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**Revision of balance between regulatory rights and investment protection  
under fair and equitable treatment: The Energy Charter Treaty framework**

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The dissertation is submitted for the purpose of obtaining the Ph.D. degree

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## TABLE OF CONTENTS

<b>DEFINITIONS AND LIST OF ABBREVIATIONS .....</b>	<b>3</b>
<b>INTRODUCTION .....</b>	<b>6</b>
<b>1. THE ISSUE OF BALANCE BETWEEN REGULATORY RIGHTS AND INVESTMENT PROTECTION IN THE ENERGY SECTOR .....</b>	<b>17</b>
<b>1.1 Features specific to the energy sector impacting on the balance .....</b>	<b>17</b>
1.1.1 Actors, stakeholders, investments and risks in the energy sector .....	17
1.1.2 Public interests .....	19
1.1.3 Sustainable development and climate change.....	23
<b>1.2 The investment protection in the energy sector from MST to FET .....</b>	<b>36</b>
1.2.1 Pre - ECT period: CIL, early concessions, UN Resolutions and BITs .....	36
1.2.2 ECT period.....	48
1.2.3 Modern investment protection regime .....	53
Findings and concluding remarks on Chapter 1 .....	55
<b>2. THE ISSUE OF BALANCE BETWEEN INVESTMENT PROTECTION AND REGULATORY RIGHTS IN THE APPLICATION OF FAIR AND EQUITABLE TREATMENT UNDER THE ENERGY CHARTER TREATY .....</b>	<b>57</b>
<b>2.1 The issues of FET in IIL .....</b>	<b>57</b>
2.1.1 Ambiguous FET in IIL sources.....	57
2.1.2 Undetermined FET in arbitral practice .....	62
<b>2.2 The issues of FET in the ECT .....</b>	<b>72</b>
2.2.1 The features of the FET under Article 10 (1) of the ECT.....	72
2.2.2 Regulatory space within the scope of FET .....	85
Findings and concluding remarks on Chapter 2 .....	99
<b>3. REVISING BALANCE BETWEEN INVESTMENT PROTECTION AND REGULATORY RIGHTS IN FAIR AND EQUITABLE TREATMENT UNDER THE ENERGY CHARTER TREATY .....</b>	<b>102</b>
<b>3.1. The anatomy and construction of new FET under the ECT.....</b>	<b>102</b>
3.1.1 FET and the MST.....	103
3.1.2 Possible delicts subsumed under new FET .....	105
3.1.3 Reservation of space for regulatory measures .....	112
<b>3.2. Application of the proposed FET provision to various measures of ECT Contracting Parties .....</b>	<b>115</b>
Findings and concluding remarks on Chapter 3 .....	124
<b>CONCLUSION .....</b>	<b>126</b>
<b>REFERENCES .....</b>	<b>129</b>

## DEFINITIONS AND LIST OF ABBREVIATIONS

ad hoc	The Latin phrase means “happening or existing only for a particular purpose” or “for this situation”
BIT	Bilateral Investment Treaty
CETA	Comprehensive Economic and Trade Agreement between the EU and Canada
CIL	Customary International Law
CIS	Commonwealth of Independent States
EEC	European Energy Charter
ECC	Energy Charter Conference
ECT	Energy Charter Treaty
ECT Contracting Parties	Contracting Parties of the Energy Charter Treaty
ECtHR	The European Court of Human Rights
ECS	Energy Charter Secretariat
ECEFP	The United States’ Executive Committee on Economic Foreign Policy in 1945
e.g.	The short Latin phrase “exempli gratia” means “for example”
ESG	Environmental, Social and Governance
etc.	The short Latin phrase “Et cetera” means “other similar things”
EU	European Union
EUR	Euro
FET	Fair and Equitable Treatment
FCN	Friendship, Commerce, and Navigation Treaty

FDI	Foreign Direct Investment
FIT	Feed in Tariff
FTA	Free Trade Agreement
GHG	Greenhouse Gas
GPL	General Principles of Law
IIL	International Investment Law
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
IEL	International Energy Law
IEC	International Energy Charter
i.e.	The short Latin phrase “id est” means “that is”
IIA	International Investment Agreement
inter alia	The Latin phrase means “among other things”
IOC	International Oil Company
IPFSD	Investment Policy Framework for Sustainable Development
ISDS	Investor-State Dispute Settlement
ITL	International Trade Law
ITO	International Trade Organisation
LNG	Liquefied Natural Gas
MFN	Most Favoured Nation Treatment
MIT	Multilateral Investment Treaty
MST	Minimum Standard Treatment of Aliens
NAFTA	North American Free Trade Agreement between the US, Canada and Mexico
NAC	The United States’ National Advisory Council on International Monetary and Financial Problems in 1949

NT	National Treatment
NGO	Non-Government Organization
NOC	National Oil Company
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of the Petroleum Exporting Countries
O&G	Oil and Gas
para (s)	paragraph (s)
PSA	Production Sharing Agreement
RES	Renewable Energy Sources
SCC	Stockholm Chamber of Commerce
TVPEE	Tax on the Value of Electricity Production
UK	United Kingdom
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNFCCC	United Nations Framework Convention on Climate Change
US	United States of America
USD	United States Dollar
USSR	Union of Soviet Socialist Republics
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

## INTRODUCTION

**Importance and relevance of the research topic.** The importance of investments in the energy sector cannot be sufficiently emphasized, as they constitute a substantial proportion of foreign investments worldwide. This proportion is expected to increase to meet rising energy demands in the near future [1]. Increasing demands and strategic importance per se make the energy sector susceptible to strict state regulation. On the one hand, this is due to the private interests of investors to generate profit in a safe regulatory climate, and on the other hand, the public interests of host states to have sufficient policy space to regulate this strategic sector without prejudice to its citizens. These two competing public and private interests have been at the center of the theoretical debate right in IIL, from the time when the first petroleum resources in the Middle East, Latin America, and Central America were developed. Outright nationalizations and later indirect expropriation disputes in the energy sector have well demonstrated this tension. Eventually, however, once some consensus was finally reached about what constituted a fair and reasonable balance in expropriation disputes in IIL, particularly regarding the amount of compensation, the dispute focus shifted from expropriation to FET. Restricting the findings of expropriation by tribunals instead thus led to finding liability based on FET [2]. Pleading a breach of FET appeared as an attractive alternative [3]. The constant development of legal interpretation has imbued FET with new meanings, and the growth of international law instruments has opened new areas of conflict between public and private interests, particularly, between two doctrinal concepts FET and the right to regulate (exercise of sovereignty). This conflict is especially evident in the framework of the ECT, which in turn, requires substantive theoretical research and solution from three perspectives.

Firstly, the lack of consensus about the normative content of the FET (not only under the ECT but also more generally) remains an obstacle to realizing by ECT Contracting Parties' state policy for public purposes. Shortcomings arising from the FET's theoretical origin, doctrinal concept and normative content led to the determination of the FET's content by tribunals. FET does not have an integrated and ordinary meaning. *Travaux preparatoires* of IIAs, including the ECT, are silent on the purpose of the FET.

Ambiguity and controversy about the normative content and essence of the FET have given rise to various international law theories which attempt to give meaning to the FET. Interpretation of the FET has been based on CIL, GPL, the rule of law and treaty standards. This has led to differing interpretations, inconsistent application and scope creep of the FET under the ECT that challenges the public policy objectives and the regulatory rights of its ECT Contracting Parties. This issue is also closely interlinked with, and mirrors, the legitimacy crisis in the ISDS system [4]. Currently, there is no solution yet in IIL theory to this issue and it requires comprehensive theoretical study.

Secondly, based on this doctrinal issue in IIL, there is a clash between the regulatory measures of ECT Contracting Parties aimed at public interests, including the promotion of clean energy transition, the protection of the environment, and sustainable

development, on the one hand, and current investment protection obligations of ECT Contracting Parties under FET of Article 10 (1) of the ECT, on the other hand.

The current FET wording in the ECT reflects the political and economic circumstances when the ECT was negotiated in the 1990s. The inclusion of investment protection standards such as the FET was especially due to the instability in the regulatory environment of the former Soviet Union States [5; 6]. Such protections were important for EU investors who were going to invest billions of dollars in the petroleum sector of the CIS such as Kazakhstan, Azerbaijan, Uzbekistan, Kyrgyzstan and Russia [5, p. 252]. As a result, the current ECT incorporated pro-investor provisions that accorded the highest level of protection to the rights of investors from regulatory measures.

