CWS/WP/200/27

WORKING PAPER

‘REGULATORY CHILL’: TAKING RIGHT TO REGULATE FOR A SPIN

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SEPTEMBER, 2016

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The author is grateful to Prof. Abhijit Das and Ms. Shailja Singh for helpful comments on the previous drafts of this working paper and would like to thank Mr. Daniel Uribe Teran, Ms. Ivis Pavez and Ms. Chloe Chan for their contributions on literature review. The author can be contacted at satwik@iift.edu.

EXECUTIVE SUMMARY

In public policy space and international investment law (“**IIL**”), the phenomenon of ‘regulatory chill’ is believed to have negative impacts on sustainable development. Regulatory Chill is understood to be a *restraint of States to enact certain regulatory or public policy measures as a result of arbitration, or a fear thereof, under investor-State dispute settlement (“**ISDS**”) provisions, thereby constraining the States’ right to regulate.*

In order to identify a common understanding of ‘regulatory chill’, it is essential to first identify the notion of the right of States to regulate and its relation with sustainable development since ‘regulatory chill’ could directly affect these two concepts. The right of States to regulate is embedded in the sovereignty of States to decide on matters which are essential within their domestic jurisdiction, as recognized in Articles 2(1) and 2(7) of the Charter of the United Nations. Sustainable Development is a normative principle which entails an obligation to manage natural, economic and social resources with a view to meet the needs of the present generation, and guarantee the ability of future generations to meet their own in all dimensions.

The literature concerning ‘regulatory chill’ is not uniform and scholars have developed a notion according to the field in which it is applied. In other words, environmentalists have developed the notion of regulatory chill while applying it in environmental studies which is different from investment-related or policy-related notions developed by researchers and political scientists respectively. In this regard, we can identify certain common elements of ‘regulatory chill’ in order to elaborate the notion (given the lack of a uniform definition of the phenomenon):

(a) A new standard;

(b) Alteration in application of domestic regulation;

(c) Threat or fear of arbitration; and

(d) Bona fide nature of the regulation.

It must be noted that the occurrence of regulatory chill in the policy process is not uniform.

The response of policy makers to actions of investors, their statements or certain other developments in investment space may be deemed to lead to the following three types of regulatory chill:

(a) ***Anticipatory chill***: risk assessment in terms of likelihood of a proposed public policy measure to be challenged before an investment arbitration tribunal;

(b) ***Response chill***: effect on a specific regulation once policy-makers become aware of the risk of an investor-state dispute; and

(c) ***Precedential chill***: response of policy-makers to a concluded arbitration while contemplating future public policy measures.

In the field of ISDS, it is important to note that there is an **asymmetrical legal relationship between States and investors**; that IIAs grew from private international law and the concepts used are those imported from the mentioned field; and that the fragmented nature of IIL, as reflected in the large number of bilateral investment treaties ("**BITs**") obligations and the institution of ad hoc arbitration with no *stare decisis* and no review on the merits, means that there is no consistent jurisprudence to rely on. These difficulties create an uncertainty in the minds of policy-makers while considering a new public policy measure.

In this regard, the future in ISDS and regulatory chill threat is a common concern for scholars. There is an urgent need to analyse the possible impact of the future investment treaty negotiations in environmental issues, both at a local and global level. The absence of explicit and comprehensive treaty provisions that enable the host States to pursue legitimate policy objectives, suggests that progressive realisation of environmental, economic or human rights policies can become a target for arbitration claims.

The future international investment negotiations might, however, provide opportunities to address such criticisms and to promote changes in ISDS. The '*Statement of the European Union and the United States on Shared Principles for International Investment*' expresses commitments not only to preserve the authority of states to regulate in the public interest, but also to increase transparency and public participation, and encourage responsible business conduct. This could be a cornerstone in mitigating the problem of regulatory chill while striking the required balance between States' right to regulate and investor protection.

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I. INTRODUCTION

International investment agreements (“**IIAs**”) are drafted, signed and enforced with a view to promote investment among the signatory States. The interests which home States have in the host States’ market and industry may be regarded as the primary motivation to enter into IIAs. However, such an interest is not the sole motivation. States want to be convinced that their investors face a favourable investment environment in host States and their investments are protected from externalities like discrimination or illegal expropriation. In order to ensure protection to foreign investors and their investments, investor-state dispute settlement (“**ISDS**”) clauses are incorporated in IIAs. Dispute settlement mechanism of diplomatic protection in public international law requires a State to initiate dispute settlement proceedings against another State on behalf of its citizen whose rights have allegedly been violated by the respondent State. The two important elements of diplomatic protection are (i) exhaustion of local remedies; and (ii) ‘nationality’ nexus where the complainant State is required to identify the aggrieved individual to be its national. However, ISDS allows individual foreign investors to initiate arbitration proceedings against the host States without requiring exhaustion of local remedies and establishing ‘nationality’ nexus. This is an important development in IIL as through ISDS, investors, though not a party to the IIAs, are provided with a right/ power to initiate arbitration against the host State.

IIAs contain provisions on treatment of foreign investors and their investments. Such provisions generally contain clauses where the host State’s laws (new or amended) which affect the investment can be said to be governed by the said clauses. In other words, though the host State may exercise its right to regulate, this right is borne out of the State’s treaty (IIA) obligation under IIL. This right to regulate is not an absolute right of the States. It is restricted under treaty obligations (IIAs) under international investment law. In light of such restriction, in the sphere of public policy making and international investment law, the phenomenon of ‘regulatory chill’ is understood by many as a principle having negative impacts on a State’s regulatory powers to act as a welfare state.

Regulations in the field of sustainable development, protection of environment, plant, animal and human life are often chilled (stalled) when there is an arbitration proceeding or a threat of arbitration by foreign investors against the host State. Such a scenario arises when the investors are of the opinion that there had been a substantial damage to their security or value of their investments due to the said regulations. In other words, when investors feel that it is difficult to carry on their business in the host State or that value of their investments has diminished as a result of certain regulations, they initiate (or threaten to initiate) arbitration proceedings against the host State under ISDS. This causes the host State to either withdraw the regulation, or amend the regulation accordingly, or pay heavy compensations to the investors in order to continue the regulation. A threat of arbitration/ actual arbitration directs towards a possibility to pay hefty compensation to investors and States prefer to avoid making such a payment (resulting in withdrawal/ amendment of regulation or settlement between investors and the host State).

Broadly speaking, ‘regulatory chill’ refers to a restraint of regulators to take certain regulatory actions for fear of arbitration proceedings under ISDS, *inter alia*, in environmental, labour, health and safety regulations.[1] Foreign investors challenge these regulations and consequently, constrain the policy and legislation space of States thereby affecting their right to regulate. Likewise, the outcome of past ISDS disputes is often taken into account while drafting regulations in order to avoid similar potential disputes in the future.[2] In this case, policy makers prioritize avoiding arbitration over ‘development of efficient regulation in public interest’.[3] This precautionary approach of ‘regulatory chill’ is also applicable during the preliminary debates for adoption of a regulation where there is a possibility of investors lobbying to oppose its adoption and implementation. It is imperative to note that the term ‘regulatory chill’ has been coined and used by the civil society (NGOs etc.) and political scientists. Broadly speaking, there is little study conducted by legal researchers, policy analysts and the corporate sector on ‘regulatory chill’. Therefore, in order to understand the concept of ‘regulatory chill’, an inter-disciplinary approach to study is the right order.

