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Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)
Managing Editor: Matthew Conte (msc2236@columbia.edu)

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Why public policy exceptions have not delivered and how to make them more effective

by
Catharine Titi*

The main substantive evolution in recent investment treaty-making is the increase in public policy exceptions found in these treaties. Exceptions typically prevent state conduct from being deemed a treaty violation. They provide, for example, that nothing in the treaty prevents a state from adopting measures that it considers necessary for the protection of its essential security interests or that nothing in the treaty precludes a state from adopting non-arbitrary and nondiscriminatory measures necessary for protecting the environment or public health.

But what exactly do these exceptions mean? Their interpretation is proving to be one of the biggest conundrums of international investment law—and it is important to understand why, because it makes the application of international investment treaties (IIAs) unpredictable.

The interpretation of investment exceptions has left much to be desired from the beginning. In *CMS v Argentina* and awards that followed, investment tribunals rendered nugatory the applicable treaty's *security* exception. These awards were criticized and some were annulled. Rare interpretations of similar exceptions in newer disputes give hope that lessons have been learned and the interpretation of these exceptions is becoming more foreseeable.

Yet, other exceptions, notably exceptions targeting measures for the protection of the environment, have given rise to new controversial interpretations. In *Bear Creek v. Peru* and *Eco Oro v. Colombia*, the tribunals held that, even when an exception applies, it does not remove the state's duty to compensate affected investors.

Treaties rarely state expressly whether an exception removes the duty to compensate. The *CMS* annulment committee addressed the issue in 2007 (para. 129): "if [the exception] applies, the substantive obligations under the Treaty do not apply." If the substantive obligations do not apply, there is no need to compensate. Otherwise, why introduce the exception? An explanation

given by the *Eco Oro* tribunal that the exception's only purpose is to make the state's environmental measures lawful is unsatisfactory—it implies that, in the absence of an exception, a state's public welfare measures are "unlawful." This interpretation reveals a misunderstanding about how exceptions function and places important limits on their usefulness.

But it raises another problem too: how does one interpret provisions that seem to excuse all but the most egregious state conduct? Exceptions are sometimes so broad that they appear to defeat the very purpose of investment protection. Consider a provision—not technically an exception—through which the parties affirm (CETA art. 8.9(1)) "their right to regulate … to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer protection or the promotion and protection of cultural diversity." Under this provision, what kinds of state measures are actually left that could, potentially, give rise to a breach?

It is time to ask whether we have gone too far in trying to safeguard policy space because this seems to be affecting tribunals' willingness to give effect to some treaty exceptions. We know that it is impossible to draft a perfect treaty. Still, states must take the long view and consider how to make their treaties (and their exceptions) effective. Here are some thoughts on how to achieve this:

- Throwing in as many exceptions as possible is not the solution. If tribunals regard exceptions as too far-reaching, they may find that they do not apply or that, if they do, compensation is still due. In other words, they may behave as if exceptions do not exist.

- It is time to specify in a treaty itself whether, if an exception applies, there is a duty to compensate. This only happens with respect to indirect expropriation and the police-powers doctrine. It led the *Bear Creek* tribunal to reason that, since compensation was expressly excluded only in relation to indirect expropriation, compensation must then be due in all other cases.

- It may be useful to draw attention to the need to apply treaty provisions reasonably, in good faith, equitably, etc. Tribunals have this obligation anyway, on the basis of general international law, including the Vienna Convention on the Law of Treaties (VCLT).

- The current all-or-nothing approach should be abandoned. Treaty interferences of different gravity should be accounted for and require different standards of compensation.

- Overly narrow exceptions, such as exceptions for tobacco control measures or feed-in tariffs, should best be avoided. They fail to predict future situations and can limit the effectiveness of other exceptions.

- Adjudicator selection matters. Adjudicators should have excellent knowledge of public international law and be able to apply treaties in accordance with the VCLT.

As the number of exceptions increases, IIAs become more complex and difficult to interpret—too long, sometimes repetitive and contradictory. It is crucial that key exceptions, such as security, environment and public health exceptions, are present in the treaty text. But it is not advisable to introduce as many exceptions as possible. Drafting well-balanced treaties and tackling the issue of compensation may be as important to enhance the predictability of their interpretation.

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* Catharine Titi (cathy_titi@hotmail.com) is tenured Research Associate Professor at the French National Centre for Scientific Research (CNRS) and the CERSA research center of the University Paris-Panthéon-Assas. The author wishes to thank Michael Reisman, Francis Ssekandi and Katia Yannaca-Small for their helpful peer reviews.

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