LUND UNIVERSITY

SCHOOL OF ECONOMICS AND MANAGEMENT

Police powers doctrine vs indirect expropriation in a new world era

Creating a practical balance between the state's right to regulate and investor protection in the global energy transition

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Master's Thesis in European and International Trade Law

15 ECTS

HARN63

Spring 2026

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Abstract

This thesis examines recent years' unresolved conflicts on the state's right to regulate and the protection of foreign investors in 'climate blind' energy agreements, such as the Energy Charter Treaty. One of the primary disputes among them is the vague language of indirect expropriation in traditional International Investment Agreements (IIAs), which mostly favours investor protection. While IIAs can potentially contribute to developing countries' economies, they contrarily impose the proportionality principle, which leads to the creation of 'regulatory chill'. To reach the target of the sustainable energy transition, the international agreement subjects must draft modern treaties, such as CETA, USMCA and the Netherlands Investment Agreements, that explicitly codify the police powers doctrine, thereby safeguarding a state's sovereign right to regulate for the public and environmental welfare without facing massive financial liabilities.

This is a legal research with a normative legal approach, starting with an analysis of the given definitions of the distinction between a state's right to regulate and indirect expropriation by customary international law, pre-modernised investment treaties on energy, and tribunal awards. Then it has assessed states' vulnerabilities in international energy treaties, and examined modern treaties. Consequently, using already existing examples gives legislative solutions to the host states which they need.

The key question is the possibility of adding exclusive clauses or annexes to modernise investment agreements by clarifying boundaries of police powers to protect host states' public welfare in the energy transition period. This thesis argues that under strict proportionality tests, states cannot exercise their autonomy. Because developing host states are rich with natural resources have been faced with a dilemma: They have to pay a massive amount of compensation under investors' heavy agreement demands or accept ruinous financial liabilities under new green energy policies.

Keywords: Energy Charter Treaty (ECT), Comprehensive Economic and Trade Agreement (CETA), police power doctrine, sole effect, proportionality principle, indirect expropriation, investor protection, energy transition, strategic sectors, rare circumstances.

Abbreviations

BIT	Bilateral Investment Agreement
CETA	Comprehensive Economic and Trade Agreement (EU-Canada)
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
ECT	Energy Charter Treaty
EU	European Union
ECHR	European Court of Human Rights
FTA	Free Trade Agreement
IIA	International Investment Agreement
IIL	International Investment Law
ISDS	Investor-State Dispute Settlement
MAI	Multinational Investment Agreement
SOCAR	The State Oil Company of the Republic of Azerbaijan
USMCA	The United States-Mexico-Canada Agreement
UNCTAD	United Nations Trade and Development

1. Introduction

1.1. Background

The balance between investor protection and states' right to regulate plays a vital role in international investment law[1]. The Investor-State Dispute Settlement (ISDS) has been criticised for many years for its failure to manage that balance. [2]Investors often clash with states' sovereign rights by challenging domestic laws in international arbitral tribunals, especially for energy treaties.[3]

International or bilateral investment agreements between states create long-term economic ties between countries[4], making investments by entities or individuals in one country into business interests located in another, especially in developing countries. Because they perceive investment as a tool to join economic growth and worldwide development. Moreover, drivers of international investment law, while leading economic development, block the internationational environment standards through indirect expropriation. [5]However, investors can also cause public problems, such as environmental and social health of society.[6] Therefore, understanding the relationship between the right to regulate and indirect expropriation is crucial, especially during the energy transition period. Nowadays, international investment law has faced some challenges, the reasons are global and regional energy transition driven by international environment standards[7].

Furthermore, the modern treaty languages offer valuable insights[8] to escape the negative outcomes of vague agreement language. In addition to this, host states have recently managed to attract significant foreign investors while striving to mitigate adverse effects through targeted legislative reforms and a focus on infrastructure and sustainability. The balance between right to regulate with its tool – police power doctrine and indirect expropriation remains in this research paper as a double-edged sword. Thus, while investors are the pillars of

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[1] *Dr. Crina Baltag,* Reformıng The ISDS System: In Search Of A Balanced Approach?'. P. 288

[2] My An Dang, 'ISDS Legitimacy Crisis: Is a Procedural Reform Enough?', p. 19

[3]Nabil Kapasi,'Climate Change as a Security Interest: A Novel Defense in Fossil Fuel Investment Arbitration', https://cjil.uchicago.edu/print-archive/climate-change-security-interest-novel-defense-fossil-fuel-investment-arbitration#footnote66_SIdkP1TyBMaWVLaYf3Qk1QzfQovRoln2rbgNtzANV0M_mgmEFmyjgazi

[4] International Investment Agreements (IIAs), https://unctad.org/topic/investment/international-investment-agreements

[5] Ying Zhu, 'Do Clarified Indirect Expropriation Clauses in International Investment Treaties Preserve Environmental Regulatory Space?' 379

[6] Omer Erkut Bulut, 'Drawing Boundaries of Police Powers Doctrine: A Balanced Framework for Investors and States' (2022) 13 Journal of International Dispute Settlement, p.587, cited US Model BITs 2004 and 2012, Annex B(4)(b).

[7] The Nickel Report , Trends and Developments In Energy and Environmental Law, 'Eroding Investor Protections: Managing CSR and Political Risk in the Sustainable Brave New World', 06 April 2020, https://www.hunton.com/the-nickel-report/eroding-investor-protections-managing-csr-and-political-risk-in-the-sustainable-brave-new-world0

[8] OECD, "The interaction between investment treaty obligations and the 'right to regulate' A scoping paper", p. 8

international economic growth, they can also spoil environmental balance with unintended consequences in host states.[9]

However, it is often criticised that regulations aren't enough to make this balance; it should be political influence alongside the legislative solutions. With the help of international environment policies and protocols, it is possible to protect a state's own public welfare in front of investors. To summarise, revision is needed for the international investment agreements and bilateral investment treaties to create a balanced approach between parties.

1.2. Purpose and research questions

The purpose of this thesis is to assess the impact of the agreements' language, such as the Energy Charter Treaty, on creating the imbalance between a state's right to regulate and the investor's protection in the context of indirect expropriation clauses in the period of green energy.

By examining this, the paper explores the elasticity of expropriation, the borders of indirect expropriation and the regulatory takings to reduce the risk of regulatory chill as well.

The primary research questions will be as follows:

Question 1:

How should the modern investment agreements be drafted to establish a legally balanced relationship in favour of the state's right to regulate by clarifying indirect expropriation in the energy transition period?

Question 2:

How might the revised indirect expropriation clauses decrease vulnerabilities of developing, sector-strategic energy-exporting countries?

1.3. Delimitations

This paper will only focus on the balance between the right to regulate and investor protection from the aspects of indirect expropriation, analysing investor protection mechanisms in the energy transition period. In a general context, investment protections such as FET, national treatment or most-favoured nation treatment need much wider conceptual analysis, and

[9] Elizabeth Wu, 'Climate and Environmental Governance: International investment rules can undermine environmental and climate protection', 31 October 2025 https://www.bilaterals.org/?climate-and-environmental

frequently don’t focus on the balancing mechanism from the state’s point of view. When it comes to agreements, choosing the exact treaty is crucial in the context in which the Energy Charter Treaty (ECT) will be applied, as discussed in this paper. It is worth to note that ECT will be analysed for its traditional indirect expropriation and police powers clauses, not in regional context.