Onward shifts in global energy policy have caused redirection of national policy goals by some EU ECT Contracting Parties towards sustainable development<sup>1</sup> [6, p. 1]. Particularly, the conversion from traditional fuels to RES has been the key driving force for the realization of regulatory actions by some EU ECT Contracting Parties. Several EU countries, for example, the Czech Republic, Italy, and Spain have offered complex tariff and financing schemes to incentivize investment in the RES sector. Later, these EU countries revised their RES incentive schemes. Other EU ECT Contracting Parties, such as Germany and the Netherlands, have started shutting down existing coal plants to reduce GHG emissions.

This development, in turn, has created a new generation of FET disputes. These do not merely concern a refusal to grant or upgrade a mining license, but also constitute a challenge to the legitimate rights of ECT Contracting Parties to implement RES tariff schemes and protection of the environment in order to meet international obligations such as the Paris Agreement<sup>2</sup>. The current ISDS creates a conflict in international law—creating treaties that aim to reduce GHG, for example, the Paris Agreement, while burdening States that attempt to make progress with multi-million awards<sup>3</sup> [7; 8]. Practice shows<sup>4</sup> that emerging legitimate regulatory measures of ECT Contracting Parties are easily captured under the FET as alleged breaches of investment protection obligations [9].

The FET is now the most invoked and breached<sup>5</sup> substantive investment standard of protection under the ECT [6, p. 1; 9]. This situation has sparked the risk of the withdrawal<sup>6</sup> of several ECT Contracting Parties from the ECT [10; 11; 12]. The rise of investment claims related to RES measures against the EU ECT Contracting Parties under the ECT arbitration is a subject of serious critique [6, p. 1; 13]. The critique is partly directed

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<sup>1</sup> The term “sustainable development” in this dissertation includes a broad range of considerations such as economic development, social well-being, social development, climate change, environmental protection, public health, human rights, and the rights of indigenous people.

<sup>2</sup> Paris Agreement is an international agreement on climate change signed on 22 April 2016 between 195 countries.

<sup>3</sup> For States any claim of investors in arbitration imposes significant financial costs despite the win or lose outcomes of the dispute since even a single arbitration award can place “burdensome” on the State’s treasury [8; 6, p. 1].

<sup>4</sup> Over the last seven years, at least 91 such investor claims have been submitted to international arbitration under the ECT in connection with States’ measures designed to promote transition into renewable energy sources [8].

<sup>5</sup> FET breach amounts to about 65% of 43 awards.

<sup>6</sup> Italy’s withdrawal and intention of withdrawal by Spain, Germany, France, the Netherlands and Slovenia.

towards a perceived lack of balance between legitimate regulatory rights and investment protection under the FET, which - as noted - is the emerging political and economic instrument of transition away from fossil fuels [6, p. 1]. In this sense, this is a theoretical debate about the transition from the *lex petrolea* to the *lex renewabilia*<sup>7</sup> [14]. The present FET under the ECT has failed to meet these challenges. Therefore, the ECT Contracting Parties need a more balanced FET approach to preserve their rights to regulate. A feasible solution must be found.

Thirdly, there is an ongoing modernization of the current ECT [15]. ECT Contracting Parties have identified key topics for revision, of which the FET is a central one. The chosen research topic, therefore, is critical and especially relevant in light of ongoing modernization reforms.

**Research aim and objectives.** The main aim of this dissertation is to propose scientifically sound ways in which the FET clause under ECT needs to be crafted to ensure the protection of both State and investor interests. Accordingly, the dissertation addresses the following research question: “How does the new FET under the ECT need to be crafted to ensure ECT Contracting Parties and investor interests are protected?”

This dissertation undertakes the following objectives:

1. to identify reasons for the balance issue under Article 10 (1) of the ECT in light of specifics of the energy sector, development of various ISDS doctrinal concepts and new regulatory measures of ECT Contracting Parties;
2. to identify the theoretical underpinning of the FET;
3. to propose a new construction of FET and codify delicts of the FET under Article 10 (1) of the ECT;
4. to propose new approaches to doctrinal concepts of the right to regulate provisions which will ensure the protection of both ECT Contracting Parties and investor interests;
5. to test the proposed new approaches and FET wording in light of the emerging regulatory rights of the ECT Contracting Parties.

**Research object.** Public relations arising from the application of the IIL norms in international investment arbitration in relation to FET under Article 10 (1) of the ECT.

**Research subject.** History, evolution, and practice of IIL and its application in international investment arbitration in relation to the FET under Article 10 (1) of the ECT, and a range of legal norms and issues arising from the application of FET under Article 10 (1) of the ECT to foreign investors and investment in the energy sector, as well as modernization of the same provision, in light of new challenges facing ECT Contracting Parties, particularly the need to protect investments while moving towards more sustainable ways of generating energy.

**Theoretical basis of research topic and literature review.** The main theoretical basis of this research dissertation and literature review may be divided into three groups.

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<sup>7</sup> The term is fashioned along the lines of *lex petrolea* and used due to the development of international regulatory mechanisms for renewable energy [11, p.380].

The first group is theoretical writings on the origin and understanding of the FET in IIL. The vague FET norm in IIAs has led to a plethora of international studies and research. A number of leading academics specialized in IIL such as Dolzer R., Schreuer C., Sabahi B., Rubins N.D., Wallace D., Brower C.H., Weiler T., Schwebel S.M., Sornarajah M., Paulsson J., Salacuse J.W., Schill S.W., Vandevelde K.J., Vasciannie S., Ortino F., Reinisch A., Yannaca-Small K., Dumberry P., Paparinskis M., Klager R., Muchlinski P., Tudor I., Newcombe A. and Paradell L., have significantly contributed to the development of understanding of the theoretical basis of the FET and its interpretation in practice. Most of these academics have been members of arbitral tribunals or representing counsels for parties, therefore they contributed their views on the FET not only from a theoretical point of view but also from a practical one.

Currently, notwithstanding the number of international studies and research, there is no consensus among academics on the origin, doctrinal concept and intention of States, not only under the ECT but generally in IIL. Currently, the ISDS community, particularly academics and commentators, has proactively engaged in a search for a consensus on the doctrinal concept of the FET and further interpretation of the norm, proposing different hypotheses and views. These include discussion around the first origin and intent of the States in the 1948 Havana Charter, justiciability clauses of 18<sup>th</sup> and 20<sup>th</sup>-century commercial and mixed claims treaty practice, FCNs, relations of the FET with the MST, the rule of law, GPL and treaty standards. Each of these discussions has found a place in this dissertation. The author further contributes to these discussions and outlines the core findings.

The second group is composed of theoretical writings on the specifics of the FET under Article 10 (1) of the ECT and the energy sector. Particularly, the current FET under Article 10 (1) of the ECT has peculiarities in comparison to FET norms under other IIAs. A number of academics specialized in energy investment disputes such as Walde T., Cameron P., Scherer M., Coop G., Ribeiro R., Cima E., Roe T., Happold M., Leal-Arcas R., Gallagher N., Brabandere E., Gazzini T., Mejia-Lemos D. and Baltag C. have made a significant contribution to the discussion of the specifics of the energy disputes and the interpretation of the ECT provisions, including the current FET wording under Article 10 (1) of the ECT.

Generally, at this time there is little commentary on the new FET under the revised ECT as well as on the balance between emerging regulatory rights of the ECT Contracting Parties for legitimate public purposes and investment protection under the FET. The author considered these writings and developed his own understanding and interpretation of the FET under Article 10 (1) of the ECT, further proposing a new FET.

The third group is theoretical writings on and the *travaux préparatoires* on modern IIAs, including IIAs, entered into by the EU. The author relies on several academics' papers such as Bungenberg M., Reinisch A., and Titi C.. Most academics posit the view that the EU made good progress on the limitation of the scope of FET norms in modern EU IIAs such as the CETA and the EU-Singapore Investment Protection Agreement. The

EU has emerged as a driver for revised substantive protection obligations. At the time of writing this dissertation, the EU is playing a key role in negotiating revisions to the ECT. Therefore, the dissertation relies on the EU documents and writings on the revision of FET provisions and the incorporation of the right to regulate clauses.