Whilst ‘regulatory chill’ could have elements of law, political science, investment/business practices; a vast majority of literature is related to political science due to a tendency of academicians to address the phenomenon in relation to public policy. Policy analysts have often adopted the interpretation of ‘regulatory chill’ by political scientists to appreciate/critique the existing ISDS regime. As a result, a new debate has started on the necessity of drafting new IIAs with a focus on interpretative provisions or general exceptions that allow a broader policy-making space for States, especially on sensitive issues; as well as

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[1] UNCTAD Secretariat, Services, Development and Trade: The Regulatory and Institutional Dimension (2014).
[2] Kyla Tienhaara, *Regulatory Chill and the Threat of Arbitration: A View from Political Science*, *in* Evolution in Investment Treaty Law and Arbitration 2 (Chester Brown & Kate Miles 1 ed. 2011).
[3] *Ibid.*

the design and implementation of new ISDS mechanisms. For instance, Indonesia is undertaking a thorough review of its 64 BITs as well as five investment chapters under various free trade agreements.[4] Before we start the study of regulatory chill phenomenon, it is necessary to address a related concept of right to regulate. As mentioned above, regulators restrain from taking regulatory action(s) due to certain developments in international investment space and this phenomenon of ‘regulatory chill’ is in direct conflict with the sovereign host State’s right to regulate.

States have adopted and continue to adopt international commitments in order to improve sustainable standards. However, there have been instances where such commitments are not reflected in the domestic regime due to a conflict between sustainable standards commitments and treaty obligations under prior IIAs. The conflict between international investment regime and other normative orders (*inter alia*, human rights, environment, labour law) in a domestic system requires the recognition of a new compromise between both the regimes.[5]

Foreign investors challenge State regulations on public policy before arbitration tribunals/ panels. Awareness about potential arbitration, reaction of the international community and adoption of new and higher standards go beyond the field of international arbitration. It is, however, difficult to understand ‘regulatory chill’ as a uniform global phenomenon. The manners in which States respond to a potential dispute and an actual dispute are different and hence, academicians and civil society alike have failed to close in on a standard definition of ‘regulatory chill’ and its elements. Probably the most important characteristic of this phenomenon is the difficulty to prove its existence. Unless the States’ regulatory bodies expressly mention that a threat of arbitration is the reason for not taking a proposed regulatory action, there could be ‘limited-to-no’ material evidence to establish that such a threat led to regulatory chill.

This paper aims at mitigate the issue of ‘regulatory chill’ by striking a balance between the host State’s *right to regulate* and *investor protection*. The next section addresses the concept of right to regulate vis-a-vis state sovereignty and studies whether the BITs restrict right to regulate. In the following section, we attempt to find the appropriate definition of ‘regulatory chill’ taking into account the scholarly work by researchers, the inconsistency of arbitration

[4] Abdulkadir Jailani, *Indonesia’s Perspective on Review of International Investment Agreements*, in Investment Treaties- Views and Experiences from Developing Countries 215 (1 ed. 2015).
[5] S. A. Spears, *The Quest for Policy Space in a New Generation of International Investment Agreements*, 13 Journal of International Economic Law 1037-1075 (2010).

tribunals in deciding investor-state disputes and the approach adopted by UNCTAD. Thereafter, due to lack of a uniform application of the phenomenon of ‘regulatory chill’, we analyze the different elements which can be ascertained from the varied application. In the section following the elements of ‘regulatory chill’, different categories of ‘regulatory chill’ are examined on the basis of different stages the chill arises and the reaction of the policy-makers in various situations. In the end, we establish the effects of ‘regulatory chill’ vis-a-vis the States’ right to regulate. This paper thereafter concludes by analyzing certain solutions to the ISDS problem and countering the ‘regulatory chill’ phenomenon.

II. RIGHT TO REGULATE

The analysis of ‘regulatory chill’ requires due consideration of the notion of right of States to regulate (“**right to regulate**”). A study of right to regulate is indispensable to establish the event of ‘regulatory chill’ in achieving legitimate public interests by the State. Right to regulate may be understood as an expression of sovereignty of States and implies the freedom of States to enact legislative measures in a variety of fields within their own jurisdiction. Additionally, this sovereign right may be restricted to ratification of certain international agreements and, particularly in the case of international investment law, it implies the exceptional legal right of States to regulate a general public policy measure, generally, without compensation due to an aggrieved investor.[6] In order to identify the effects of ‘regulatory chill’ with respect of the right to regulate, it is necessary to address the reasons why sovereignty may be restricted under general international law and the characteristics of the legal right to regulate under IIL.

Firstly, it is important to start from the premise that States have an inherent right to enact legislations or policy measures for achieving legitimate public purposes. As stated above, this right is embedded in the sovereignty of States to decide on matters which are essential within their domestic jurisdiction, as recognized in Article 2(1) and 2(7) of the UN Charter. This premise allows identifying right to regulate as part of sovereignty of States. Following this approach, sovereignty should be understood, in the words of Prof. Jorge E. Viñuales, as “*a mosaic of actionable legal concepts of varying density and legal nature that seek to express the pre-eminent position of the state as a unit of social organization*”.[7] In this regard, sovereignty is legally operational only when expressed in specific concepts and norms.[8] Prof. Viñuales develops a four-stage approach to sovereignty. It includes:

a) The study of sovereignty in a specific legal context allowing a manageable study of evolution of this concept in legal terms;
b) The specificity of the idea of sovereignty in different legal contexts, allowing its comparison among other contexts, such as human rights or environmental law.
c) The concept of sovereignty becoming modular, and permitting some adjustments for public policy reasons, and;

[6] Aikaterini Titi, The Right to Regulate in International Investment Law (1st edn, Nomos Verlagsgesellschaft 2014).
[7] Jorge E. Viñuales, *Sovereignty in Foreign Investment Law*, in The Foundations of International Investment Law: Bringing Theory into Practice 317 (Zachary Douglas, Joost Pauwelyn & Jorge E. Viñuales 1 ed. 2014).
[8] *Id*, p. 319.

d) Identifying the "…'location' of the main legal concepts expressing the idea of sovereignty in different areas."[9]

The concept of sovereignty as a mosaic of legal concepts allows its characterization not as an absolute right of States, but one that allows flexibility for States to be able to restrict their faculties in order to fulfil international commitments. In this case, States are prevented or obliged to enact certain types of regulations as agreed under an international treaty. Nonetheless, in these cases it is plausible to believe that a broader interpretation of this flexibility may limit the opportunity of States to effectively regulate in its domestic affairs, and thus they may disregard other objectives for legitimate purposes.

In order to address this issue, Prof. Viñuales considers the need and value of a "*better integration of customary international law into foreign investment law and investment arbitration*" which would provide "a powerful tool to assess whether the expression of sovereignty is being unreasonably restricted or expanded in one area of international law without a specific rationale".[10] The importance of better integration of customary international law into the interpretation of IIAs is particularly important when addressing State's defences for breach of conventional IIL obligations.[11]

The possible restrictions to the right to regulate emerging from international legal instruments may create conflicts between different international commitments and States, particularly in IIL, this situation is evidenced in the ISDS mechanisms. By providing the investors an opportunity to challenge the host State's right to regulate, ISDS provisions in IIAs restrict this right which is generally in conflict with the State's international commitments (given that the impugned regulation yields out of such international commitments). Hence, a better understanding of States' right to regulate is required to provide States with a broad opportunity to achieve public policy objectives.

Why do States incorporate ISDS provisions which restrict their right to regulate?