Additionally, this paper will analyse the imbalanced approach of tribunal awards in order to examine the adopted language of international investment agreements. Given the difficulty of demarcating the boundaries of indirect expropriation and police power, this paper limits its analysis to investment agreement clauses and relevant awards on indirect takings.

Further, but not finally, the author will seek mainly a solution for the protection of host state sovereignty. In order to do that, state vulnerabilities should be examined first. Then, to find out the best agreement and practice, some cases will be discussed in the context of strategic sectors.

1.4. Methods and materials

This research paper benefits from both doctrinal and qualitative methods, using detailed agreement breakdowns and case law analysis to evaluate how international tribunals interpret the right to regulate and indirect expropriation provisions.

In this material, arbitral tribunal cases, BITs or multi-national agreements, academic literature, reports and official websites of international organisations have been used to enrich findings. Those mentioned sources help to build a theoretical foundation to comprehend how International Investment Law should create a balanced approach through the lens of tribunal cases and modern agreements.

To enhance the relevance and applicability of the consequences of the research, the case study has been used in this research, which gives a practical analysis of regulatory takings and legislative reforms continuing to attract investment in developing economies.

This thesis employs doctrinal methodology supported by qualitative analysis of case law. By approaching the problems of vagueness of indirect expropriation in investment agreements, while synthesising customary law resources, relevant agreements on international investment law and tribunal awards, the study seeks to provide a clearer understanding of how balance can be managed to foster sustainable economic growth without compromising the state’s sovereignty.

As the exponential growth in the number of Bilateral Investment Treaties is happening, arbitration cases are increasing constantly.[10]

However, ICSID and UNCTAD's websites are the most accessible links; the listing is not complete. It should be checked for cross-referencing to the other good resources, UN Treaty Collections, case resources like Italaw[11]. Still, if the targeted BIT is not found, then the information should be obtained from the state's Ministry of Foreign Affairs. During writing of thesis AI (Artificial Intelligence) tools, such as Notebook LM and Google Gemini, had been used in order to focus more faster which sections are relevant. Also, Grammarly has been used in order to check grammar mistakes. Other than all text in this thesis has been written by author.

1.5. Outline

This thesis contains three main chapters with their sub-chapters to address the balance between investor protection and the state's regulatory rights, with the focus of right to regulate under the energy treaties. Following this introduction, section two establishes the theoretical framework, defining the state's right to regulate, analysing indirect expropriation provisions and police power doctrine, and pinpointing the proportionality tests. Part three examines state vulnerabilities, real-world political problems, difficulties in defining boundaries indirect expropriation, and proposals for rebalancing treaty language, supported by case laws. The sub-section expands the analysis to the global impacts of the energy transition industry, with suggested investment agreements language addressing sector-specific regulatory concerns. The final section offers conclusions and recommendations, with proposed treaty text for limiting indirect expropriation, improving governance, and refining investor-state dispute settlement (ISDS) mechanisms, as well as suggestions for future research.

[10] Campbell Mclachlan, Laurence Shore and Matthew Weiniger, International Investment Arbitration: Substantive Principles (Oxford University Press 2017), page 26

[11] Italaw, Newly Posted Awards, Decisions & Materials, https://www.italaw.com/

2. The Doctrinal Conflict: The Police Power Doctrine vs Sole Effect Doctrine

This section will examine how state sovereignty and regulatory authority are grounded in international investment law, tracing the evolution of the right to regulate from customary principles to treaty-based constraints. There is a consensus among legal scholars that the concepts of right to regulate and indirect expropriation together have been subjects of perennial debate within international law. But the vagueness of the definition of indirect expropriation complicates the ability of tribunals to render equitable adjudications for host states and the investor. The right to regulation of host states is provided by the police power doctrine, conversely, investor protection is on the assumption of sole effect doctrine.

2.1.The right to regulate as the foundational principle of sovereignty

2.1.1. The right to regulate as part of customary law

The term customary principles or customary international law is often referred to as general principles of international law,[12] which is necessary to be accepted as law *(opinio juris)* to be binding.[13] Additionally, Article 38(1) of the International Court of Justice declared that the Court applies international custom as evidence of a general practice while functioning with international disputes.**[14]** With its obligatory nature, customary international law holds that state's right to regulate is commercial and business activities within its territories[15], meaning the fundamental right of any sovereign state. As we have seen, older treaties were silent on the state's sovereign rights, but now things have started to change to give the proper definition.

2.1.2. International investment treaties define the right to regulate provisions

[12] Michael Wood and Omri Sender, 'Customary International Law' (*Oxford Public International Law* 2024) <https://opil.ouplaw.com/display/10.1093/law:epil/9780199231690/law-9780199231690-e1393>.

[13] Magdalena Pacholska, 'New Kids on the Block' (2019) 21 International Community Law Review 325.

[14] International Court of Justice, 'Statute of the International Court of Justice' (*International Court of Justice* 1945) <https://www.icj-cij.org/statute>.

[15] Stephen Olynyk, 'A Balanced approach to distinguishing between legitimate regulation and indirect expropriatıon in Investor-State Arbıtratıon', 2012**,** p. 265, cited Inaamul Haque and Ruxandra Burdescu, 'Monetary Consensus on Financing for Development: Response South from International Economic Law' (2004) 27 *Boston College International and Comparative Law Review* 219, 249.

In 2004, the OECD,[16] while examining 'right to regulate' gave a reference to the Multinational Investment Agreement drafted between 1993 and 1998[17]. In MAI, it is indicated with Annex 3 as follows:

> *"A Contracting Party may adopt, maintain or enforce any measure that it considers appropriate to ensure that investment activity is undertaken in a manner sensitive to health, safety or environmental concerns, provided such measures are consistent with this agreement."*

Also, it is very crucial to mention that MAI was never in force[18], due to heavy backlash from developing countries, civil society groups, and non-governmental organisations.[19]

Currently, the right to regulate is understood as a form of state sovereignty[20] to adopt and maintain government measures for public welfare objectives[21], establishing the state's broad, declaratory authority to govern in the public interest.

Though there is no single agreement for maintaining international investment law, there are other important agreements that determine the relationship between parties.

Mega-regional agreements, like the Comprehensive Economic and Trade Agreement (CETA, 2017) (European Union - Canada)[22], the Comprehensive and Progressive Trans-Pacific Partnership Agreement – CPTPP (signed and ratified in 2018)[23] define a fine line between investor protection and the state's right to regulate, in Annex 9-B[24] as follows.

> *'(b) Non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations, except in rare circumstances.'*[25]

[16] OECD Working Papers on International Investment 2004/04, "Indirect Expropriation" and the "Right to Regulate" in International Investment Law, p. 9.

[17] Multilateral Agreement on Investment Draft Negotiating Text as of 24 April 1998, Annex 3, p. 212

[18] U.S. Department of State, 'Multilateral Agreement on Investments' (*1997-2001.state.gov*), 23 March 1998, <https://1997-2001.state.gov/issues/economic/fs_980323_multilat.html>.

[19] Ibid.

[20] Jus Mundi, 'Wiki Note: Right to Regulate in the Public Interest: Treaty Practice' (*jusmundi.com,* 17 September 2025) <https://jusmundi.com/en/document/publication/en-right-to-regulate-in-the-public-interest>.