Among Russian and CIS region academics, recently Levashova Y. in her book elaborated analysis on the FET topic in detail under different IIAs [16]. Some scholars Badmayeva N., Borgoyakov A., and Labin D. wrote about general FET problems in IIL. Other academics such as Bogatyrov A., Doronin N., Boguslavsky M., Farkhudinov I., Solovyova A., Kotov A., Mamai A., Yulov D., Ayupov A., Tulayeva M., Evteeva M., Pacherman G. generally wrote about the regulation of foreign investment in the Russian Federation and IIL matters. However, they have not analyzed and touched on the topic of the dissertation specifically.

Among Kazakhstani academics, Suleimenov M. took part in ECT negotiations in the early 1990s and contributed to the chapter “The Energy Charter Agreement and the development of Kazakhstan legislation” in the book of Walde T. “The Energy Charter Treaty: An East-West Gateway for Investment and Trade”, where he analyzed the correspondence of Kazakhstan legislation to ECT and the possible effects of the adoption of ECT to Kazakhstan law [17]. Suleimenov M. wrote a number of writings on international commercial and investment arbitration matters from a Kazakhstan law perspective and he was appointed as a Kazakh law expert in a number of international investment arbitrations.

Other Kazakh academics such as Zimanov S., Basin Y., Mukhitdinov N., Yelubayev Zh., Maulenov K., Didenko A., Ilyasova K., Safinov K., Moroz S., Zhanaidarov I., Nogaibai Z., and Kaziyeva G. wrote a number of writings on subsoil use and regulation of foreign investment in Kazakhstan and many of them have been also Kazakh law experts in a number of international investment arbitrations.

Generally, in Kazakhstan, there is a lack of academic research on this research topic. The following academics conducted doctoral research on generally the topics of international economic law, international trade law, international energy law and international commercial arbitration: Maulenov K. “Государственное управление и правовое регулирование в сфере иностранных инвестиций в Республике Казахстан” (State administration and legal regulation in the field of foreign investment in the Republic of Kazakhstan); Bitenov G. “Regulating Trade in Petroleum under WTO Regime: Trade Rules vs Reality of Petroleum Industry”; Taimova M. “Гарантии иностранным инвесторам по законодательству Республики Казахстан” (Guarantees to foreign investors under the legislation of the Republic of Kazakhstan); Ahmadieva G. “Правовое регулирование внешнеэкономических контрактов в Республике Казахстан” (Legal regulation of foreign economic contracts in the Republic of Kazakhstan); Kulzhabayeva Zh. “Клаузула о наиболее благоприятствуемой нации” (Most favoured nation clause); Sarina S. “Разрешение споров международным коммерческим арбитражем” (Dispute Resolution by International Commercial Arbitration); Irzhanov A., “Порядок

разрешения межгосударственных экономических споров” (Procedure for resolving interstate economic disputes); Shokenov К. “Правовое регулирование иностранных инвестиций в месторождения нефти и газа” (Legal regulation of foreign investments in oil and gas fields).

**Normative basis of the research topic.** The normative basis of the research topic was based on the ECT and various IIAs, including BIT and FTA with investment protection provisions.

**Practical basis of the research topic.** The practical basis of the research was based on the decisions of international arbitral tribunals: ICSID, ad hoc tribunals constituted under the UNCITRAL rules and SCC arbitration. The practical basis of the dissertation is important because the vague FET provisions were largely uncovered by tribunals in ISDS. Arbitration practice under NAFTA, the ECT, and other IIAs, including a large number of awards and dissenting opinions, have contributed to interpretation of the FET and are the valuable practical basis of the dissertation.

The author supports the research with practical examples from his experience because the author has many years of work experience in the O&G sector of Kazakhstan, including representing the Government of Kazakhstan in international investment and commercial arbitrations and negotiations.

**Research methods.** In pursuing the research objective, this dissertation employed four research methods: historical-legal, comparative-legal, legal analysis (descriptive) and legal modeling.

First, the historical-legal method helped to identify key historical, political, and economic factors that influence the protection of investors in the energy sector. The results of the analysis have demonstrated the development of investment protection rules in IIL and, more specifically, the FET standard within the context of the IIAs, including the ECT. Further applying this method, the dissertation elaborated analysis of the origin, doctrinal concept and normative content of the FET.

Second, a comparative method has been used to analyze FET norms in different IIAs and decisions of tribunals. Utilization of the comparison method was essential. It provided an overview of other IIAs and decisions of tribunals trying to address similar concerns about the FET and legitimate regulatory measures and how those FET provisions and the right to regulate are likely to be interpreted by tribunals and commentators, which helped determine their possible application in the ECT framework.

Third, a legal analysis (descriptive) method has been used to collect and systematize many tribunal decisions, *travaux préparatoires* documents, and academic studies. Employing a legal analysis (descriptive) method, relevant protocols, annexes, decisions, understandings of, and statements about FET under the ECT were considered for this research. References were made to *travaux préparatoires* of the ECT and its negotiating history. Documents generated after the negotiation and ratification of the ECT have also been analyzed as they helped understand the FET under Article 10 (1) of the ECT.

Fourth, a legal modeling method was employed to test various public policy regulatory measures under the new proposed FET.

In addition to the above methods, the dissertation has employed the general rule of interpretation under Articles 31-32 of the VCLT to analyze the ECT text and to test the proposed formulation of the FET. The ECT has six authentic versions of the ECT: English, French, German, Italian, Russian, and Spanish [18, article 50]. Article 33 of the VCLT guides the interpretation of treaties authenticated in multiple languages [19]. Given the author's linguistic proficiency, the English and Russian versions were used for analyzing and interpreting the ECT provisions.

**Scientific novelty of the dissertation and its contribution to science.** The dissertation is the first full doctoral research in Kazakhstan with an in-depth and critical analysis of sources, doctrinal concepts and normative content of FET under Article 10 (1) of the ECT and the right to regulate norms.

The scientific novelty of the dissertation is determined by proposing new approaches to the application of doctrinal concepts of the FET and the right to regulate norms in order to reconcile them under the new ECT.

The dissertation makes a feasible step in reconciling a balance between two competing doctrinal concepts under the new ECT, particularly:

- determination and substantiation of the normative content of FET based on the doctrinal concept that the FET is a self-contained treaty obligation, in this way by separating FET from other sources/doctrinal concepts such as CIL, GPL, the rule of law;
- determination and provision of new sense to the normative content of the right to regulate norms;
- determination and substantiation of the new approach in the application of two concepts, i.e., the right to regulate is the centerpiece permission, not a defense norm, therefore, the right to regulate norms should limit the scope of FET.

Therefore, the dissertation contributes to:

- current academic debate around the origins and doctrinal concepts of the FET and the right to regulate;
- contemporary academic discussion around the normative content and delicts of FET and the right to regulate under the ECT;
- application of two doctrinal concepts in relation to emerging regulatory measures of ECT Contracting Parties;
- development of IIL norms in relation to the FET and the right to regulate provisions.

In the opinion of the author proposed new approaches better safeguards the legitimate regulatory measures of the ECT Contracting Parties. The proposed norms are hypothetically tested under various regulatory measures and well demonstrate the protection of regulatory rights. These proposed approaches as a sample could be tested under other IIAs.

### **Provisions submitted for defense.**

1. The absence of doctrinal concept, ordinary meaning and normative content of FET, expansive application of the vague FET norms under Article 10 (1) of the ECT by tribunals in light of arbitration practice (precedents), interpretation and recognition of declaratory sentence of Article 10 (1) of the ECT as a FET delict created a strict obligation for ECT Contracting Parties to provide a stable regulatory framework and protect the legitimate expectations of investors in the stability of the national legislation. Such application of FET led to multi-million arbitral awards under ECT which raise a fundamental doctrinal issue in IIL regarding the liability of States for bona fide public purpose measures. Therefore, there is a need for specific measures such as the identification of the doctrinal concept of FET, codification, revision of treaty text and revision of approaches to the right to regulate and FET concepts in order to ensure a balance between regulatory rights and investment protection.

