way that prevented the arbitrary invocation of such clauses so as to prevent hidden discrimination. At the same time, one expert pointed out that exception clauses may have a legitimate scope of application in order to counterbalance an overly broad prohibition of *de facto* discriminations under the national treatment provision.

Second, the question was debated whether there were existing models for the formulation of public interest exception clauses. In this context, several experts discussed whether exception clauses included in the WTO General Agreement on Tariffs and Trade (GATT) or the General Agreement on Trade in Services (GATS) could serve as a model. Drawing on models from trade law had the advantage that at least some jurisprudence existed on how these clauses should be interpreted and put into practice. In addition, drawing on GATT/GATS-models might be helpful given that investment and trade issues were increasingly coming together in one set of agreements in modern preferential trade and investment agreements and one and the same government measure may need to pass muster under both the investment and trade disciplines of such agreements. Having common standards on the level of exceptions might therefore make sense.

Furthermore, the experts discussed whether exceptions should be formulated in a general manner so as to cover policy matters across all sectors or, in the alternative, be formulated so as to address specific areas and industry sectors (such as, for example, clauses that would permit measures specifically for the regulation of the tobacco industry). A wide-spread view existed that the formulation of exceptions clauses in a general manner was preferable, both i) because investment treaty disciplines functioned as general laws that applied to all economic sectors and hence also should have general exceptions clauses and ii) because with the development of new technologies specific clauses were insufficient to cover legitimate government reactions. Yet, several experts pointed out that there were certain areas of government activity that merited special treatment, also at the level of exceptions. Taxation was mentioned as an area where exceptions clauses might need to be more specific, and the same was considered to be the case for financial regulation. One expert stressed the need include balance-of-payments exceptions.

Finally, the need for procedural mechanisms relating to the application of exception clauses was also raised. Some experts pointed to the benefits joint committees of the contracting parties could have in clarifying the interpretation and application of exception clauses, in particular when the contracting parties were not satisfied with the way arbitral tribunals interpreted the clauses. Similarly, one expert expressed the hope that the question of exception clauses was addressed in a multilateral setting, rather than through bilateral treaties.