[21] Vera Korzun, 'The Right to Regulate in Investor-State Arbitration: Slicing and Dicing Regulatory Carve-Outs', p. 355.

[22] 'CETA Chapter by Chapter' (*Trade and Economic Security*2023) <https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/canada/eu-canada-agreements/ceta-chapter-chapter_en>.

[23] Department of Foreign Affairs and Trade, 'Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)' (*Australian Government Department of Foreign Affairs and Trade*2025) <https://www.dfat.gov.au/trade/agreements/in-force/cptpp/comprehensive-and-progressive-agreement-for-trans-pacific-partnership>.

[24] OECD, "The interaction between investment treaty obligations and the 'right to regulate' A scoping paper", 02 Mart 2026, p. 8.

[25] 'Comprehensive and Progressive Agreement For Trans-Pacific Partnership Preamble' <https://www.iilj.org/wp-content/uploads/2018/03/CPTPP-consolidated.pdf>.

United States – Mexico – Canada Agreement (USMCA) (ratified in 2018)[26] mirrors the CPTPP's approach with its Article 14.16 and Annex 14-B.

One of the prime tribunal cases is *Philip Morris v. Uruguay*, a landmark victory for states, which raised public awareness of investment treaties. In that case, the investor has been challenged by the host state with a good-faith regulation and non-discriminatory public health measures. Despite Uruguay having a huge amount of cigarette consumption, has adopted two essential regulations, such as the 'Single Presentation Regulation' and the '80/80 Regulation'[27]. Single Presentation Regulation declares that companies cannot sell multiple products of the same brand. By that time, the other measuring covers 80 per cent of the packaging with health warnings, which means only 20 per cent remains for the label of the brand.[28] Thus, Uruguay has the sovereign right to exercise its "police powers" and is not required to provide any compensation. [29]

2.1.3. The police power doctrine as the operative instrument

When analysed through a broader doctrinal lens, it demonstrates that the police powers doctrine is not distinct from, but rather constitutive of, the primary legal mechanism through which a state executes its inherent right to regulate. Without crippling financial liabilities, host states have required a reliable legal instrument to protect and defend their sovereign rights in evolving international law.

Police Power Doctrine is a main operative instrument of the state's protection[30]. International investment arbitration first used this concept, and then IIL started to think about it[31]. Independent of specific treaty provisions, the sovereign state has the right to protect health, public welfare, and the environment[32]. As mentioned in the right to regulate, the police powers doctrine is deeply rooted in customary international law,[33] and it is recognised as a legal tool to regulate and enable tribunals to distinguish between these regulations.[34] North American

[26] Office of the United States Trade Representative, 'Agreement between the United States of America, the United Mexican States, and Canada Text | United States Trade Representative' (*Ustr.gov*2020) <https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between>.

[27] Jus Mundi, 'Philip Morris v. Uruguay, Philip Morris Brand SARL, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7, Award, 8 Juil. 2016'.

[28] 'Philip Morris v. Uruguay – Investment Treaty News' (*Iisd.org* 2018) <https://www.iisd.org/itn/2018/10/18/philip-morris-v-uruguay/>.

[29] Jus Mundi, 'Philip Morris v. Uruguay.

[30] UNCITRAL, 'Saluka v. Czech Republic, Partial Award, 17 Mar 2006', 260. <https://jusmundi.com/en/document/decision/en-saluka-investments-bv-v-the-czech-republic-partial-award-friday-17th-march-2006>.

[31] Adelisa Wigati,Prita Amalia, The Police Power Doctrine As A State's Protection Against The Claim Of Indirect Expropriatıon Under The International Investment Arbitration, p. 22

[32] Ben Mostafa, 'The Sole Effect Doctrine, Police Powers and Indirect Expropriation under International Law' (2008) p.273

[33] Adelisa Wigati,Prita Amalia, p. 22

[34] Ben Mostafa, p. 275

Free Trade Agreement (NAFTA)[35] settles down in 2006 with *Methanex Corporation v. United States of America*, as a subject of general international law, non-discriminatory regulations designed to protect public welfare.[36] Thus, a state is not obligated to pay compensation for economic and strategic injuries sustained by an investor if those damages result from *bona fide*.[37] Moreover, in *Chemtura v. Canada* [38]case tribunal considered the protection of human health and the environment via police powers.

In practical use, the police power doctrine is the primary legal shield of host states against claims of indirect expropriation[39]. Several policy members claim that ISDS has been mainly designed to protect investor rights[40]. Obviously, back then, the host states were aware of the consequences of this one-sided approach, and they tried to ensure these did not lead to more expensive consequences for the host state. When an investor state claimed that newly adopted environmental regulations caused economic losses to their investments[41], the host states defended themselves with the police powers doctrine.[42]

Generally, the host states have been the respondent, rather than the claimant, because of financial concerns.[43] Sovereign actions targeting foreign investors fall to be judged through the lens of general standards of international law and not by reference to any national system of law.[44]

Besides, international arbitral tribunals require many strict legal criteria from the host states to operate the police powers doctrine effectively and legally. Along with tribunals, while enacting measures, OECD and even the European Commission consider that good faith is one of the most important requirements for drawing a line between the right to regulate and indirect expropriation.[45] As a next step, the 'essential' public interests are taken into account,[46] such as in *Philip Morris v. Uruguay* tobacco packaging case and the environmental protection case – *Methanex.* [47]

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[35] https://www.italaw.com/sites/default/files/case-documents/ita0529.pdf

[36] Restatement of the Law Third, the Foreign Relations of the United States,' American Law Institute (American Law Institute Publishers 1987) 712.

[37] UNCITRAL, 2006

[38] *Chemtura Corporation v. Government of Canada* (*Chemtura v. Canada*), Final Award (2010), UNCITRAL IIC 451, para. 266.

[39] Adelisa Wigati,Prita Amalia, p. 24

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[41] Omer Erkut Bulut, p.583.

[42] Adelisa Wigati,Prita Amalia, p. 24

[43]Gustavo Laborde, 'The Case for Host State Claims in Investment Arbitration' (2010) 1 Journal of International Dispute Settlement, p. 98.

[44]Trevor Zeyl, 'Charting the Wrong Course: The Doctrine of Legitimate Expectations in Investment Treaty Law' (2011) 49 Alberta Law Review, p. 206, cited Campbell Mclachlan, Laurence Shore and Matthew Weiniger, International Investment Arbitration: Substantive Principles (Oxford University Press 2017), 265.

[45] Omer Erkut Bulut, p. 589

[46] Ibid, p. 597

[47] 'Methanex Corporation v. United States of America, UNCITRAL.

Furthermore, tribunals do frequently proportionality test as an operative check on that doctrine.[48] It leads them to weigh the severity of economic losses for investors against the overarching public interest that the state is trying to protect. We will touch on that point in the next chapters.
Conclusively, the police powers doctrine provides tribunals an effective strategy with its operative nature to balance the long-awaited conflict between the investor and the host state. Because while the host state executes its sovereign duty in order to protect public welfare can face unavoidable interference, the doctrine establishes a safe place.