2. To reconcile a balance between two competing concepts, the dissertation substantiates that the doctrinal concept of FET should be considered from the perspective of a self-contained treaty obligation agreed between contracting state parties. This is substantiated by the fact that the development of FET as a *lex specialis* rule was created by BITs and FCNs and the incorporation of FET in IIAs was associated with the elimination of the uncertainty around MST. The FET concept should be without the link to any other doctrinal concepts/sources such as CIL, MST, GPL and the rule of law. The self-contained treaty obligation concept reduces the risk of expansion in interpretation.

3. Based on the doctrinal concept of a self-contained treaty obligation the dissertation codifies FET delicts and proposes a new construction of FET under ECT. The new construction of FET should truly reflect the meaning of FET such as a denial of justice, arbitrariness or unreasonableness, discrimination and abusive treatment. The rationale behind this proposal is that an ECT Contracting Party may be held liable only for breaches of a limited above set of delicts. This proposed new construction of FET increases the certainty and predictability for the ECT Contracting Parties and investors in the application of FET norms.

The concepts of stability obligation and protection of legitimate expectations should be taken out of FET delicts and if needed, such obligation and protection may be agreed upon or granted during individual contractual negotiations between the host state and the investor or in national legislation.

4. To reconcile a balance between two competing concepts, the dissertation proposes to integrate into the ECT the applicable right to regulate norms for public purposes. The current ECT lacks the practicable right to regulate norms. After analyzing different concepts such as “general exceptions”, “carve-outs” and “emerging right to regulate”, the dissertation proposes a “strict” right to regulate norms in the ECT preamble and in a separate article of the ECT, which effectively safeguards the public policy measures.

The proposed preamble wording is as follows:

preamble wording:

*“RECOGNIZING the right of the Contracting Parties to regulate within their territories in order meet public policy objectives, including but not limited to the protection of the environment, public health, consumer rights, climate-change mitigation, energy security”.*

*the right to regulate as a separate article:*

*“For greater certainty, the bona fide exercise [footnote] of Contracting Parties’ right to regulate within their territories to achieve public policy objectives, including but not limited to the protection of the environment, public health, consumer rights, climate-change mitigation, energy security should not be treated as a breach of the fair and equitable treatment obligation”*

*“Footnote wording: the determination of whether there is bona fide exercise requires a case-by-case and fact-based consideration”*

5. The dissertation proposes a new approach to the application of proposed two competing norms: FET and the right to regulate. By hypothetically testing various public policy measures under the proposed norms, the dissertation proposes to apply the right to regulate clause as a permission norm, i.e., the centerpiece clause of the new ECT, not a defense norm. Therefore, the right to regulate norms should limit the scope of FET. In this manner, FET delicts may be only invoked by investors when the host state improperly exercises regulatory measures. The results of the testing demonstrate the effectiveness of the proposed formulation in balancing the rights of States and investors.

**Theoretical importance of the research.** The dissertation proposes an alternative view to a number of theoretical discussions around the FET norms and doctrinal concepts and the future construction of a balance between the right to regulate and investment protection under the FET norms. The conducted research dissertation could be useful guidance material for academics covering the theoretical bases of the FET.

**Practical importance of the research.** The research dissertation could be useful guidance material for:

1. practicing lawyers wanting to better understand the scope of the FET and its application to regulatory measures;
2. government bodies, especially Kazakh Government, wanting to understand the relationship between regulatory measures and how they interact with the FET in practice;
3. ECT Contracting Parties, especially Kazakh Government, for further improvement of ECT text in light of modernization reforms;
4. States, especially Kazakhstan, to take into account if they wish to incorporate the FET in future IIAs;
5. investors to take into account relevant regulatory measures and the scope of the FET for due diligence purposes.

**Approbation of the results of the research.** The findings of the research are reflected in the following articles and conferences:

1. Article “The Energy Charter Treaty reform: Why and how to reach a consensus on fair and equitable treatment?” Energy Policy, Volume 163, April 2022 (1 quartile Scopus);
2. Article “Regulatory Space as a Factor of Change of International Investment Treaty Regime”, KazNU Al-Farabi Law Bulletin, No.2 (98) 2021, 15 June 2021;
3. Article “The standard of fair and equitable treatment in the new environment” ENU Gumilyov Law Bulletin, No.1 (134)/2021, 26 March 2021;
4. Article “Проблемы Стандарта Справедливого и Одинакового Режима в Договоре к Энергетической Хартии”, Bulletin Institute of Legislation and Legal Information of the RoK, No.2 (65)-2021, 30 June 2021;
5. The International Conference is the topic for “Energy Charter Treaty Framework: What is a Matter of Concern for Contracting Parties?” Russian Federation, 15 May 2020.

**Research design.** The dissertation is structured as follows. Chapter 1 analyses the development of the investment protection rules under international law under three periods: the pre-ECT period, the ECT period, and at present when the current revision of ECT provisions is taking place. The pre - ECT period covers the early evolution of diplomatic protection, the emergence of MST, *lex petrolea*, and BITs. The ECT period focuses on political, historical, and economic aspects of the ECT and investment protection. The current modernization period covers ongoing shifts in the IIA system and sustainable development, as well as new regulatory measures based on the two-case studies EU and Kazakhstan. The results of Chapter 1 are used in Chapter 3.

Then, Chapter 2 is the central research part that includes a review and analysis of issues of doctrinal approaches to normative content and sources of FET and the issues of the current formulation of FET under the ECT. It covers the determination of the normative content of FET and interpretation under the ECT. This part is mainly based on the analysis of academic studies and arbitration practice, which are essential to formulate new proposals for a modernized FET language under the ECT which is discussed in Chapter 3.

Chapter 3 is the important part of the dissertation which outlines the new construction of FET wording under ECT, applicable delicts and the right to regulate provisions. This Chapter also examines the applicability of the new FET and the right to regulate clause to emerging regulatory measures. This Chapter hypothetically tests various regulatory measures under the proposed formulations in order to assess the effectiveness of the proposals.

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# 1. THE ISSUE OF BALANCE BETWEEN REGULATORY RIGHTS AND INVESTMENT PROTECTION IN THE ENERGY SECTOR

## 1.1 Features specific to the energy sector impacting on the balance

### 1.1.1 Actors, stakeholders, investments and risks in the energy sector

One of the features specific to the energy sector is the active role of state participation. State participation derives from direct state sovereignty over energy resources. The energy sector is perhaps one of the economic sectors where state sovereignty permeates more than anywhere else. This is due to two fundamental principles. First, many UN General Assembly Resolutions recognize state sovereignty over natural resources. Resolution 1803 (XVII), dated 14 December 1962, provides that States and international organizations shall strictly and conscientiously respect the sovereignty of peoples and nations over their natural wealth and resources [20]. The principles set out in eight articles of Resolution 1803 (XVII) cover, among other things, the exploration, development, and disposition of natural resources, nationalization/expropriation, foreign investment, the sharing of profits and other related issues [20]. Second, local law within States often incorporates the notion that the state is the owner of natural resources within their territories. For instance, Article 6 of the Constitution of the Republic of Kazakhstan states that “*the land, its subsoil, water, flora and fauna, and other natural resources belong to the nation*”. On behalf of the nation, this right is exercised by corresponding state bodies. Therefore, state bodies take responsibility for management and maximization of energy resources on behalf of the whole nation.

Generally, the State gives responsibility<sup>8</sup> for energy resource management to a ministry and/or a state-owned company. Thus, these entities become the contracting parties in energy transactions. On occasion, in particularly large strategic projects, the State government itself may be a contracting party. This practice is usually used in developing countries and countries with transition economies to provide an additional level of guarantee to investors by fortifying undertakings in the contracts on, for example, stabilization of terms of contracts, tax, and other exemptions.

The second main party to energy transactions is an investor (or a consortium of investors in the case of large projects). Typically, foreign investors in energy projects are the large integrated IOC such as Chevron, ExxonMobil, BP, Shell, etc. Irrespective of the location of oil fields from Africa to Eurasia and South America to South Asia, IOCs have participated in every stage of the relevant energy industry (e.g., exploration, extraction, processing, storage, transportation). Traditionally, some investors in the mining sector

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<sup>8</sup> For example, in Kazakhstani practice in subsoil use contracts, the government is represented by the Ministry of Energy in model petroleum contracts. While in PSAs on major O&G fields, the Kazakhstani government is a contracting party and uses a special appointed authority PSA LLC to represent their interests.