In light of the above discussion, Prof. Joost Pauwelyn raises the question of why countries limit their sovereign rights to regulate over foreign investors.[12] According to Prof. Pauwelyn,

[9] *Ibid.*
[10] *Ibid.* p. 362.
[11] Supra note 6.
[12] Joost Pauwelyn, *Rational Design or Accidental Evolution? The Emergence of International Investment Law,* in The Foundations of International Investment Law: Bringing Theory into Practice (Zachary Douglas, Joost Pauwelyn & Jorge E. Viñuales 1 ed. 2014).

the answer to this question lies in the recognition of investment law not as a designed regime, but one arising from incidental evolution and heavily influenced by historical events.[13] The principle of reciprocity is the origin for this limitation since host States grant safe passage, access and equal right to aliens of certain States, while in turn, home States agree to not use countermeasures in order to protect assets or enforce debts held by their nationals abroad.[14] The existence of treaties on friendship, commerce and navigation (FCN treaties), BITs and foreign trade agreements (FTAs) are proof of the evolution of the use of arbitration as a pacific dispute settlement mechanism in these circumstances.[15] Thus, the reasons why States feel the need to limit their right to regulate in IIL from a State-centric point of view comprise the protection of its nationals abroad, promotion of foreign investments abroad, and provide fair and effective procedures for peaceful resolution of disputes[16] other than the traditional diplomatic protection or other countermeasures.

Secondly, following the four elements identified in the mosaic approach, the evolution of sovereignty in the specific field of IIL allows a better study of the concept in legal terms. The first element (element (a)) allows an understanding of this legal right as two folded. On one hand, it implies the possibility of States to regulate in areas where specific commitments have already been covered in IIAs; and, on the other hand, the derogation of these commitments does not entail an obligation to compensate.[17]

An analysis of the specific characteristics of sovereignty in IIL allows its comparison with other legal contexts (element (b)), thus allowing its application on a more comprehensive basis, for example, by adding interpretive provisions or general exceptions clauses or as a principle of general international law,[18] such as those encountered in Article XX of GATT and Article XIV of GATS, and following the jurisprudence of the WTO Appellate Body for the interpretation of IIAs. The modular approach of sovereignty under element (c) also grants regulatory flexibility to the State, since the incorporation of interpretative clauses could ensure the balance between achieving public policy objectives and protection to the investors

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Jorge E. Viñuales, *Sovereignty in Foreign Investment Law*, in The Foundations of International Investment Law: Bringing Theory into Practice 317 (Zachary Douglas, Joost Pauwelyn & Jorge E. Viñuales 1 ed. 2014).

[13] *Ibid.*

[14] J. Pauwelyn, At the Edge of Chaos?: Foreign Investment Law as a Complex Adaptive System, How It Emerged and How It Can Be Reformed, 29 ICSID Review 372-418 (2014), p. 14.

[15] Supra note 12.

[16] Nico Schrijver and Weiss Friedl (eds), *International Law and Sustainable Development: Principles and Practice*, Developments in International Law, v. 51. Leiden (Martinus Nijhoff Publishers 2004).

[17] Supra note 6.

[18] *Ibid*

recognized in IIAs.[19] Finally, the identification of the main legal concepts obligation to compensate on the basis of legitimate public purposes has a direct connection with other areas of IL. In the case of defences for breach of commitments comprised in IIAs it is possible to apply circumstances precluding wrongfulness by State, more specifically, the test of necessity.[20]

This evolution creates dynamism between the IIA obligations of States and their right to regulate, which may create conflicts in their mutual application. One of the problems arising from this assumption is that most of ISDS tribunals have “*rarely balanced host States’ rights and duties to regulate in public interests against investors’ rights when interpreting an IIA*”.[21] A central concern about this issue is that tribunals use the vague standards of investment protection to intrude into the regulatory space of host States and become the ultimate controller of central public policy decisions as they limit domestic courts and domestic regulators in exercising jurisdiction.[22]

For Prof Schill, one element that should be addressed in order to overcome this situation is the research of “*the contours of how private rights and public interests relate to each other in specific areas of public–private co-operation or of public administration*”.[23] This approach allows a better understanding of the role of arbitration in a global public law tradition and develops a balance of public interests and investors rights while rendering awards in arbitral proceedings.

These views can be exemplified in the last public consultation of the European Commission on investment protection and ISDS which identifies “*specific concerns about the possibility of government being sued by corporations for high amounts of money*.”[24] This conflictive relationship between the right of States to regulate and the decisions taken by ISDS mechanisms generates the so-called ‘chilling effect’.

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[19] Ana Joublin-Bret, Marie-Estelle Rey and Jörg Weber, *International Investment Law and Development* in Sustainable Development in World Investment Law 24 (Marie-Claire Cordonier Segger, Markus W. Gehring, and Andrew Paul Newcombe ed. 2011).
[20] *CMS Gas Transmission Company v. Argentine Republic*, ICSID case No. ARB/01/8, Award on 12 May 2005 and *Enron Corporation Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No ARB/01/3, Award on 22 May 2007.
[21] Supra note 5, p. 1038.
[22] S. W. Schill, Deference in Investment Treaty Arbitration: Re-conceptualizing the Standard of Review, 3 Journal of International Dispute Settlement 577-607 (2012). p. 578.
[23] *Id*. p. 607
[24] European Commission, Online Public Consultation on Investment Protection and Investor-to-State Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement, Brussels, 13 January 2015, online available http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153044.pdf accessed 4 August, 2016.

On this basis, it is possible to conclude that the right to regulate, as part of the sovereignty of States, is not absolute and it might be limited by the adoption of different international commitments of States, which, by itself, are indicative of exercising their sovereignty. Nevertheless, the specificity of sovereignty in IIL and the identification of the legal right to regulate in this specific legal context permit different adjustments for public policy reasons. Thus, there is a need to integrate principles of IL into the sphere of IIL, which shifts the current problems of the international investment regime to the interpretation of IIAs, and not directly to their content. This implies that arbitral tribunals must give due consideration to the principles addressing State sovereignty while examining its right to regulate. A contrary approach may negatively affect the legitimacy of the outcome and may create ‘regulatory chill.’

As stated above, the literature on ‘regulatory chill’ is not uniform and scholars have, over time, developed notions according to the fields in which the phenomenon is applied (for example, in political science, law or investment). Nevertheless, it is apparent that ISDS provisions are triggered when there is a change in an existing law in the host State. In this regard, one can identify some common elements of ‘regulatory chill’ in order to elaborate the common notion, if not a common definition.

III. DEFINING 'REGULATORY CHILL'

Since literature is not uniform in its definition of 'regulatory chill', it often depends on the area of study and its perspective to establish a definition. While one perspective establishes 'regulatory chill' in relation to abstinence of States from enacting higher standards, the others relate 'regulatory chill' with a threat of arbitration or enactment of a higher standards and its ulterior derogation. Thus, it is safe to say that there is a correlation between ISDS and 'regulatory chill'. It is also true that the phenomenon is not a purely legal issue. Some may argue that it is more closely related to political science in cases of enactment of new standards or to economics when it is considered as an externality for implementation of such new standards.

The first area where the hypothesis of 'regulatory chill' may be applied is environment where scholars like Eric Neumayer define 'regulatory chill' as a situation where developed countries *fail to raise standards over time because of a feared capital flight*.[25] Also, Nordström and Vaughan outline a situation where new environmental regulations are occasionally defeated in the political arena on the grounds that they would harm national competitiveness.[26] In her book 'The Expropriation of Environmental Governance'[27], Kyla Tienhaara refers to pollution havens and argues that the 'regulatory chill' hypothesis suggests that countries fear raising environmental standards because they believe that it may deter new investment or lead to industrial flight. Fear of capital flight and thereby, maintaining status quo can be the two common but important elements of 'regulatory chill'.