2.2. The challenge of defining indirect expropriation: Direct vs. indirect takings

While explaining the state's protection functions, the right to regulate and diving into the police power doctrine concept, an important question arises: What is indirect expropriation?
As in the concept of the state's protection mechanisms, contrarily, foreign investors had faced significant problems with nationalisation or expropriation by host countries, before the 1950s.[49] In the past, expropriation meant a clear and direct government action, like a factory without compensation. After that, the number of Bilateral Investment Treaties has been increasing, which means parties have already started to be aware of their rights. They have added clauses to the treaties about the government's policy on expropriation. Treaties give the general definition, but don't explain where the line is between a fair regulation and an illegal taking. The concept depends on many factors or situations, even cultural elements[50], which makes it hard to determine what expropriation is, especially direct expropriation.[51] In addition to all these, investment treaty awards often skip two essential steps for defining the expropriation, Jon Paulsson and Zachary Douglas claimed in their article.[52] That makes it much clearer if compensation is necessary, then it is referred to as expropriation[53], which is also considered lawful behaviour in general law.[54] In practice, different tribunals use different logic[55], some

48 Ibid, p. 601
49 Ibid, p. 265.
50 Jan Paulsson and Zachary Douglas, Indirect Expropriation in Investment Treaty Arbitrations***The views expressed in this article are exclusively those of the authors and do not necessarily reflect the opinions of Freshfields Bruckhaus Deringer or its clients. (2021), 1.
51 Campbell and Matthew, p. 265.
52 Jan and Zachary, Indirect Expropriation in Investment Treaty Arbitrations, p. 2
53 Jan and Zachary, p. 3
54 Jörg Kammerhofer, International Investment Law and Legal Theory, Expropriation Reconstructed, (Cambridge University Press 2021) p. 307.
55 Christian Riffel, Indirect Expropriation and the Protection of Public Interests, p. 953.

care most about how badly the investor was affected, others focus on what the government was trying to do. The lack of a clear definition means the rules aren't predictable, which can make both states and investors uncomfortable. [56]

Moreover, the host state may implement expropriation operations for public benefit, without discrimination, following procedural rules and on condition,[57] and that compensation is paid in return. Exemplarily, the article titled 'Expropriation' in the Bilateral Investment Treaty signed between Sweden and Turkiye is as follows;

> *"(1) Neither Contracting Party shall take any measures of expropriation or nationalisation or any other measure having the same nature or the same effect against investments and returns belonging to investors of the Other Contracting Party or otherwise depriving them, directly or indirectly, of their investments, unless the following conditions are complied with: (a) The measures are taken in the public interest and under due process of law; (b) The measures are not discriminatory; and…"*[58]

As can be observed, no distinction was made between indirect taking and regulatory expropriation to facilitate an understanding and application of the relevant procedural measures. In the period when there were few Bilateral Investment Treaties, there was uncertainty; currently, concepts have become confused, and complexity has increased.[59] The reason for that there is a vast amount of increasing number of BITs, which makes matters complicated, and each treaty uses fluctuating language to define the concept.

The intervention's effects are concrete, ECT Article 13 Expropriation[60]. State practice on the content of the applicable standards of treatment is rare outside the area of the deprivation of property[61]

[56] Jörg Kammerhofer, p. 186.

[57] Hümeyra Zeynep, 'Milletlerarası Yatırım Hukukunda Dolaylı Kamulaştırma', 25

[58] 'Sweden - Turkey BIT (1997) - Agreement between the Kingdom of Sweden and the Republic of Turkey on the Reciprocal Promotion and Protection of Investments ' (*Wti.org*2025)

[59] Campbell and Matthew, International Investment Arbitration, 377.

[60] 'Energy Charter Secretarıat The Energy Charter Treaty, Trade Amendment and Related Documents' <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2427/download>.

[61] Bilateral treaties and multilateral instruments on investment protection Sacerdotti 1997

2.2.1. Defining the scope of Indirect Expropriation

There is no single document that defines what indirect expropriation is, but in general, it can be said: "…any measures or series of measures of a Party has an effect equivalent to direct expropriation".[62]

Back then in 2004, the OECD mentioned that it is important to identify whether expropriation is compensable or not. For the parties, it is hard to determine which action leads to expropriation and which does not. [63] It is an increasing trend for parties to define exact meaning of indirect expropriation in agreements like the CETA (Article 8.9), USMCA (Article 14.8) and Netherlands model Investment Agreement.

De facto indirect expropriation has been analysed and identified in the *CME v. Czech Republic* case, while creeping expropriation has been examined in the *Starrett Housing v. Iran* case. In some materials, even regulatory expropriation has been examined. Because it is very hard to detect which behaviour breaches the clause, the definition of regulatory expropriation should be clarified attentively in agreements.

In this phase, the question arises: Do states have the right to expropriate? There are two angles for this occasion. As a short answer, '*yes',* states have the right to regulate expropriation indirectly for the protection of public interest and safety. *Tecmed v. Mexico*[64] case makes the distinction by weighing the severity of economic harms against the legitimacy of the state's regulatory targets.

The doctrinal ambiguity surrounding indirect expropriation[65] precludes a monolithic solution, as any comprehensive resolution inherently goes beyond the limits of the law. The experience shows us it merely depends on politics [66] and state interest. Even though we cannot set the definitive legal norms to prevent negative incomes of indirect expropriation for investors, several legal regulations can be set which limit its boundaries.

It is very important to define the exact meaning of indirect expropriation to understand limits of the right to regulate.[67]

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[62] Jus Mundi, 'Bilateral Investment Treaty between the Government of the Republic of India and [...] (2015)' (*Jusmundi.com*28 December 2015) <https://jusmundi.com/en/document/treaty/en-bilateral-investment-treaty-between-the-government-of-the-republic-of-india-and-india-model-bit-2016-friday-1st-january-2016>.

[63]OECD, '"Indirect Expropriation" and the "Right to Regulate" in International Investment Law' (www.oecd.org) <https://www.oecd.org/daf/inv/investment-policy/WP-2004_4.pdf>

[64] 'Técnicas Medioambientales Tecmed, S.A. V. The United Mexican States, ICSID Case No. ARB (AF)/00/2 | Italaw' (*Italaw.com*2015) <https://www.italaw.com/cases/1087>.

[65] Jörg Kammerhofer, p. 183.

[66] Sattorova, Mavluda. 'The Impact of Investment Treaty Law on Host States: Enabling Good Governance?', (2019) 23 Edinburgh Law Review 289., p. 17

[67] Hümeyra Zeynep, 'Milletlerarası Yatırım Hukukunda Dolaylı Kamulaştırma' (2015), 45

Host States' main goals are to attract foreign investments to their country; therefore, they simply avoid taking over a foreign investment openly or directly, instead, they use indirect methods that hurt the investments. [68]

In *Occidental Exploration and Production Co v Ecuador*, the tribunal found indirect expropriation where government actions destroyed contract rights, having "substantially the same impact on effective control over use and operation" as a formal taking. The *Metalclad v Mexico* line of cases emphasized deprivation "of the use or reasonably to be expected benefit of property". The *Tecmed* tribunal, referring to European Court of Human Rights case law, applied a test of proportionality between the burden on the investor and the aim sought. The concept of **partial expropriation**, where only a part of the investment is affected, also adds complexity and relates to the debate over intensity and the relevant object ("investment" vs "property").