By contrast, in Azerbaijani petroleum contracts, the government is represented by the sole State Oil Company of Azerbaijan Republic (SOCAR). While in Russia, the party's role in subsoil use contracts is delegated to the local government level, taking into account the federative political system of Russia. But under PSAs state is represented by the central Russian government.

have also been regarded as significant players in the energy sector. Glencore, BHP, Rio Tinto, and others could be considered for this list.

In recent years, several NOC such as CNPC, Equinor (Statoil), Rosneft, Gazprom, Saudi Aramco, PETRONAS, and ONGC have entered this market. The entry of NOCs has created a new kind of competition in the traditional petroleum sector.

Today, the term energy sector investor refers to several other players, such as those involved in the electricity, power, and gas industries. The largest power investors are Siemens, Enel, EDF, TEPCO, KEPCO, Engie, State Grid Company of China, Iberdrola, General Electric and E.ON.

Another group of prominent energy investors is those involved in the renewable, nuclear and LNG sectors.

At present, a number of energy investors involved are simultaneously involved in multiple sectors of the energy industry. Even traditional IOCs have diversified their portfolio, investing significantly in the renewable energy industry. Moreover, many medium-sized investors are actively investing in different energy sub-sectors.

The typical features of energy investments derive from the capital-intensive nature of the industry, the long-term nature of such investment, international or cross-border trade implications and regulatory risk. The capital-intensive nature of energy projects is easily understood. Development of oil fields or the construction of LNG plants and nuclear or wind stations all require a significant financial commitment. Almost every energy project involves the participation of several lending parties, including international financing institutions and private banks. For instance, the development of one of the largest oil fields Kashagan in Kazakhstan so far has cost investors over USD 50 billion [21].

Given this capital-intensive nature, energy projects are typically based on long-term agreements which provide a significant time period over which investors get a return on their investments. Such agreements take a variety of forms. PSAs and subsoil use contracts, for example, are among the more popular and commonly used forms. The average term of energy agreements varies from jurisdiction to jurisdiction and may range anywhere between 15 to 45 years. For instance, in Kazakhstan, the duration of subsoil use contracts ranges from 25 to 45 years.

These long-term contracts expose the investor to a variety of risks, notably regulatory changes within a host state. In order to alleviate investors' concerns, it is common for a host state to demonstrate a strong will to attract foreign investments and to provide a guarantee to hold the investor's activity immune from a regulatory change at the outset of the project. After the investment had been made and when a project begins generating cash, should the host state change its attitude towards the investor, the investor can do little to protect itself. It might commence litigation or arbitration, but this may not be a realistic option if it intends to stay in the host state-whether on that specific project, or another. In this situation, the investor may even agree to a revision of the initial terms and conditions of the agreement to the benefit of the host state. Vernon R. described it as

“obsolescing bargains” [22]. By this, he meant that the host state is eager to change the terms of the agreement with the investor once the investment had been made. Scherer M. described it as a “prisoner’s dilemma” when the investor has little choice but to accept unfavorable renegotiations [23].

The energy sector remains a high-risk sector for investors. The impact of wars on the energy sector can be easily historically traced. The wars in Iraq and Libya in the recent two decades have had a dramatic impact on the energy sector. As of the date of this writing, the unstable political situation in the Eurasian continent caused by the Russia/Ukraine war, and the resulting Western sanctions on Russia and Belarus continue to resonate globally. This is not the first time that the EU and Russia's relationship with respect to Ukraine has deteriorated. During Russia’s annexation of Crimea, the EU recognized its dependence on Russian gas and felt threatened by this. The annexation also affected the transit of energy to Europe and caused an increase in the price of energy commodities. The volatility of energy prices is another risk for long-term investments since the investor would be in a vulnerable position should the energy price fall below predictions/financial assumptions used to cost and model the financial viability of the project.

Transit is another risk for long-term investments. This risk is illustrated by the recent example of the shutdown of the Caspian Pipeline, one of the world’s largest pipelines which takes oil from Kazakhstan to the Black Sea. After several failures at oil pumping stations, a Russian court ordered the oil pipeline to be halted for environmental reasons [24]. IOCs developing and transporting 80% of oil from Kazakhstan to this pipeline were in a vulnerable position.

### 1.1.2 Public interests

*Energy security.* The energy sector is considered essential to security, geopolitical, and vital national economic interests [25; 26]. In particular, reliable access to energy sources at an affordable price is the main priority of any State if it is to meet the needs of its population and economy. The driving force for the conclusion of the ECT was energy security [27]. At the time of signing the ECT, the EU was already a major energy consumption region [27, p. 68]. The increase in oil prices in 1973 and 1979 initiated by OPEC members, the Gulf Crisis, rising instability in the Middle East after the Iraqi invasion of Kuwait, and intensified conflicts between the government and Islamic fundamentalists in Algeria influenced the change of EU energy policies and strategies [27, p. 74, 77, 104].

Geopolitical developments have increased threats to the provision of a stable energy supply to the West. To address the threat, a number of initiatives were undertaken: fuel substitution, investment in opening new reserves, alternative energy development, and energy efficiency and conservation [27, p. 69]. The EU was vulnerable to a significant decrease in energy supplies and had to deal with it as a priority in the short term. In this

sense, cooperation between the EU with the former mineral-wealthy ex-USSR states was a way of solving the immediate energy supply problem [27, p. 81-82].

Currently, the EU ECT Contracting Parties have faced energy supply and security problems due to the “invasion” of Russia into Ukraine. It caused a high inflation rate in the EU [28]. All these factors eventually impact the price of electricity or fuel which the consumers would bear. Many ECT Contracting Parties are forced to control the price and overregulate the energy sector.

*Environmental concerns.* Environmental concerns are a sensitive issue for the energy sector. The main ecological concerns in the energy sector are pollution, emissions, decommissioning, waste management and accidents. Investors have to comply with the environmental standards of the host state<sup>9</sup> and at the same time meet international standards<sup>10</sup> [2, p. 568]. Notwithstanding, environmental incidents do arise during the exploitation of energy resources. There are several notorious examples that have been the subject of investment arbitration or negotiations between the host state and the investors.

One of these examples is the environmental dispute which arose out of Chevron’s petroleum operations in Ecuador. In 1964 Ecuador Government signed a Concession Contract with a Consortium made up of TexPet and Ecuadorian Oil Company. In 1992 the Concession Contract expired and the Consortium was dissolved [29, paras 22, 31]. Ecuador, TexPet and other Consortium members signed the dissolution Memorandum in 1994 and the Settlement Agreement in 1995 according to which among other obligations TexPet spent \$40 million on environmental remediation [29, para 20]. Years later, from the 2000s onwards, claims were made against Chevron by the Amazon Defence Coalition<sup>11</sup> (working on behalf of several indigenous people and farmers). These claims amounted to almost USD \$16 billion and related to pollution of the forest and harms caused to people’s health during 1964 - 1992 [30]. In 2011, Ecuador’s local court ordered Chevron to pay USD \$9 billion in damages [31]. The issue further found its continuation in an investment arbitration brought by Chevron against Ecuador [29]. Chevron and Texaco claimed a breach of FET, including denial of justice under the US-Ecuador BIT [29]. The arbitration is currently pending. Chevron also sued in the US the American lawyer, Donziger S., who was the leading individual behind the lawsuit against Chevron in Ecuador. Donziger S. was later disbarred and the US Federal courts ruled that the US\$9 billion judgment was procured through fraud and was unenforceable [32].

Another example is the Sakhalin II LNG processing project in the east of Russia. Sakhalin II is one of the largest offshore projects led by a Consortium comprising Shell, Gazprom, Mitsui and Mitsubishi. Several environmental protection NGOs have raised concerns about likely damages caused by the petroleum operations to marine ecosystems

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<sup>9</sup> In Kazakhstani legislation, for example, maintaining environmental safety is one of the core principles of Subsoil and Subsoil use Code of the Republic of Kazakhstan.

<sup>10</sup> Some larger energy investors have become proactive in accepting the best international practice with regard to environmental and safety standards. In recent few years environment, social, and governance (ESG) has become a global trend for investors in the energy sector.