In the field of health, The Glossary on World Trade Organization and Public Health[28] defines the term 'regulatory chill' as *a term coined to describe the impact of the potential costs of trade disputes on governments' willingness to introduce new health regulations*. This brings into mind a second element, the existence of a threat of arbitration, which limits the space of States to regulate. Christine Côte goes beyond environmental issues and argues that this notion of 'regulatory chill' has been further extended to address concerns regarding international investment arbitration such that regulators, with knowledge of investor state

[25] *Regulatory Chill- Do Countries Fail to Raise Environment Standards Because of Feared Capital Flight?*, in Greening Trade and Investment 68-78 (Eric Neumayer 1 ed. 2001).
[26] *Does Economic Integration Undermine Environmental Policies?*, in Trade and Environment 35 (Håkan Nordström & Scott Vaughan 1999).
[27] Kyla Susanne Tienhaara, The Expropriation of Environmental Governance: Protecting Foreign Investors at the Expense of Public Policy (2009).
[28] J Epidemiol Community Health, 2006 Sep; 60(9): 738-744 available online at http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2566018/ accessed on 04 June 2016.

challenges to regulatory measures or the threat of such challenges, will curtail regulations or be reticent to pursue more stringent regulations in these areas.

These views have developed concerns among States. The English Parliament[29] has observed that if policy makers in developed countries fear that high environmental standards will induce internationally mobile capital to move to low standards countries then they might themselves lower their standards to keep this capital or—perhaps more realistically—at least fail to raise environmental standards by as much as they would otherwise do over time. In this case, we encounter one of the (cases of) 'regulatory chill'.

In a study prepared for the Ministry of Foreign Trade of the Netherlands, professors Tietje and Baetens[30] state that "for the purposes of this study, we define regulatory chill as follows: *a State will fail to enact or enforce bona fide regulatory measures because of a perceived or actual threat of investment arbitration*". These concerns are typically expressed in fields such as health, environment and labour. This definition highlights one of the most important elements in this study. Improvement of standards must be done in light of a real public purpose and respect of the rule of law, and avoiding discrimination or arbitrariness. Otherwise, the measure could be challenged on the basis of violation of fair and equitable treatment (FET) or expropriation provisions inserted in investment protection agreements and would, in all likelihood, prevail in favour of the investor.

Suzanne A. Spears focuses on arbitration and considers that the uncertainty of arbitral awards generates 'regulatory chill'. The conclusions and awards given by different arbitrators and tribunals in similar cases, like *Methanex* v. *USA*[31] and *Metalclad* v. *Mexico*[32] exemplify this scenario. She writes:

> *"[...]The uncertainty this creates—coupled with a suspicion that arbitrators drawn from the ranks of economic specialties within international law will interpret substantive guarantees expansively and will find in favour of investors when*

[29] UK Parliament, 'Memorandum Submitted by Professor Eric Neumayer' (Parliamentary Business) available online http://www.publications.parliament.uk/pa/cm200607/cmselect/cmtreasy/90/90we20.htm accessed on 04 June 2016.

[30] Christian Tietje and others, *The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership* (2014) (Study prepared for Minister for Foreign Trade and Development Cooperation, Ministry of Foreign Affairs, The Netherlands).

[31] UNCITRAL, Final Award on 3 August 2005.

[32] ICSID Case No. ARB(AF)/97/1.

> *assessing politically sensitive actions taken by sovereigns—is said to result in regulatory chill.”*[33]

Considering the definitions above presented, some common elements can be elucidated under the broader idea given by UNCTAD[34] that the regulators’ restraint to take certain regulatory actions boils down to the fear of arbitration under investor-state dispute mechanisms.

[33] Supra note 5, p. 1038.
[34] Supra note 1.

IV. COMMON ELEMENTS OF REGULATORY CHILL

Given that there is no unique or a strictly defined legal definition of ‘regulatory chill’, it is important to identify the basis on which this notion is constructed. This exercise is useful in order to apply it to cases and assess the real impact of the phenomenon.

a) New standard

In principle, the grounds on which States must apply new measures are determined by international obligations to improve existing levels of protection (or standards) in certain fields, particularly in human rights, environment and health. States have a right and a duty to enact regulations in accordance with the rule of law; States are sovereign to decide on matters that are essential within their domestic jurisdiction, as recognized in the UN Charter. But exercising this right may affect foreign investors and/or their investments.

In *Phillip Morris* v. *Australia* case[35], Australia, under an international commitment as per The World Health Organization Framework Convention in Tobacco Control[36], decided to enact a domestic legislation aimed at decreasing tobacco consumption among the populace while deterring the younger generation away from it. Although the tobacco market was already restricted, the new measure, The Tobacco Plain Packaging Act 2011, Act No. 148 of 2011, was considered by Phillip Morris Asia Limited as an indirect expropriation and decided to challenge the measure under the ISDS provision contained in the Australia-Hong Kong Bilateral Investment Treaty (“**BIT**”) even before the Tobacco Plain Packaging Bill was introduced before the Australian Parliament.

In light of the above developments, the Government of New Zealand had expressly stated that a similar plain packaging legislation was being contemplated by the government but in light of the ISDS proceedings against Australia, the New Zealand government expressly stated that the proposed legislation would be benched till the outcome of ISDS proceedings is decided. The Associate Minister of Health, Dame Tariana Turia said “*There is a risk that tobacco companies will try and mount legal challenges against any legislation, as we have seen in Australia. In making this decision, the Government acknowledges that it will need to manage some legal risks. As we have*

[35] UNCITRAL, PCA Case No. 2012-12.

[36] Article 11 of the WHO Framework Convention in Tobacco Control lays down standards for packaging and labelling of tobacco products.

seen in Australia, there is a possibility of legal proceedings.”[37] In February 2016, Prime Minister of New Zealand, John Key, commented that there was a firm legal ground for plain packaging and that the legislation could become law by the end of 2016.[38]

b) Threat and fear of arbitration

Whether there is a real threat of arbitration or a mere perception of a threat can be identified through the attitude of governments on the enactment of new standards, on the awareness of investment arbitration, potential capital flight or the falling of foreign investment rates. Kyla Tienhaara suggests that the ‘regulatory chill’ exists because States believe that international arbitrations may deter new investments or lead to industrial flight. In the same line Neumayer argues that *what really matters is what policy-makers believe, not what economy theory and evidence says*.[39]

c) Lack of application of domestic regulation or its application with restraint

Scholars refer to several situations while developing the idea of ‘regulatory chill’. Some authors take into account the idea of a factual situation of a total failure to enact the regulation, while others focus on alteration or modification in application of the domestic regulation. These two aspects can be distinguished here:

(i) Failure to enact:

In all fairness, failure to enact a legislation/ measure could be deemed as a negative fact and hence could be the most difficult situation to prove. Scholars have agreed on the vital importance of anecdotal evidence. Statements of civil servants, opinions of stakeholders, and lack of incorporation of new standards in local legislation with no apparent reason can give an idea of this negative action. Again, the case of *Phillip Morris v. Australia* is a good example where the countries obliged to adopt relevant regulations under WHO Framework Convention in Tobacco Control were reluctant to legislate accordingly. Moreover, New Zealand made an express declaration that the legislation would be suspended until the outcome of the herein-stated ISDS arbitration.

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[37] https://www.beehive.govt.nz/release/government-moves-forward-plain-packaging-tobacco-products accessed on 08 September, 2016.

[38] http://www.stuff.co.nz/national/politics/76917027/tobacco-plain-packaging-likely-to-be-law-by-end-of-year--john-key accessed on 08 July 2016.

[39] Supra note 25.

The Glossary on World Trade Organization and Public Health uses the example of Guatemala, which backed away after a US complaint on behalf of Gerber Foods that the former's legislation entrenching the WHO's International Code on Marketing of Breastmilk Substitutes prohibiting marketing by showing pictures of babies expropriated Gerber's "pudgy baby" trademark. The dispute was never heard because the potential costs of defending it were beyond Guatemala's financial reach or priorities.[40] It must be noted that the US had threatened Guatemala with withdrawal of MFN trading status for violating trademark agreements.[41] In light of such a threat, the Guatemalan Supreme Court decided the injunction case in favour of Gerber Foods, thereby exempting Gerber from obligation to comply with labelling requirements.