Furthermore, some international investment agreements have been criticised for conflating the question of whether a taking has occurred with whether it was lawful (i.e., whether legality conditions like public purpose or due process are met). This debate about the "doubling" or "selection" of legality conditions within the definition itself adds another layer of interpretive challenge.

In conclusion, the imprecision in defining expropriation, especially its indirect form, stems from the broad and inconsistent language in IIAs, the inherent complexity of assessing the degree and nature of state interference "short of direct possession", and the consequent reliance on varied arbitral interpretations and case-by-case factual analyses.

However, when researching the concept of expropriation, many sources fail to provide a sufficiently comprehensive or precise explanation of the term within the context of International Investment Law. Therefore, it would be more appropriate to examine the original meaning of the term in question, firstly[69]. According to Kammerhofer, most investment treaties do not define "expropriation"; when they do, they use a dictionary explanation, emphasising the absence of a precise definition; it also needs a political explanation and deep research.[70]

[68] WM Reisman and RD Sloane, 'Indirect Expropriation and Its Valuation in the Bit Generation' (2004) 74 British Yearbook of International Law 115.

[69] Jörg Kammerhofer, p.168.

[70] Ibid, 169.

2.2.2. Elasticity of expropriation: A doctrinal tightrope

The Olynyk article provides the details of the clash between the 'sole effect' [71]doctrine and 'police power' doctrine.[72] The modern case-by-case balanced approach that tribunals use to evaluate measures, which looks at four main factors: the degree of interference with property rights, the purpose and proportionality of the measure, the frustration of legitimate expectations, and the presence of arbitrariness or discrimination[73]. Investors had few options and often relied on their home countries for help.

Today, the meaning of expropriation has expanded[74]. It can include indirect actions, like regulations or policy changes that don't take property physically but still harm the investment. This broader, more flexible definition is what scholars call "elasticity."[75]

Investment treaties now let investors go to international arbitration, and tribunals must decide if a state's actions, even without a formal taking, effectively amount to expropriation. This shift makes expropriation claims more complex — and sometimes more controversial. In this section, it was broken down mostly into the theoretical parameters of doctrinal conflict in order to create a balance between international investment parties. Having an established background in the context of the right to regulate and the indirect expropriation, the analysis now pivots to examine the more practical side of this dispute through the lens of the global energy transition.

[71] *CCL v. Republic of Kazakhstan* (*CCL v. Kazakhstan*), Award (2004), SCC Case No 122/2001, para. 173; Shirlow, n11, p. 598.

[72] Stephen Olynyk, 'A Balanced approach to distinguishing between legitimate regulation and indirect expropriatıon in Investor-State Arbıtratıon', 2012**,** p. 270.

[73] Kate Miles, 'International Investment Law and Climate Change: Issues in the Transition to a Low Carbon World', Society of International Economic Law Working Paper, (2008) 39 SSRN Electronic Journal, p. 25

[74] Campbell and Matthew, International Investment Arbitration, 265.

[75] However author is referencing the book, but the term is not attributed to the specific source. Instead, over time, scholars or arbitral tribunals has started to use widely.

3. The clash in practice: Proportionality, Regulatory Chill, and Reform through the lens of energy transition

Having an established theoretical background in the context of the right to regulate and the indirect expropriation, the analysis now pivots to examine the more practical side of this dispute through the lens of the global energy transition.

Finally, the chapter explores legislative solutions, finding the evolution from the reliance on customary international law to explicit treaty drafting, emphasising the latest tribunal case and other instruments like CETA and the Netherlands Model BIT.

3.1 Examining the practical challenges for the balance

3.1.1. Proportionality

In international investment law, the ‘proportionality’ principle has been referenced frequently to balance between the regulatory rights of the sovereign state and the investor’s protection.[76] The principle of proportionality is the subject examined in both IIL and international law, and it is evaluated as a measure such as necessity, suitability and proportionality *stricto sensu* [77]in dispute settlements.[78] As it is emphasised in the regulatory expropriation section, the *Tecmed*[79] the tribunal stands as a pioneering authority using the principle in this way. The tribunal has also shown that a host state’s actions are not excluded from the definition of expropriation, even if it fails the proportionality test[80]. But the investor stays under financial burden. Again, the *Philip Morris* case shows up as a ground example, where the tribunal determined the compliance of packaging requirements with ‘reasonable’ or ‘proportionate’ measures.[81] Similarly, in *Tecmed,* in the following cases, like *Azurix* [82]and *Casinos Austria v. Argentina Award,*[83] tribunals used the proportionality principle to evaluate the state’s right to regulate.

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[76] Omer Erkut Bulut, p. 601.

[77] Christian Riffel, p. 956.

[78] Jasper Krommendijk and John Morijn, ‘Proportional’ by What Measure(s)? Balancing Investor Interests and Human Rights by Way of Applying the Proportionality Principle in Investor-State Arbitration’ in Pierre-Marie Dupuy and others (ed), Human Rights in International Investment Law and Arbitration (OUP 2009) 427.

[79] *Tecmed,* para. 122, cited to the *Matos e Silva Lda., and Others v. Portugal* case

[80] Ibid.

[81] *Philip Morris,* p.399.

[82] ‘*Azurix Corp. v. The Argentine Republic,* ICSID Case No. ARB/01/12, Award, para. 311 .

[83] ‘Casinos Austria International GmbH and Casinos Austria Aktiengesellschaft v. Argentine Republic, ICSID Case No. ARB/14/32, Award of the Tribunal, para. 178.

Although the tribunals have repeatedly referred to it, the practical contribution of the proportionality principle is still arguable. Thus, the proportionality policy should give the meaning of ‘designed to protect’ with a low threshold.[84] In his article, Christian Riffel has mentioned the term strict proportionality [85]test, which leads to the investor’s interest taking precedence over the protected purpose. As an example, the tribunal investigated, in *PL Holdings v. Poland* case[86], whether the state’s right to regulate in the banking sector has been exceeded. If the investor was forced to sell its shares quickly, it was called an excessive interference. Even though the state’s right was proven within that case, critics argue that this method of approaching still limits the state’s boundaries.[87]

Moreover, the difference between tribunals exacerbates the unknown nature of the principle. As a case in point, the permanent court members, the judges of the ECHR, have accustomed states’ legal systems, while ISDS tribunals – *ad-hoc* bodies – struggle to formulate a centralised approach to the cases.[88] Consequently, with these unpredictable awards, the subjective nature of the proportionality principle leads to an increase in investors’ protection over a sovereign state’s autonomy. To prevent this global problem, tribunals should use strict proportional tests over states only in rare circumstances[89].

Along with all the mentioned cases, this paper’s core focus is still on creating a balance to investment disputes in the green energy sector. Therefore, the principle also should be examined to find proper solution to it.

3.1.2. Threat of regulatory chill

Investor’s implications for the host states frequently discourage them from ratifying new regulations in their own territory and for their own welfare in all aspects. Also, states limit their right to regulate voluntarily to attract foreign direct investments[90]. That cause-and-effect situation, called ‘regulatory chill’ [91]or ‘chilling effect’, [92]is often noticed in the indirect

[84] Christian Riffel, p. 957, cited De Brabendere and Baldini Miranda da Cruz (n 94) 218–19 argue that there is not one proportionality test in international investment law but many.

[85] Ibid. p, 958

[86] ‘*PL Holdings S.à.r.l. V. Republic of Poland, SCC* Case No. V 2014/163, Partial Award, para. 384, p.151.