<sup>11</sup> Non-Government Organization

and especially to, the grey whale, birds and seals [33;34]. NGOs not only raised concerns but demanded substantial design changes and recommended that commercial banks should not finance the project [33; 34]. In 2006, the Ministry of natural resources of the Russian Federation canceled its own 2003 order requiring compliance with an environmental review [35]. This action affected the availability of international funding for the project. In 2007, the European Bank for Reconstruction and Development declined to lend to shareholders of Sakhalin II [36]. The Consortium members significantly underestimated the scale of environmental problems associated with the project [2, p. 425]. Having accepted the recommendation of the Independent Scientific Review Panel and the Consortium re-routed the offshore pipelines to bypass whale-feeding areas [37]. Subsequently, environmental issues were further also used by the Russian Government as leverage for Gazprom's entry into the Sakhalin II project [38].

Environmental concerns were also raised by the Government of Kazakhstan regarding the large Kashagan oil field. Kashagan is one of the giant offshore discoveries of the last four decades containing approximately 9-13 billion barrels of recoverable oil reserves [39]. Consortium members comprising Eni, Shell, ExxonMobil, Total, CNPC, Inpex, and KazMunaiGaz announced the discovery of oil in 2001 [39]. The project was initially led by Eni. Oil production finally started in 2016, after several failures [39]. In 2013 the commissioning of the project failed due to a pipeline gas leak [40]. The Ministry of Environment imposed a USD \$737 million fine for gas flaring [41]. The Kazakh Government and the Consortium had long and tough negotiations which resulted in a Settlement Agreement signed in 2014 and 2015.

*Public health.* Another sensitive issue in the energy sector is public health. Public health problems caused by fossil fuels remain as relevant as ever and one may extrapolate from this to anticipate further difficulties in other scenarios [42]. For a long time, public health experts have been raising the adverse effects of fossil fuels on global public health and have monitored and recorded ill-effects on health due to air pollution near O&G facilities.

Globally, health problems from fossil fuel emissions are empirically proven and well-established [42, p. 1]. Climbing levels of carbon dioxide impair healthy living, exacerbate chronic diseases, and increase mortality rates [43]. The World Health Organization has developed and drafted a roadmap for an enhanced global response to the adverse health effects of air pollution [44].

Local health issues associated with energy production are also well-known. Most of them relate to air pollution from coal emissions and those caused by other traditional energy resources [45; 46; 47]. Burning fossil fuels produce toxic emissions that increase air pollution and lead to early deaths, heart attacks, respiratory disorders, asthma, etc [46]. Of particular concern is the exposure to pollution of communities living near O&G facilities [48]. For example, conducted studies have used health data from communities in O&G production regions of the US to measure the impact of petroleum operations on public health [49; 50]. To a certain extent, these studies have found a link between

petroleum facility emissions and health problems within local communities [49, p. 412-417; 50, p. 4514-4525].

As an example, we may look at the public health concern that occurred near the Karachaganak gas field in Kazakhstan. The Karachaganak gas field is one of the world's largest gas fields and is being developed under a PSA dated November 18, 1997, between the Government of Kazakhstan and a Consortium currently comprising of Shell, Eni, Chevron, Lukoil, and KazMunaiGas. The field is located in the north-west of Kazakhstan. The field is the second largest funder of the National Oil Fund and the Kazakhstan's budget after the Tengiz oil field. In 2021, the Consortium paid over USD \$0,65 billion in taxes to the budget and the Kazakh Government received around USD \$2 billion in the form of profit oil share [51].

In 2003, local residents of the Berezovka village, which is located 3 km away from the Karachaganak field, raised concerns about an increase in health problems such as memory loss, respiratory illness, cardiovascular problems, etc. [52]. Several environmental and human rights NGOs such as "Green Salvation", "Crude Accountability", and "Shanyrak" were involved in an effort to protect the rights of the local community. These NGOs have conducted independent air quality monitoring and have found that the increase in the illnesses of Berezovka villagers was linked with toxic gas emissions from the Karachaganak field [52]. The NGOs requested the Karachaganak field operator and the state Ministry of Environmental Protection to publish environmental assessments and asked local government authorities to resettle the population of Berezovka to a safe area [53]. No regulatory measures were taken.

In 2009, after several unsuccessful attempts in regional courts, the NGOs filed a claim in the national Special Economic court against the Kazakh Government for failure to act and for ignoring the Senior Sanitary Inspector's recommendations [53]. The court upheld one of the claims.

In 2010, the NGOs filed another claim to the same court against the Ministry of Environmental Protection, the local administration, and the West Kazakhstan regional administration for failure to immediately resettle the affected population to a safe area. The court upheld the claim on the basis of land and environmental legislation [53].

Still, local executive bodies failed to organize the resettlement. In 2014, an incident of mass poisoning of children occurred in Berezovka, caused by an unknown toxic gas [54]. The Kazakh Government denied that this was linked to the Karachaganak gas field [54]. In 2017, finally, the resettlement of the residents of Berezovka was successfully completed.

*Labor rights and other public interests.* Another sensitive matter in the energy sector is labor rights and the interests of the local community. The trilateral relationship between workers, investors and the host state is described as raising a variety of intricate conflicts [55]. The roots of these conflicts seem to derive from the traditional conflict between public and private interests [55, p. 217]. This matter has particular importance in developing and undeveloped States, in which, the energy sector is a main source of

employment. Typical issues encountered include hostile attitudes to expatriate employees, low wages for local employees, poor working conditions and strikes. According to the International Labour Organization and International Renewable Energy Agency, the energy transition from fossil fuels to renewables increases job creation [56]. Jobs in the energy sector are expected to increase by USD 38 million by 2030 and USD 43 million by 2050, while jobs in the energy sector as a whole are projected to reach 122 million by 2050 [56].

The host state needs to consider the local community interests in both national legislation and/or the contract with the investor. In Kazakhstani practice, for example, the subsoil user must contribute to the local government budget for the construction of social infrastructure projects such as schools, hospitals, roads, etc. [57, article 129].

### 1.1.3 Sustainable development and climate change

By the end of the twentieth century, industrialized States had taken decisive steps toward sustainable development. In 1987 the UN published a report titled “Our Common Future”, also known as the “Brundtland Report” [58]. The Report sets out new approaches to the protection of the environment and sustainable development. The concept of sustainable development was explained as “*humanity has the ability to make development sustainable to ensure that it meets the needs of the present without compromising the ability of future generations to meet their own needs. The concept of sustainable development does imply limits - not absolute limits but limitations imposed by the present state of technology and social organization on environmental resources and by the ability of the biosphere to absorb the effects of human activities*” [58]. In a number of further documents of UNCTAD, OECD and Commonwealth Secretariate, the concept of sustainable development has been refined [59; 60; 61]. While there are different definitions, there is a general consensus that sustainable development includes a broad range of considerations such as economic development, social well-being, social development, environmental protection, human health, human rights and the rights of indigenous people.

The 1992 UNFCCC was a major step forward, as was the 1997 Kyoto Protocol [62; 63]. In 2015 the Kyoto Protocol was substituted by the Paris Agreement [64]. The objectives of the Paris Agreement are, inter alia, the reduction of GHG emissions, preventing further increases in the global average temperature, and mobilizing capital towards low greenhouse gas emissions and climate-resilient development projects [64, article 2].

In 2015, the UN adopted the Sustainable Development Goals<sup>12</sup> initiative, also known as Global Goals, which are regarded as a universal call to action to end poverty, protect the planet and ensure peace and prosperity. In its turn, sustainable development has shifted

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<sup>12</sup> The UN set seventeen goals: no poverty; zero hunger; good health and well-being; quality education; clean water and sanitation; affordable and clean energy; decent work and economic growth; industry, innovation and infrastructure; reduced inequalities; sustainable cities and communities; responsible consumption and production; climate action; life below water; life on land; peace, justice and strong institutions; partnerships for the goals.

the twentieth-century paradigms in diverse fields, including the energy policy of ECT Contracting Parties and international investment protection.

In the context of the ECT, there was a long step-by-step path to the adoption of sustainable development goals. Table 1 demonstrates this development.