The New Brunswick province of Canada had appointed a Select Committee on Public Automobile Insurance to explore the most suitable form of a public insurance system for the province. The committee concluded that the public system was required and recommended "made-in-New Brunswick model of public automobile insurance" system to offer extensive coverage at an affordable rate for all the drivers.[42] However, the recommendations were questioned by investors in insurance sector on the grounds that the proposed regulation would violate Canada's NAFTA and GATS commitments. In light of these developments and a threat of NAFTA arbitration, the then Bernard Lord government rejected the committee's recommendations. This decision underlines how the latest generation of services and investment treaties increasingly impede legitimate public policy options.[43] It must be noted that though the government rejected the proposed regulation, neither the NAFTA nor the GATS precluded New Brunswick from going ahead with public auto insurance. The impediments posed by these agreements, while significant, were navigable according to a study conducted by Canadian Centre for Policy Alternatives.[44]

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[40] Supra note 28.
[41] Jagdish N Bhagwati, In Defense of Globalization (2004), pg. 188.
[42] S. Shrybman and S. Sinclair, *Public Auto Insurance and Trade Treaties*, Briefing Paper, volume 5 number 1, Canadian Centre for Policy Alternatives (2004).
[43] *Ibid*
[44] *Ibid*

(ii) Enactment but with restraint/compensation

As a consequence of adoption of new improved standards, the rights of a foreign investor are supposedly affected and adopts several conducts in order to obtain an exceptional and beneficial regime, compensation or even the derogation of the new standard. These are the cases which are settled by the host States and the investor either before or during the arbitration proceedings. Host States have been observed to prefer paying the investor a settlement amount which is less than the huge sums of money claimed as compensation by the investors. In other cases, compensation to the investor is awarded by tribunals and such compensation is followed by amendments to the impugned regulation. Thus, *in order to continue implementing the measures/regulations, host States end up paying certain amounts of money (either as settlement amount or compensation) to the investors despite such regulations being a public policy measure.*

In *Ethyl Corporation* v. *Canada*[45], the Fuel Additives Act was challenged before a NAFTA tribunal with USD 251 Million claimed as compensation. The tribunal's decision on jurisdiction was in favour of the investor. Canada preferred to settle the dispute with Ethyl before the final award on merits was decided. As part of the settlement, Canada preferred to pay USD 13 Million settlement amount as against the compensation claimed. Another case where the host State had to pay compensation for a regulation was the *Eastern Sugar B.V.* v. *Czech Republic*[46]. This case establishes a complex relationship between EU Law and the intra-EU BITs. After the split of Czechoslovakia, Czech Republic joined the EU and had to comply with the EU Model on sugar regime. As a result, Czech Republic adopted regulations on sugar imports which were challenged successfully by Eastern Sugar. The Tribunal awarded a EUR 25.4 Million compensation to the investor by holding that the regulations, despite borne out of the Czech's EU obligations, violated the Dutch-Czech BIT.

The *Indonesia case study* is an interesting example of instances where host States give in to the demands of foreign investors and provide a beneficial investment environment to them instead of creating an environment in favour of sustainable development, protection of human rights, plant, animal and human life. The Forestry

[45] UNCITRAL/NAFTA Case, 24 June 1998.
[46] *Eastern Sugar B.V.* v. *Czech Republic*, Partial award, SCC Case No. 088/2004, 27 March, 2007.

Law implemented by Indonesia banned open pit mining in protected forest areas but the regulation was implemented with exceptions which allowed a list of foreign investors to operate in protected forest areas after investors threatened to initiate arbitrations against Indonesia. Interestingly, acknowledging a legal threat by investors, the Environment State Minister, Mr. Nabiel Makarim said “*There were investment activities before the Forestry Act was effective. If shut down, investors demand compensation and Indonesia cannot pay.*”[47] This was the reason he cited for Indonesia to allow mining activities in protected forest areas. Additionally, the President of Constitutional Court of Indonesia sympathized with the ‘need of investment climate’ in Indonesia’s struggling economy at that time while deciding on a judicial review of the Forestry Act.

d) Bona fide nature of the regulation

‘Bona fide regulation’ is an essential and distinctive element of ‘regulatory chill’. The investment law regime was developed upon an idea of offering protection to foreign investors from potential abuses by the host State. ISDS eliminates the possible bias of national jurisdiction by addressing the issue before a non-domestic tribunal (arbitration tribunal). Nonetheless, this investor protection is not unconditional. States must be capable to prove that the impugned new standard is enacted in a non-discriminatory manner, respecting due process and giving adequate compensation to the investors. Satisfaction of all the three conditions is what would make a regulation a ‘bona fide’ measure. Although this term is potentially subjective and would vary among States, investors, arbitrators, and civil society observers, this restriction is nonetheless important because some measures (which are discriminatory) are meant to be ‘chilled’. Indeed, the purpose of investment law is to ‘chill’ the promulgation of measures designed with discrimination and protectionism in mind.[48]

[47] MAC, ‘Nabiel Makarim agreed with Mining in Protected Forests’, (15th June, 2002) http://www.minesandcommunities/org/article.php?a=7737 (accessed on 5 August, 2016)
[48] Supra note 30.

V. CATEGORIES OF REGULATORY CHILL

Following the distinction made by Tietje and Baetens[49] there are three categories of this ‘chilling effect’.

a) <u>Anticipatory chill</u>

In this case, the potential disputes with foreign investors are taken into account before drafting the concerned regulation or legislation,[50] although it is difficult, for obvious reasons, to show that the policy regulators were affected by arbitration threats. In *Ethyl Corporation* v. *Canada*[51] the representatives of the investor appeared before the Senate to argue that the proposed Bill should not be passed in order to resolve a NAFTA claim already submitted by them.[52] The settlement agreed between Canada and the investor is the kind of chill concerned with the overall phenomenon whereby the regulatory process is hampered by all areas impacted by foreign investors.[53]

The response of New Zealand government to the Philip Morris v. Australia dispute is the most appropriate example of anticipatory chill. The policy makers in New Zealand had not drafted a plain-packaging regulation and decided to wait till outcome of the dispute was made public. The statement of Dame Tariana Turia acknowledging the risk of tobacco companies mounting legal challenges against such legislation and the need to manage legal risks establishes the case of anticipatory chill.

b) <u>Specific response chill</u>

It refers to ‘chilling’ of a specific regulatory measure once policy makers become aware of the risk of an investor-state dispute[54]. In *Vattenfall* v *Germany 1*[55] the notice of arbitration was sufficient for the Federal Government of Hamburg to issue a modified and enforceable permit as well as absolve Vattenfall of prior responsibilities.

Two instances of specific response chill can be highlighted from Costa Rica. The first case involves offshore oil exploration in the country. A Hydrocarbons Law was passed by the government as part of a series of measures designed to implement a structural adjustment

[49] *Id*. at para. 68.
[50] *Id*. at para. 69.
[51] Supra note 42.
[52] *Id*. at para. 87.
[53] *Id.* at para. 41.
[54] *Id*. at para. 70.
[55] ICSID Case No. ARB/09/6.

programme of World Bank and International Monetary Fund. The Law included Environment Impact Assessment ("**EIA**") process and requirements for acceptance of EIA by the government. After deliberations and court proceedings, The Ministry of Environment and Energy had rejected Harken Energy's EIA relying mainly on precautionary principle, international agreements and the lack of resources in Costa Rica to deal with oil spills caused by Harken's oil exploration activities (Harken Energy was a Texas-based company). The company claimed USD 57 Millions in damages and lost profits before ICSID but later withdrew the request. On the other hand, Costa Rica was apparently willing to pay Harken up to USD 11 Millions as the amount was "cheaper than being sued" and "preferable to facing retaliatory sanctions from the US government". The Costa Rican government's willingness to avoid international arbitration and instead, negotiate, which it deemed to be a cheaper alternative than being sued, is an example of specific response chill. Even though the concessions were finally cancelled, the amount paid to Harken by Costa Rica was borne by the tax payers of the country despite the fact that Hydrocarbons Law was a legitimate regulation to protect marine life and the indigenous communities.