[87] Ben Mostafa, p. 284

[88] Maryam Malakotipour, ‘The Chilling Effect of Indirect Expropriation Clauses on Host States’ Public Policies: a Call for a Legislative Response’, p. 253

[89] Christian Riffel, p. 967.

[90] Berfu Beysulen Angin, ‘The Right to Regulate vs Investment Protection: Unveiling the Causes of Imbalance and the Limits of Current Reform Efforts in International Investment Law’, p. 34, cited Catherina Titi,’The Right to Regulate in International Investment Law’, 19

[91] David Gaukrodger, ‘The balance between investor protection and the right to regulate in investment treaties: A scoping paper’, OECD Working Papers on International Investment 2017/02, p.21

[92] Maryam Malakotipour, p. 245

expropriation cases[93]. As established above, this is connected to a persistent vagueness in international investment law, wherein either in IIAs or the tribunal awards fail to define precise boundaries of indirect expropriation. Not surprisingly, in investment disputes, compensatory awards are at stake.[94] Host states need to prioritise the financial aspect of the tribunal's hearings, as their economic welfare depends on it. [95] Therefore, facing the threat of billion-dollar financial compensation claims, states prefer cost-avoidance[96] rather than protecting public welfare or the environment.

Practical evidence of this phenomenon has been observed in essential tribunal cases such as *Ethyl v. Canada, Sedco Inc v. National Iranian Oil Co., and El Paso v. Argentina*.[97] Specifically, in the *Ethyl v. Canada* dispute, if Canada failed to prove the health and environmental impacts, the tribunal would confidently award the deciding state's action as the regulatory chill[98].

Nevertheless, the more these precedents increase in the global tribunals, and the lack of interpretation of indirect expropriation, the more foreign investors have a "powerful political influence" over the sovereignty of states. As a result, the regulatory chill is also one of the tools that causes a financial burden for the host states.

3.2. Sectoral vulnerability: Evaluating the state's right to regulate through the lens of indirect expropriation in the energy transition period

Foreign investments create long-term economic ties between host countries and investors, especially for states rich with natural resources. Typically, host states accept foreign investments for economic growth and global development. International energy investment agreements play a significant role at the crossroads of international investment law and international environmental law. In international investment law, the oil and gas agreements hold one of the most important strategic roles not only for host states, but also for investors. On the other hand, as the world has been challenged by global warming, international organisations have executed several preventive actions, including formulating agreements.

[93] Jörg Kammerhofer, p.168.

[94] Kate Miles, 'International Investment Law and Climate Change: Issues in the Transition to a Low Carbon World', Society of International Economic Law Working Paper 27/08 (2008) p. 23.

[95] Maryam Malakotipour, p. 245

[96] OECD 2004/04, p. 5

[97] '*Ethyl Corporation v. the Government of Canada'*, UNCITRAL, '*Sedco, Inc. V. National Iranian Oil Company*, Award (Award No. 309-129-3), *'El Paso Energy International Company v. the Argentine Republic*, ICSID Case No. ARB/03/15

[98]

Therefore, investment agreements struggle with adapting to climate change. Consequently, in light of the practical challenges of the proportionality principle and the chilling effect, this section will examine vulnerabilities of the host states in energy projects.

3.2.1. The practical challenges of green energy in ECT

Fundamentally, the texts of international investment agreements were ‘climate-blind’ and did not differentiate between low-carbon and carbon-intensive investments[99] for a long time. As the unique example in the arena, the ECT[100], states that “*States are determined to create a climate favourable to the operation of enterprises…”*. As is apparent from the imprecise language of these clauses, the Treaty doesn’t mandate specific climate targets. Anyway, it wouldn’t be adequate to expect ECT to encourage a bold transition to renewables, though the Treaty was negotiated during a high-carbon energy period[101].

In 2023, UNCTAD emphasised that *“Investment will be the engine of the energy transition…”*.[102] Moreover, it dictates that investment should be sustainable energy-focused within a short time and will demand investing 1.5 times today’s global GDP by 2050.[103]

The United Nations Climate Change Conference[104] has served as the cornerstone for international climate diplomacy, resulting in the groundbreaking agreements, such as the Paris Agreement[105] and Kyoto Protocol[106]. Unlike parties of IIAs or BITs, the private sector plays a decisive role in preventing climate change, leading towards low greenhouse gas emissions.[107] As a consequence of the Paris Agreement’s highly challenging targets, host states terminate several tariffs to attract green energy investments. As a solid example, the ‘*Spanish renewable energy Saga’*, shows a very important outcome for host states. In 2007, Spain decided to eliminate tariffs to attract both national and international investments to support photovoltaic energy.[108] This state of affairs aligns perfectly with the ideal regulatory environment desired by foreign investors. On the contrary, host states drastically suffered from their huge debt hole

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[99] Fernando Dias Simões, Renewed Injustice: Domestic Investors and the Energy Transition, 2026, p. 205

[100] ‘Energy Charter Treaty - Energy Charter’ (*Energycharter.org*18 February 2019), Title I: Objectives, page 13 <https://www.energycharter.org/process/energy-charter-treaty-1994/energy-charter-treaty/>.

[101] Nathalie Bernaschoni-Osterwalder & Martin Dietrich Brauch, *Redesigning the Energy Charter Treaty to Advance the Low-Carbon Transition*, TRANSNAT’ L DISP. MGMT., Feb. 2019, at 1, 4

[102] UNCTAD, World Investment Report 2023, Investing in Sustainable Energy for All, Chapter IV, Section A, p. 142

[103] UNCTAD, Chapter IV, p. 140.

[104] United Nations, ‘UN Climate Change Conferences’ (*United Nations*2024).

[105] UNFCCC, ‘The Paris Agreement’ (*United Nations Climate Change* 2025).

[106] UNFCCC, ‘The Kyoto Protocol’ (*UNFCCC.int, 2022*).

[107] Fernando Dias Simões, p. 207

[108] ‘Spain’s Renewable Energy Saga: Lessons for International Investment Law and Sustainable Development – Investment Treaty News’ (*Iisd.org*2019),<https://www.iisd.org/itn/2019/06/27/spains-renewable-energy-saga-lessons-for-international-investment-law-and-sustainable-development-isabella-reynoso/>.

to national investors. The reason for this crisis was the miscalculation of the tariff deficit[109], and investors flooded into Spain. Under Fear and Equitable Treatment[110], Spain made specific commitments to the investors regarding the provision of subsidies[111]. Suddenly, the host state found itself in significant debt. Further compounding this issue, massive ISDS claims collapse by foreign investors under ECT.[112]

Additionally, small host states that own natural resources in strategic sectors, specifically Azerbaijan, actively seek foreign direct investment (FDI).[113] Azerbaijan pursues renewables to reach 30% of its electricity capacity, in light of green energy, but it can struggle to attract investment in the core sector – oil and gas production.[114] Alongside goals to be achieved, Azerbaijan is part of numerous BITs

To assess the effectiveness of long-term energy investments, host states must consider their own applicable laws, [115]economic and political stability[116], the potential execution rate of energy projects,[117] as well as the ongoing relationship with foreign investors. This condition is also applicable for the investor to gauge its potential. The unpredictability complicates the ability of the host state to adapt to new green energy projects and related legislation[118]. Owing to the severe lack of consistency and predictability, green energy disputes will remain a major practical challenge in international investment law.