Table 1 - The chronology of adopted documents

Date	Document	Brief description
1	2	3
April 16, 1998	The Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects	Established an international framework encouraging cooperation in the field of energy efficiency in a way compatible with sustainable development
September 4, 2002	The Plan of Implementation of the World Summit on Sustainable Development	Called for enhanced international and regional cooperation to improve access to reliable, affordable, economically viable, socially acceptable and environmentally sound energy services, as an integral part of poverty reduction programs, by facilitating the creation of enabling environments and addressing capacity-building needs, with special attention to rural and isolated regions
July 16, 2006	The Declaration of Global Energy Security of the G8	Leaders of G8 signified their support for the principles of the Energy Charter and the efforts of participating countries to improve international energy cooperation and reaffirmed their intention on addressing climate change and sustainable development
November 18, 2007	The Riyadh Declaration of the 3 OPEC Summit	Committed to conserve, efficiently manage and prolong the exploitation of their exhaustible petroleum resources in order to promote sustainable development and welfare of future generations
January 26, 2009	The Statute of the International Renewable Energy Agency	Set out the desire of parties to promote increased adoption of renewable energy with a view to sustainable development

Table continuation		
1	2	3
December 9, 2009	The Rome Statement by the Energy Charter Conference	Noted the need to consider possible modernization of the Energy Charter Process
December 11, 2010	The Cancun Agreements of UNCCC	Encouraged the participation of all countries in reducing GHG emissions, in accordance with each country's different responsibilities and capabilities to do so
July 27, 2012	The Resolution of the UN "The future we want"	Recognized the critical role that energy plays in the development process, as access to sustainable modern energy services contributes to poverty eradication, saves lives, improves health, and helps to provide for basic human needs
December 21, 2012	The UN Declaration on "Decade of Sustainable Energy for All"	Called upon governments and relevant international and regional organizations and other relevant stakeholders, to combine as appropriate the increased use of new and renewable energy resources, more efficient use of energy, greater reliance on advanced energy technologies, including cleaner fossil fuel technologies, and the sustainable use of traditional energy resources, to meet the increasing need for energy services
July 5-9, 2012	Monaco Declaration and Resolutions of OSCE	Stressed the crucial role of energy security in the new security environment and the imperative need for fairness and transparency, in accordance with international law and the European Energy Charter
May 17, 2013	The UN Resolution on "Reliable and stable transit of energy and its role in ensuring sustainable development and international cooperation"	Noted that stable, efficient, and reliable energy transportation as a key factor in sustainable development, and that sustainable development of energy transportation systems is in the interest of the entire international community

On 20 May 2015, the IEC was adopted and signed. ECT Contracting Parties recognized the global challenge posed by the trilemma between energy security, economic development, environmental protection, and efforts to achieve sustainable development by setting out their intention in the preamble of the IEC in 2015 [65]. The IEC set the following objectives in the context of sustainable development: *“the desire of signatories for sustainable energy development; formulation of a stable and transparent legal framework creating conditions for the development of energy resources in the context of sustainable development; and promotion of a sustainable energy mix designed to minimize negative environmental consequences in a cost-effective way”* [65].

Therefore, the IEC has paved the path for balancing the interests of the host state and investors under the modernized ECT. On 6 October 2019, following decisions made at the ECC on 28 November 2017, the ECC approved some suggested policy options for modernizing the ECT. ECT Contracting Parties expressed a willingness to modernize substantive investment protection standards in line with the regulatory rights of ECT Contracting Parties on sustainable development.

During consultations on the modernization of the ECT, the ECC noted the new approaches in IIAs, including explicit incorporation of public policy goals such as sustainable development, transparency, environmental and labor standards as well as human rights [66].

At the same time, various ECT Contracting Parties submitted their own proposals for ECT modernization in light of sustainable development [67]. Several ECT Contracting Parties saw a need for a stand-alone clause reserving regulatory rights of ECT Contracting Parties in light of sustainable development; others suggested reserving regulatory rights in the preamble of the modernized ECT. The key proposals of some ECT Contracting Parties for the modernization of the ECT are set out below in Table 2 [67].

Table 2 – Modernization proposals of the ECT Contracting Parties

ECT Contracting Parties	Proposals
1	2
EU	<p>The modernized ECT should:</p> <ul style="list-style-type: none"> <li>– provide for legal certainty and ensure a high level of investment protection while respecting ECT Contracting Parties’ regulatory rights</li> <li>– address challenges and opportunities of the transition to a safe and sustainable low-carbon, more digital, and consumer-centric energy system in its definition of “economic activity in the energy sector”</li> <li>– understand the issue of the scope and applicability of Article 24 ‘Exceptions’ to other provisions of the ECT</li> </ul>

	<ul style="list-style-type: none"> <li>– reflect environmental and labor protection, relevant internationally-recognized standards and agreements, sustainable development principles</li> </ul>
Table continuation	
1	2
Turkey	<p>The modernized ECT should:</p> <ul style="list-style-type: none"> <li>– provide more policy space to ECT Contracting Parties</li> <li>– include reference to the right to regulate in the Preamble and within Article for protection of health, safety, and the environment</li> </ul>
Luxembourg	<p>The modernized ECT should:</p> <ul style="list-style-type: none"> <li>– be aligned with ECT Contracting Parties’ commitments in light of the Paris Agreement and climate change objectives</li> <li>– establish a stand-alone article with reference to Climate Change Commitments, Decarbonisation process, Corporate Social Responsibility, and Sustainable Development instruments</li> </ul>
Georgia	<p>The modernized ECT should:</p> <ul style="list-style-type: none"> <li>– include a separate provision for the right to regulate that underlines the powers of ECT Contracting Parties to exercise their legislative and regulatory authority on a non-discriminatory, non-arbitrary and proportional basis in order to satisfy its essential security, public policy, and regulatory goals</li> <li>– promote investment and business activities that are in line with internationally recognized principles of sustainable development and responsible business conduct</li> <li>– reflect a language supporting and reiterating the commitments for sustainable development and corporate social responsibility</li> </ul>
Azerbaijan	The modern ECT should comply with the global agenda and its key elements, including UN Sustainable Development Goals, the Paris Agreement on Climate Change

There are ongoing discussions in the Modernisation Group. ECT Contracting Parties well understand the need for the protection of regulatory rights against investors’ claims in the “new” ECT. On 24 June 2022, ECC approved the Agreement in Principle on the modernization of the ECT.

Ongoing shifts in global energy policy have brought about changes in the character of regulatory measures adopted by ECT Contracting Parties. Based on international commitments in these instruments, the ECT Contracting Parties have changed their energy

policy and have taken measures at a national level to mitigate climate change and foster sustainable development. While the more common regulatory measures in the petroleum sector such as expropriation and direct intervention in the contractual rights of investors have become less frequent; the risk of intervention in ownership and use rights of energy investors remains in some ex-USSR states<sup>13</sup> and ECT Contracting Parties while their economies are in transition [68]. Today, ECT Contracting Parties are more likely to implement complex regulatory measures that do not fully undermine investors’ business and rights of use but rather reduce the expected rate of return.

The same trend is expected to continue in the near future. The character of regulatory measures in the energy sector will depend on contemporary challenges, particularly ongoing energy transition, adequate energy supply and achievement of sustainable development goals, including recognition of public needs and environmental matters.

Revisions will also need to take into account factors such as the development stage of ECT Contracting Parties, energy policy, and the political situation as it stands at the time of revision. Currently, the ECT Contracting Parties are at different stages of economic development. The table below demonstrates the developmental stage of ECT Contracting Parties’ economies, according to their rates of growth of real GDP [69].

Table 3 – ECT Contracting Parties according to their rates of growth of real GDP

Criteria	ECT Contracting Parties
Developed GDP economies	Japan; Austria; Belgium; Bulgaria; Croatia; Cyprus; Czech Republic; Denmark; Estonia; European Union and Euratom; Finland; France; Germany; Greece; Hungary; Ireland; Latvia; Liechtenstein; Lithuania; Luxembourg; Malta; The Netherlands; Norway; Poland; Portugal; Romania; Slovakia; Slovenia; Spain; Sweden; Switzerland; Iceland; United Kingdom
Developing GDP countries	Turkey; Yemen; Afghanistan; Jordan; Mongolia;
Transitional GDP	Albania; Bosnia and Herzegovina; Moldova; Montenegro; North Macedonia; Armenia; Azerbaijan; Belarus (Provisional application suspended); Georgia; Kazakhstan; Kyrgyzstan; Tajikistan; Turkmenistan; Ukraine; Uzbekistan

<sup>13</sup> A recent example is the transfer of subsoil use rights from the Canadian Centerra Gold to the Kyrgyz Government with respect to the large Kumtor gold mine. After the revolution in October 2020 and the presidential election in January 2021 newly elected President Sadyr Japarov initiated the return of Kumtor gold mine shares from the Canadian Centerra Gold to state ownership. In 2021 the Kyrgyz Parliament passed the law on the temporary takeover of the Kumtor gold mine due to a number of reasons, including environmental concerns and tax claims. The investor – Centerra Gold initiated arbitration against Kyrgyzstan for violation of the fundamental provisions of the Restated Investment Agreement between the investor and the Kyrgyz Government. In April 2022 Centerra Gold and the Kyrgyz Government entered into a global arrangement agreement.