The second case of specific response chill from Costa Rica was a result of a moratorium on open-pit mining which was challenged by a Canadian company, Vanessa Ventures, after its EIA was rejected by the government. The company claimed USD 200 Millions as compensation based on loss of return of investment. In light of claims against Costa Rica, the company's EIA was approved by the environment agency. It is interesting to note that the CEO of the company's local subsidiary, Industrias Infinito S.A., acknowledged that the approval of EIA was a result of pressure for arbitration request before ICSID and the company would consider withdrawing arbitration request as a "good faith" gesture against the approval. These two cases from Costa Rica involve payment of compensation by the government even if the laws/regulations were passed to protect environment and indigenous communities.

c) <u>Precedential chill</u>

It could also be observed that some States change the proposed regulation in public policy space as a result of an already settled investor state dispute whether it has been party to the dispute or not. When the host State was a party to lost investment arbitration, apprehensions while contemplating new regulations can be described as a roll back of legislation after losing an investor state arbitration. On the other hand, policy makers keep a keen eye on the investment disputes arising around the world and consider the arbitral awards and their legal effects to decide whether they want to propose regulations and risk similar disputes or not. When the decision is to drop a proposed regulation in light of arbitral awards (whether or not involving host States), it leads to precedential chill.

VI. EFFECTS OF ‘REGULATORY CHILL’

Once the different elements comprised in the notion of ‘regulatory chill’ and its different categories are identified, it is necessary to question the extent ‘regulatory chill’ is affecting the State’s sovereign right to regulate.

The potential effects of ‘regulatory chill’ is examined in cases where a regulation threatened usually falls within the purview of the State’s public policy space, *inter alia*, health, environment. Critical analysis of existing standards, such as expropriation and FET, which are used by arbitral tribunals to determine if there has been a violation of a BIT (Bilateral Investment Treaty) is essential to recognising the effects of ‘regulatory chill’.

‘Regulatory chill’ can be said to occur when the threat of potential liability leads States to forego needed environmental or social legislation that might negatively affect the value of foreign investment. Why is there a real concern for ‘regulatory chill’? Firstly, it can be said that there is an asymmetrical legal relationship between States and investors. While investors can submit claims in the ISDS regime, States cannot because BITs grant direct procedural and substantive rights to investors to hold States to account. Secondly, IIAs grew from private international law and the concepts used are those imported from it. Lastly, the fragmented nature of international investment law, as reflected in the diversity of treaty obligations (different BITs/ IIAs concluded) and the institutions of ad hoc arbitration without any form of *stare decisis* and confidentiality of the procedure, means that there is no consistent jurisprudence to rely upon.

a) <u>‘Regulatory Chill’ vis-à-vis the Right to Regulate: Environment and Health Issues</u>

For an investor, the environmental cost, i.e. the cost of complying with environmental regulations, contributes considerably to the total costs of investment and there are a broad range of factors like infrastructure, access to resources, wage costs, labour productivity and political risk which determine the decision to stay or relocate the operations. It is argued that in order to deal with the problem of ‘regulatory chill’ there shall be prior harmonization of environmental standards and the enactment of minimum standards.

In the *Indonesia Case Study* discussed above, the Law of the Republic of Indonesia 41 of 1999 on Forestry (Forestry Act) is a clear example of ‘regulatory chill’ on a State’s right to regulate the environment. It presupposes a hypothesis that investors are attracted to countries with lower environmental costs and countries seeking to attract investors have to keep these costs low in order to be competitive.[56] Mabey and McNally propose two closely related concepts, 'industrial flight' and 'race-to-the-bottom'. According to them, these concepts mean that States prioritise foreign investment over protection of environment and thus undervalue the environment through law or non-enforced regulation i.e. the 'pollution havens' hypothesis.[57] As a result, investors tend to relocate operations to less developed countries with less stringent regulations and weak legal systems to benefit from them.[58] Such an approach by States and investors is undesirable as there will be a 'race-to-the-bottom' in environmental standards, thus leading to environmental damage".[59] It is also important to note that much of this research has focused on emissions rather than habitat destruction and biodiversity loss, the main scope of environmental concerns in the mining sector.[60]

For some developing countries, a small share of global flows of mineral investments can represent a considerable share of overall FDI entering the country and can contribute significantly to state revenue.[61] In the mining sector, there is no comprehensive international agreement on mining[62] and where there are regulations, the governments often lack the relevant tools and management to enforce them.[63] Therefore, this is an interesting sector for the purposes of the research.

It can also be seen in Australia's plain packaging case where New Zealand[64] and other countries i.e. United Kingdom, France and Norway which are introducing plain packaging legislation or contemplating it, are awaiting the results of the investor state arbitration as well as the related WTO challenges. The Government of Australia recently announced that it would not pursue in investor state disputes settlement provisions in preferential trade

[56] Eric Neumayer, *Do Countries Fail to Raise Environmental Standards? An Evaluation of Policy Options Addressing "Regulatory Chill"* 4 IJSD 231 (2001), at p. 148.
[57] Nick Mabey & Richard McNally, Foreign Direct Investment and the Environment (1999), p. 3.
[58] *Ibid.*
[59] *Ibid.*
[60] Kyla Tienhaara, *Mineral Investment and The Regulation of The Environment in Developing Countries: Lessons From Ghana*, 6 International Environmental Agreements: Politics, Law and Economics, p. 371-394 (2006).
[61] Richard Sandbroke and Pradeep Mehta, FDI and Environment – Lessons from the Mining Sector (2002), Rapporteurs Report from the OECD Global Forum on International Investment Conference, OECD, p. 2.
[62] Maria Cecilia G. Dalupan, *Mining and Sustainable Development: Insights from International Law*, in International and Comparative Mineral Law and Policy: Trends and Prospects 149-170 (Elizabeth Bastida, Thomas W. Walde, & Janeth Warden-Fernandez eds. 2005.
[63] Chika B. Onwuekwe, *Reconciling The Scramble For Foreign Direct Investments And Environmental Prudence: A Developing Country's Nightmare*, 7 Journal of World Investment and Trade 113-141 (2006), at p. 121.
[64] Supra note 38.

agreements that would confer greater rights on foreign investors than those enjoyed by domestic businesses.

As observed in these cases, it clear is that although monetary compensation is by far the most common remedy for breaches of investment treaties, meaning that states can still take public-interest measures so long as they pay compensation, the issue is not just about the distribution of the costs of public action. Given the large amounts awarded as compensation by arbitral tribunals to investors, the cost of regulation could, in principle, skew incentives for public action and discourage regulation, as well as the investment flight that comes with negative publicity.

b) ‘Regulatory Chill’ vis-à-vis the Right to Regulate: Regulatory Taking and Expropriation

In international investment law, there is a distinction to be made between ‘general, non-discriminatory public purpose legislation’ and ‘measures amounting to expropriation or indirect expropriation’. Nowadays, direct expropriation is a rarity. The definition of indirect expropriation can be found in BITs/ IIAs, Conventions and academic texts. The Abs-Shawcross Draft Convention on Investment Abroad (1959) mentions “measures against nationals of another Party to deprive them directly or indirectly of their property”. The same wording appears in the Organisation for Economic Co-operation and Development Draft Convention on the Protection of Foreign Property.[65]

First the tribunal would ascertain whether the impugned measure amounts to expropriation or if it is a general regulatory measure. A general regulatory measure does not require the host States to pay compensation. However, where the measure amounts to expropriation, even where it is lawful and serves a public purpose, compensation shall be paid. ‘Regulatory chill’ is strengthened insofar as the distinction between lawful indirect expropriation and regulatory takings is blurred. The following analysis will turn on the current jurisprudence as well as any treaty carve-outs.