3.2.2. Host states natural resources as their sectoral vulnerabilities

Alongside the Spanish scandal, there are several fusel fuel arbitration cases[119] in which ECT imposes significant boundaries on the right to regulate in the public interest. Although investors face economic and political challenges during the investment period, they still create host states that cannot overcome vulnerabilities in energy projects. As the international organisations urge

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[109] An unofficial translation in *RENERGY v Spain* (n 21), para.181

[110] Filip Balcerzak, Renewable Energy Arbitration – Quo Vadis? Implications of the Spanish Saga for International Investment Law (Brill Nijhoff 2023) 384.

[111] Comprehensive Economic and Trade Agreement Between Canada, and the European Union and its Member States,, Can.- E.U., art. 8.9, Oct. 30, 2016, O.J. (L. 11/23) (2017)

[112] *AES Solar and others (PV Investors) v. Kingdom of Spain*, PCA Case No. 2012-14, para 566, p. 172

[113] 'Azerbaijan - United States Department of State' (*United States Department of State*4 January 2025) <https://www.state.gov/reports/2024-investment-climate-statements/azerbaijan>.

[114] 'SOCAR' webpage (*SOCAR*2021) <https://socar.az/en/page/korporativ-strategiya> accessed 25April 2026.

[115] Robert A. James, Alicia M. McKnight, 'An Integrated Approach to International Energy Investment Protection', p.13,

[116] Sattorova, Mavluda, p. 17

[117] Robert A. James, Alicia M. McKnight *cited* Robert J. Spjut, *Transaction Risk: A Legal Guide to Contractual Management Strategies*, Tort Trial & Insurance Practice, American Bar Association (2018).

[118] Berfu Beysulen Angin, p. 27

[119] ISDS, 'Overview of Recent Fossil Fuel Arbitration Cases under the Energy Charter Treaty - Investment Treaty News' (*Investment Treaty News*27 January 2025) <https://www.iisd.org/itn/2025/01/27/overview-recent-fossil-fuel-arbitration-cases-under-energy-charter-treaty-clementine-baldon-rosanne-craveia/>.

states to reach the goals of the Paris Agreement, oil and gas-producing states are exposed[120] to severe both economic and legal risks during the energy transition. These kinds of state vulnerabilities have been noticed primarily in economic reliance on carbon-intensive industries[121] and legal boundaries imposed by petroleum contracts.[122] Economically, those governments are susceptible to energy price fluctuations and massive losses in government assets.[123] Unfortunately, these urgent climate policies come back to host states as legal vulnerabilities under international investment law.

As mentioned in favour of the investor, investor protection, and traditional petroleum agreements[124] – a form of investment agreements – blocked the legal sovereignty of the host states with their 'stabilisation', 'force majeure', and 'determining international arbitration' [125]clauses. Stabilisation clause protects investors from legislative and regulatory changes in the host states, as well as political impact.[126] In addition to these clauses, 'freezing clauses' have also been set as a stable provision in international investment agreements, in which host states have been prohibited from terminating or making unilateral changes without the consent of the investor.[127] Those provisions and arbitral hearings create a severe regulatory chill for the host states. Consequently, host states are deterred from applying new climate rules to the agreements or the existing projects. The more the threat is imminent, the more host states are exhausted from being late for climate action or losing financial resources.

Notwithstanding these obstacles, the host states have started seeking control over their own natural resources[128] and managing the phase-out of fossil fuel production[129]. Venezuela established the foundational precedent of this practice in 1976 and subsequently resurged during the 2000s.[130] The central legal concern was that such state interventions constituted direct expropriations, particularly driven by massive waves of nationalisations in the oil, mining and other strategic sectors.[131] To collapse those kinds of barriers, investors implemented all possible vehicles, such as political superpower actions over host states or legal

[120] IISD Report, 'A Legally Sound Oil and Gas Phase-Out: How to design policies to mitigate investor-state arbitration risks' (April 2025), p. 10

[121] IISD Report, p. 1

[122] Nicola Woodroffe, 'Tying Their Hands? How Petroleum Contract Terms May Limit Governments' Climate Policy Flexibility' (September, 2021), p. 2

[123] Christopher Hajzler, 'Expropriation of foreign direct investments: sectoral patterns from 1993 to 2006', p. 127

[124] Nicola Woodroffe, p. 7.

[125] Ibid, p. 4.

[126]'Stabilisation Clause' (*jusmundi.com*4 November 2025), I. Definition <https://jusmundi.com/en/document/publication/en-stabilization-clause>.

[127] Ibid., A.

[128] Robert A. James, Alicia M. McKnight, p. 10

[129] IISD Report, p. 13

[130] Peter Muchlinski, Federico Ortino and Christoph Schreuer, '*The Oxford handbook of International Investment Law',* p. 403

[131] Robert A. James, Alicia M. McKnight, p. 14

regulations derived from international law. In the aftermath of the events, the Venezuelan Government adopted significant amendments to the Hydrocarbons Law, while simultaneously signalling the intention of a prospective bilateral investment treaty between the U.S. Government.[132]

As an indirect consequence, host states face the regulatory dilemma: whether they should risk the imperative to accelerate climate action, which is starkly constrained by the risk of incurring substantial ruinous financial liability, or the appropriation of their natural resources oil, gas, mining and other strategic sectors, under the international investment agreements.

3.3. Legislative solutions: Drafting explicit clauses and defining determinative elements of the police powers doctrine through the lens of the state's legislation and the modern agreements, such as CETA and the Netherlands Model BITs

3.3.1. Modern Investment Agreements Netherlands Model Investment Agreement

The indefinite boundaries of indirect expropriation in customary law and in traditional IIAs lead to regulatory chill and massive compensation for host states. Yet, the International Investment Law defines unpredictable decision-making experience with ad hoc-based tribunal awards. Establishing more definitive and comprehensive agreement language is essential to mitigate existing interpretive uncertainty[133]. An advanced legislative solution for balancing investor protection and the right to regulate is the inclusion of specialised clauses or annexes to the modern agreement[134]. As arbitral discretion by mandating case-by-case and fact-based, these clauses or annexes shall restrict the tendency among tribunals to produce awards that overly favour foreign investors.[135] The good news in here is that the modern treaties, the such

[132] 'Venezuela Reopens to Foreign Investment: Legal Reforms and Emerging International Dispute Risks' (*Pillsbury Law*2026) <https://www.pillsburylaw.com/en/news-and-insights/venezuela-foreign-investment-reforms-international-disputes.html> accessed 10 May 2026.

[133] Maryam Malakotipour, p. 240

[134] Government of Canada, 'Canada-European Union: Comprehensive Economic and Trade Agreement (CETA)', Annex 8-A-Expropriation (*Government of Canada*2016).

[135] Christian Riffel, p. 946.

as the Comprehensive Economic and Trade Agreement (CETA)[136] and the Netherlands Model Investment Agreement[137] have started to take into consideration adding those annexes.

The European Union – Canada agreement, CETA, explicitly defines the phenomenon of regulatory chill and protects state autonomy. Particularly, Paragraph II, Article 8.9 note as follows:

> *"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, including its expectations of profits, does not amount to a breach of an obligation under this Section."*

By adding this specific clause to the chapter on investment specifically, CETA formally restricts the scope of investors' legitimate expectations.

Additionally, the Netherlands Model Investment Agreement takes the reform agenda one step further by defining the distinction between police power and investor protection. In order to break down Article 12, let's see, in the first place:[138]

> *"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, nondiscriminatory measures of a Contracting Party that are designed and applied in good faith to protect legitimate public interests, such as the protection of public health, safety, environment or public morals, social or consumer protection or promotion and protection of cultural diversity, do not constitute indirect expropriations."*

The most necessary points in this clause is definition of 'rare circumstances' and 'non-discriminatory measures'. Codifying the police power doctrine in this explicit way establishes strict elements to determine whether indirect expropriation has occurred.

Moreover, other agreements, such as the Comprehensive and Progressive Trans-Pacific Partnership Agreement[139], and the United States–Mexico–Canada Agreement [140] (hereinafter

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[136] Laura Puccio, Krisztina Binder and Christian Dietrich, 'Trade and Sustainable Development Chapters in CETA' (2017), p. 3. <https://www.europarl.europa.eu/RegData/etudes/BRIE/2017/595894/EPRS_BRI(2017)595894_EN.pdf>.

[137] Eric De Brebande, 'The 2019 Dutch Model Bilateral Investment Treaty: Navigating the Turbulent Ocean of Investment Treaty Reform', (2021) 19 ICSID Review - Foreign Investment Law Journal.

[138] Netherlands model Investment Agreement, Article 12, p. 12. https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5832/download

[139] 'TPPA Full Text', Investment, Annex 9-B, Expropriation (*www.dfat.gov.au*)

[140] United States Trade Representative, 'United States-Mexico-Canada Agreement', Chapter 14 – Investment (*Office of the United States Trade Representative*2020)

relatively TPPA and USMCA) have also moved away from the brief, ambiguous definitions to exhaustive annexes that define the scope of direct expropriation as a real intervention and straightforward taking over by the government.

As an example, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) has defined expropriation as follows:

> *"An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment."*[141]

Moreover, a private sectors agreement can be named for this kind of example, like the 'Exploration, Development and Production Sharing for the Shallow Water Area Around the Absheron Peninsula in the Azerbaijan Sector of the Caspian Sea' Between the State Oil Company of the Republic of Azerbaijan and BP Exploration (Azerbaijan) Limited and SOCAR Oil Affiliate. That PSA's Article 26 [142]talks about environmental protection and safety in order to balance the relationship between parties.

Consequently, state sovereignty cannot be protected solely with an arbitral tribunal award, specifically in the context of indirect expropriation during the green energy period. The transition on formulation should be realised primarily legislative. From the economic and political aspects, preventing tribunal cases from benefiting both parties to the agreements. When managing the phase-out of existing fields, host states should stick to the agreements and their domestic legislation for creating long-term projects with investors.[143]

3.3.2. State's national legislation impact

To protect their own autonomy, states have increasingly adopted new regulations or made amendments to national legislation. As a bold example of this phenomenon, the Azerbaijan Republic's recent changes can be exemplified. Necessary amendments have been made to the 'Law on Investment Activity' of the Azerbaijan Republic. Thus, Article 13.1 stated that "*…host states don't have to expropriate foreign investment without any permission, in exceptional circumstances where they harm the interests of the Azerbaijani state and people or contradict national interests, and except for the investments of strategic importance.*[144]

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[141] Jus Mundi, 'Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)' (*Jusmundi.com*8 March 2018) <https://jusmundi.com/en/document/treaty/en-comprehensive-and-progressive-agreement-for-trans-pacific-partnership-cptpp-comprehensive-and-progressive-agreement-for-trans-pacific-partnership-cptpp-tuesday-8th-may-2018>

[142] Production Sharing Agrement,Production Sharing Agreement

[143] IISD Report, p. 1

[144] İnvestisiya fəaliyyəti haqqında, Azərbaycan Respublikasının Qanunu, Article 13, 'E-QANUN' (*E-qanun.az*2024) <https://e-qanun.az/framework/50048>.

Under the wording, compensation will be calculated in accordance with the procedure stipulated in the investment agreement. Where such a procedure is not provided, it will be defined on the basis of the fair market price[145].

Notwithstanding this, the Constitution of the Azerbaijan Republic[146] demands the following rule in relation to international agreements:

> *"If there is a conflict between the normative legal acts included in the legislative system of the Republic of Azerbaijan (except for the Constitution of the Republic of Azerbaijan and acts adopted by referendum) and interstate treaties to which the Republic of Azerbaijan is a party, those international treaties shall apply."*

Despite having a strong domestic legislative background, host states remain constrained by the restrictive nature of international investment agreements, which barely limit states' capacity to execute independent regulatory policies.

[145] Ibid. 13.4

[146] Constitution of the Azerbaijan Republic, Article 151, 'E-QANUN' (*E-qanun.az*2024) <https://e-qanun.az/framework/897>.

4. Conclusion

The tension between a host state's sovereign rights and the protection of foreign investors hasn't been adequately decreased yet. Because of the vagueness of indirect expropriation, investors claim that their investment gets financially damaged and apply to arbitral tribunals.
On the other hand, without being sure that implications are factually leading to expropriation, investors abuse their power to demand huge amounts of compensation from host states, which is obviously impossible to pay without heavy consequences.
Mentioned concerns are deepened when the subject comes in strategic sectors – energy agreements. The 'climate blind' energy treaties don't cover boundaries of police powers or public welfare. In the absence of clear treaty-based guidance, the resolution of this issue has been left to the discretion of highly costly arbitral tribunals. The lack of precise statutory boundaries forced the tribunals to rely on subjective mechanisms, such as proportionality tests, and the stabilisation clause protects investors from legislative and regulatory changes. With this unpredictable arbitral jurisprudence, international investment law is becoming more investor-friendly by generating a regulatory chill (chilling effect).
In the broader context, this situation highlights the increasing fragmentation between international investment obligations and international environmental standards. While International Investment Law is still changing and improving, on the other side, the sole effect doctrine and the police power doctrine struggle to define a concrete line. Investor-state disputes arising in public health debates, the trademark rights of tobacco products, in the global energy transition period, or specifically oil and gas contracts, prove that the classical approach also remains ineffective. There should be a well-known and widely used international agreement formulation for all states and investors. After 2016, specifically 2020, this subject has been analysed at an accelerating pace. Following the blueprint of modern agreements like CETA, the Netherlands Model Investment Agreement and USMCA, modern investment agreements should include explicit expropriation annexes that codify the police powers doctrine. This practice is also happening in inter state level. Thus, states should amend or adopt laws on investment activities to regulate the compensation mechanism with foreign investors, as in the case of the Azerbaijan Republic. Thus, Azerbaijan, specifically, SOCAR, has determined green energy goals and should implement those policies until 2030, despite having natural resources like oil and gas.
Concurrently, the agreement clause emphasising rare circumstances can create a balance between the interests of the investor and the state's right to regulate. With these kinds of

research papers, it can be reflected a need for codifying police powers doctrine in order to draw the limits as a first attempt until solving high-cost tribunal cases. Ultimately, resolving the indirect expropriation conundrum requires a bold, explicit treaty mechanism to ensure a sustainable and global energy transition.

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