It is argued that the Tribunal’s inconsistent application of indirect expropriation concept leads to an unpredictable outcome in any given case, which may cause the forewarned ‘regulatory chill’.[66] This is because a claim for indirect expropriation has the potential to target regulations, which have the effect of legally or physically depriving an investor of property.

[65] Article 3 of the Organisation for Economic Co-operation and Development Draft Convention on the Protection of Foreign Property, 1967.
[66] Marwan Shehadi, Investor-State Dispute Settlement in the Transatlantic Partnership Agreement Between the European Union and United States of America (2014) LL.M Public International Law Thesis.

Additionally, the tribunal's inconsistent application of the concept leads to an unpredictable outcome in any given case, leading to 'regulatory chill'.

Depending on whether the court adopts the 'sole effects doctrine'[67] or the 'police powers'[68] test, the outcomes may be different. The adoption of the 'sole effects doctrine' in *Middle East Cement Shipping* v *Egypt*[69] is problematic in so far as the effect of a measure upon an investment is emphasized rather than the purpose and intent in determining whether an expropriation has taken place. This means that a regulation, even if adopted in public interest, but having an effect of expropriating an investment, is prima facie considered an expropriation, notwithstanding its intention. This was restated in *Tecmed* v *Mexico*[70] where the Tribunal stated "we find no principle stating that regulatory administrative actions are per se excluded from the scope of the Agreement, even if they are beneficial to society as a whole —such as environmental protection—, particularly if the negative economic impact of such actions on the financial position of the investor is sufficient to neutralize in full the value, or economic or commercial use of its investment without receiving any compensation whatsoever".[71]

[67] Sole effects doctrine states that a direct/ indirect detrimental effect of a measure/ regulation on an investment shall be the sole criterion for determining whether the impugned measure amounts to expropriation or it is a general public measure.

[68] "In the United States, governmental regulatory powers are referred to as 'police power'": R Dolzer and C. Shreuer, Principles of International Investment Law (2 ed., Oxford University Press, 2012), p. 109.

[69] *Middle East Cement Shipping and Handling Co. S. A.* v. *Arab Republic of Egypt*, ICSID Case No. ARB/99/6, award on 12 April, 2002.

[70] *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2, award on 29 May 2003.

[71] *Id*. at 121.

VII. REGULATORY CHILL AND SUSTAINABLE DEVELOPMENT

Since the mid-1980’s foreign direct investment (FDI) has become directly complementary to economic growth, particularly by encouraging incorporation of technology in production process in host States. Likewise, UNCTAD has stated that ‘new generation’ investment policies recognise the primary role of investment for economic growth and development. This relation has also been expressed by the commitments undertaken by States in order to fulfil the Millennium Development Goals[72], which require a broader base of investment and “economic transformation, in areas such as basic infrastructure, clean water and sanitation, renewable energy and agricultural production”. In this regard, the current debate on investment law should be focused on striking a better balance between investor protection and the rights of States to regulate.[73]

The objective behind this approach is not only to promote a better understanding of the right to regulate, but also to increase the level of legitimacy of ISDS, and thus allowing a better understanding of the relation between investment and sustainable development. Prof Stephan W. Schill has observed that:

> “[…] *developing standards of review that balance the protection of foreign investors and public interests, is one way, among others, of (re-) injecting legitimacy into investment treaty arbitration. It may contribute to ensuring the system’s long-term viability without the imminent need to redraft investment treaties or to make institutional changes to investment treaty arbitration as it currently stands*.”[74]

The balance between the sovereign right of States to regulate and the rights of investors is not only required to achieve sustainable development, but also to promote legitimacy of ISDS decisions. Currently, the international investment law regime has been heavily contested due

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[72] The eight Millennium Development Goals (MDGs) – which range from halving extreme poverty rates to halting the spread of HIV/AIDS and providing universal primary education, all by the end of 2015 – form a blueprint agreed to by all the world’s countries and the entire world’s leading development institutions. They have galvanized unprecedented efforts to meet the needs of the world’s poorest. The UN is also working with governments, civil society and other partners to build on the momentum generated by the MDGs and carry on with an ambitious post-2015 development agenda.
As the MDGs era came to a conclusion with the end of 2015, 2016 ushers in the official launch of the bold and transformative 2030 Agenda for Sustainable Development adopted by world leaders in September, 2015 at the United Nations. The new Agenda calls on countries to begin efforts to achieve 17 Sustainable Development Goals (SDGs) over the next 15 years.

[73] Ana Joublin-Bret, Marie-Estelle Rey and Jörg Weber, International Investment Law and Development, in Sustainable Development in World Investment Law (Marie-Claire, Cordonier Segger, Markus W. Gehring, and Andrew Paul Newcombe eds. 2011), at p. 24.

[74] Stephan. W. Schill, *Deference in Investment Treaty Arbitration: Re-Conceptualizing the Standard of Review,* 3 Journal of International Dispute Settlement (2012).

to implications of ISDS arbitral awards in the application of regulatory measures of States. Prof Joost Pauwelyn mentions that:

> "*Many critics have argued that IIL is out of balance or biased in favour of private investors to the detriment of national policy space or a system of inappropriate private, behind-closed-doors arbitration of what are essentially public interest disputes.*"[75]

The supposedly lack of transparency the ISDS regime and the review of States' regulatory measures of general character has promoted a wave of "new generation" bilateral investment treaties, most of them prioritizing the law and policy making space of States. The current debate concerning the adoption of the Transatlantic Trade and Investment Partnership ("**TTIP**") between Europe and the US, offers a practical example for this issue. The Report prepared by the European Commission on the Online Public Consultation on Investment Protection and ISDS in the TTIP[76] recognizes that, in the question of ensuring the right to regulate and investment protection:

> "*The vast majority of respondents in virtually all categories agree with the broad objective of finding an adequate balance between investment protection and the confirmation of the right to regulate in the public interest.*"[77]

Furthermore, it acknowledges that finding this balance is one of the areas in which further work will continue. Particularly, the proposed approach applied in the negotiation of the TTIP would achieve a mutually supportive relation between the protection provisions of investors and the provisions on sustainable development and may include:

> "[…]*specific references to international convention on labour or the environment or a prohibition of lowering labour and environmental levels of protection with a view to attracting investment.*"[78]

In addition, some of the respondents proposed the possibility of applying the term 'sustainable economic link' instead of 'substantial business' in order to identify an investment protected by the TTIP. In this sense, the relation between the right to regulate of

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[75] Joost Pauwelyn, Rational Design or Accidental Evolution? The Emergence of International Investment Law, in The Foundations of International Investment Law: Bringing Theory into Practice (Zachary Douglas, Joost Pauwelyn and Jorge E Viñuales eds. 2014), at p. 16.

[76] http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153044.pdf, accessed on 12 July 2016.

[77] Id at p. 18.

[78] Id at p. 27.

States and the sustainable development are indispensable pillars for the recognition of ‘regulatory chill’. Therefore, both terms must be first considered in order to comprehend the scope of this phenomenon, and particularly the manner, if any, in which ‘regulatory chill’ affects sustainable development by limiting the regulatory space of States.

VIII. CONCLUSION

As seen from the literature, ‘regulatory chill’ is a phenomenon distinctly related to the field of social and political sciences than law. Researchers and authors have relied on ‘anecdotal evidence’ to prove the existence and effects of regulatory chill.[79] A strictly legal study of anecdotal evidence might not be sufficient to establish ‘regulatory chill’ as the anecdotes under consideration might be non-representative samples of typical cases and hence, inadmissible before law. Law requires ascertaining facts beyond all reasonable doubt. Anecdotal evidence cannot be free from doubt as these are isolated instances or may take different guises (most of the government data is classified). However, such anecdotal evidence cannot be overlooked because it is through such evidence that the actions/inactions of regulators are deduced to determine existence of ‘regulatory chill’. It is in such cases that academicians and scholars adopt a socio-political point of view.

The Tobacco Plain Packing case, as discussed in this paper, exemplifies the relation between investment arbitration and reaction of the international community. While Australia enacted the Tobacco Plain Packaging Act 2011, the effect of ‘regulatory chill’ was felt by New Zealand, which preferred to wait for the results of the ISDS arbitration case (initiated by Phillip Morris Asia Limited) in order to decide whether or not to enact its own plain packaging legislation. In this sense, the notion of ‘regulatory chill’ implies a limitation of States from enacting certain regulatory measures for fear of arbitration under ISDS, and consequently the States’ policy and law making space is directly constrained, thereby affecting their right to regulate. Following these considerations, the effects of ‘regulatory chill’ are detrimental to general public welfare. Sustainable development is an important element of general public welfare. It entails an obligation on States to manage natural, economic and social resources with a view to meet the needs of the present generation, and guarantee the ability of future generations to meet their own. In order to do so, States must maintain a sufficient policy space to regulate for public good,[80] which in turn may promote an adequate regulatory framework that would guarantee clarity, stability and predictability of investment environment. Moreover the existence of ‘regulatory chill’ may limit the

[79] Supra note 56.
[80] United Nations Conference on Trade and Development, ‘Investment Policy Framework for Sustainable Development’ (United Nations 2012), p. 12.

regulatory space of States to raise standards in their domestic legislation[81] and would directly hinder sustainable development.

Following this approach, there are three reasons why 'regulatory chill' is addressed in this paper. First, it recognises the existence of an asymmetrical legal relationship between States and investors. This distorted relationship is due to the fact that investors have a right to initiate arbitration proceedings against States for the latter's sovereign actions that apparently harm the investment-related interests, while States have no such remedy in international sphere against actions of the investors. Secondly, the nature and objectives of IIAs are encountered in private international law, and thus the principles and notions applied for the interpretation of IIAs during an ISDS proceeding are imported from the aforementioned field. This issue will not raise a problem if the procedure is based on a contractual claim, where the State and the investor act in a level playing field as commercial parties with equal rights in conjunction with stronger exceptions for legitimate public policy measure. Lastly, it has been argued that the lack of consistent decisions adopted by the arbitration tribunals have adversely affected the confidence and reliance on the regime. In addition, the high number of BITs concluded and the diversity of treaty obligations has fragmented the international investment law regime, thereby, producing concerns on the ability of States to maintain its domestic regulatory space and on the accountability of foreign investors for the damage caused by their investment.

For these reasons, identification of common elements of 'regulatory chill'; namely, (a) a new standard; (b) alteration in application of domestic regulation; (c) threat or fear of arbitration; and (d) bona fide nature of the regulation; is useful to mitigate the issue of regulatory chill. An analysis of these common elements may allow scholars, policy makers and regulators to design strategies aimed to address and prevent this phenomenon. Academicians and commentators have considered that a better balance between the rights of investors and the rights of States to regulate[82] is required and that this approach will also increase the level of legitimacy of the ISDS regime.

Proactive solution

When a host State backtracks on a general public measure in response to an arbitration proceeding (or a threat thereof), one may wonder if the State could have likely been successful in contesting the said arbitration. An inadequate understanding of the applicable

[81] Supra note 56.
[82] Supra note 5, at p. 1038.

law on part of the State could be one of the factors on the basis of which investors threaten to initiate arbitration against the State. However, the structure of ISDS mechanism and the provisions of BITs play an equally important role in determining the strength of the threat. As mentioned in this paper, regulators and investors are aware of a lack of *stare decisis* coupled with high cost of contesting arbitration, ad-hoc nature of tribunals and the resulting uncertainty of awards. Investors, therefore, rely on these factors while threatening host States which generally do not have large currency reserves.[83]

In 2014, two developing countries Mozambique and Sudan faced their first ISDS cases. In *Oded Basserglik* v. *Republic of Mozambique*[84], a South African company is suing for alleged indirect expropriation of prawn-fishing quotas concerning a joint fishing operation in which the claimant had allegedly invested based on the 1997 Mozambique-South Africa BIT. If this claim is successful, Mozambique, one of the poorest and most underdeveloped countries in the world would be forced to pay huge sums to a private company that it could have otherwise spent on the delivery of social services for its citizens. In the case of Sudan, *Michael Dagher* v. *Republic of the Sudan*[85], the claimant is seeking for awards to the tune of USD 35 million for the government's alleged failure to grant frequencies for a wireless internet network that was built by a company in which the claimant held shares.[86] As Mozambique and Sudan have witnessed, there is no end in sight to investor-state disputes and developing and underdeveloped countries would certainly refrain from enacting general public policy measures if the trend of suing them continues. As a result, the proactive solution which one could think of is renegotiating/amending existing BITs and/or making right to regulate of States stronger in future IIAs. As discussed above, Indonesia is undertaking a thorough review of its 64 BITs as well as five investment chapters under various free trade agreements. Interestingly, an analysis by UNCTAD on whether BITs fostered bilateral FDI flows from developed to developing economies between 1985-2012 concluded that "*...BITs appear to have no effect on bilateral North-South FDI flows...(and)...the BIT coefficients are not statistically significant; in other words, results do not support the hypothesis that BITs foster bilateral FDI.*"[87] In light of this observation, it

[83] According to World Investment Report, 2015 published by UNCTAD, around 70% of investor-state arbitration cases were brought against developing and transition economies and 80% of the claims were brought by investors from developed countries. Cited in Opeyemi Abebe, Emerging Disciplines on Investments in Trade Agreements 7 (2016).
[84] ICSID Case No. ARB(AF)14/2).
[85] ICSID Case No. ARB/14/2
[86] Opeyemi Abebe, Emerging Disciplines on Investments in Trade Agreements 7-8 (2016).
[87] United Nations Conference on Trade and Development, Trade and Development Report 159 (2014).

could be the approach adopted by Indonesia that could result in a decline in foreign investment as investors might not look kindly of such an approach, if followed by other developing/underdeveloped countries.[88] Their economies may not afford to take this risk.

The proactive solution to the menace of 'regulatory chill' could be for the States to attempt clarifying the ambiguity surrounding the structural problems in ISDS mechanism. This could be done by defining FTA/IIA/BIT provisions in a way which ensures that the intention of the signatory States is the paramount binding factor when tribunals attempt to interpret the terms of the treaty. This would essentially remove the uncertainty of arbitral awards. On the other hand, countries like Brazil[89], India, South Africa and Indonesia are working towards removing ambiguities by proposing model BITs which strike a better balance between States and investors by preserving the right, autonomy and policy space of host States. The onus for addressing the issue vests with the developing/underdeveloped host States to vehemently negotiate for greater policy space for general public regulations without being undermined by either the economic might of the developed States or their wealthy corporations.

[88] Stuart G. Gross, *Inordinate Chill: BITs, Non-NAFTA MITs, and Host-State Regulatory Freedom-- An Indonesian Case Study*, 24 Michigan Journal of International Law 959 (2003).

[89] Opeyemi Abebe, in her Briefing Note for The Commonwealth, writes that Brazil, in their recent investment cooperation agreements signed with Mexico and Mozambique, create investor obligations and have State to State dispute settlement procedures in place of ISDS.