As shown in the table above, the majority of ECT Contracting Parties are developed EU member states that are energy import-dependent [70]. On the other hand, other ECT Contracting Parties (most, if not all, of which are energy exporter States) are transitional economies [70]. Therefore, it is reasonable to consider the impact of regulatory measures from two differing ECT Contracting Party perspectives: firstly, of transitional economy energy exporters and secondly of import-dependent developed EU States.

The current pace of energy transition towards renewables in developing ECT Contracting Parties is slow in comparison to that in the import-dependent developed EU ECT Contracting Parties [71]. The pace of transition is driven by the availability of international financing, existing infrastructure, regulatory environment and cost of technologies [71]. At the other end of the scale, ex-USSR states are still the main exporters of fossil fuels to EU ECT Contracting Parties. For the purposes of regulatory environment analysis, the dissertation takes Kazakhstan and the EU as an example.

*Case study: Kazakhstan's regulatory environment of the energy sector.* Kazakhstan is an ECT Contracting Party and truly one of its beneficiaries. Accession to the ECT was an important step for the young independent and resource-rich ex-USSR state. By accession, Kazakhstan intended to address two important strategic concerns: firstly, to secure stable energy transit routes; secondly to encourage EU investment through the protection of interests expressed in the ECT [17, p.180-181]. Critically, Kazakhstan does not have access to either sea or international ports. This represented a significant barrier to its ability to export O&G. The ECT could facilitate negotiations for the construction of pipelines that transited the territories of Russia and Azerbaijan before reaching EU territory [17, p.180]. The other factor that limited Kazakhstan's ability to generate income from its natural resources was regulatory instability, which caused it to be seen as a high-risk investment by EU investors [17, p.181]. At the time of accession, Kazakhstan had just embarked on its market economy development and was gradually abandoning the centralized Soviet system. Between 1991 and 1999, Kazakhstan passed the first market liberalization laws, which aimed at facilitation of foreign investment, and achievement of regulatory stability. Key legislations included the Civil Code (1994), Foreign Investment Law (1994), Petroleum Law (1995), Tax Code (1995), and Subsoil Use Law (1996). These legislative acts built a core framework to enable crucial foreign investment in the energy sector, along with the IIAs. This legislative framework provided for varied and extensive stability guarantees, including stabilization clauses for large energy projects [72; 73]. Moreover, the Kazakh Government concluded most of its IIAs, including 23 BITs, during this period [74].

In 1993, two years into the country's independence, the Kazakh Government signed a concession contract with Chevron and ExxonMobil for developing the giant Tengiz oil field. In 1997, the Kazakh Government signed PSAs for two other giant oil and gas fields, Kashagan and Karachaganak. IOCs such as Shell, Eni, BP, ConocoPhillips, Total, Chevron, Exxon Mobil, CNPC, and Inpex have entered into the energy sector along with

other international mining companies such as Cameco, Rio Tinto, AREVA, BASF, Uranium One and Arcelor Mittal. Currently, Kazakhstan is among the top twenty oil-producing states, the ninth-largest coal producer, and the largest producer of uranium in the world [75].

In a nutshell, in a relatively short period of time, Kazakhstan has transitioned into one of the key energy players in Central Asia. For the last thirty years, Kazakhstan's economy has experienced rapid growth, fuelled by structural reforms, ample mineral resources, and an increasing flow of foreign direct investments, all of which helped to transform the economy [76].

Between the 2000s and 2010s, Kazakhstan passed the second package of energy sector legislation. Key legislation base was: the Law on Investments (2003), the Law on PSA (2005), the Tax Code (2008), the Law on Support of Renewable Energy (2009), and the Subsoil Use Law (2010). These legislative instruments allowed for a range of petroleum contracts, taxation agreements, and customs duties arrangements.

In 2008, Kazakhstan abandoned the PSA regime and developed concession-based model contracts for investors. Stabilization guarantees included in the model contracts were applied to existing investors, with some exceptions. At the same time, the Kazakh Government concluded further negotiations with IOCs relating to the Kashagan and Karachaganak fields. As a result, the share of the NOC KazMunaiGaz on the Kashagan project increased to 16,81% and the NOC KazMunaiGaz entered into the Karachaganak project, acquiring a 10% share [77; 78].

Also at this time, however, foreign investors brought the first arbitration claims involving energy disputes against Kazakhstan. Key examples were the claims of Anatoli Stati, Caratube, and AES [74]. Anatoli Stati and Caratube cases alleged expropriation of contract rights to explore, develop and produce oil at different petroleum fields [79; 80].

Between 2011 and 2022, Kazakhstan adopted a third legislative package that affected the energy sector regulatory framework. From 2014 to 2017, the Kazakh Government prepared a new Subsoil Use Code and Tax Code designed to attract investors to the energy sector. For the first time, Subsoil Use legislation provided mining investors with a “first come-first served” licensing basis (i.e., without tender) [57]. For the petroleum and uranium sectors, the Subsoil Use Code provides a contractual regime based on model contracts [57].

Regulatory risk for investors in the Kazakh fossil fuel sector remains. Petroleum contracts including PSAs were signed between investors (mostly EU) and the Kazakh Government at the end of the 1990s, i.e., shortly after its independence, will expire in the next 10 - 15 years. Disputes may arise, including those relating to the non-renewal of contracts, liquidation and decommissioning works, environmental matters and etc. The Kazakh Government may also have counter-claims for breach of the contractual terms.

In December 2021 and January 2022, there was social unrest in Kazakhstan, at least partly caused by the cost of LNG. Kazakh Government deregulation of the LNG market led to a significant increase in domestic gas prices from \$0,11 to \$0,24. There was rioting

in several cities and the government had to step in. The Ministry of Energy was forced to implement price controls at a lower rate. This is disadvantageous for LNG investors.

Notwithstanding its abundant mineral resources, the Kazakh Government is paying real attention to the development of renewable energy. In 2013 the President of Kazakhstan signed an Order on the adoption of “the Concept for the transition of the Republic of Kazakhstan to a “green economy” [81]. In 2018, he adopted a National Development Plan which aims to supply 6% of total electricity production from renewable sources by 2025 [82]. The current regulatory regime of renewable energy provides for a wide range of support and incentive mechanisms [83]. In particular: guaranteed purchase of produced energy from renewable sources through State Electricity Grid Operating Company KEGOC, FIT, auction prices, investment preferences such as exemption from customs duties and value-added tax on imports, government in-kind grants in the form of a provision of land plots, equipment, etc [83]. FITs are approved by the Kazakh Government for a period of fifteen years for a particular type of renewable energy source [83]. For example, a fixed tariff of 70 tenge/kWh for solar power projects using Kazakhstani silicon (Kaz PV) photovoltaic modules with a total capacity of 37 MW to convert solar energy [84]. In 2017, the Kazakh Government introduced an auction price mechanism [85]. Its aim is to select the most efficient renewable energy projects, as well as to develop competitive market pricing for renewable electricity.

*Case study: EU’s regulatory environment of the energy sector.* Developed economy ECT Contracting Parties mainly comprise EU member states<sup>14</sup>. As a key player among ECT Contracting Parties, an ECT beneficiary, and one of the largest global energy consumers. The EU energy market is diversified and heavily dependent on other states for energy supply [86; 87]. The EU is largely dependent on Russian O&G; Russia supplies almost 40% of the gas and 25% of total EU oil consumption [88; 89]. Other ECT Contracting Parties Kazakhstan and Azerbaijan also rank among the key suppliers of O&G. Their combined share of oil (36%) and gas (25%) represents the EU’s main energy generation source [90]. Due to this import dependence, energy security has become the top priority on the EU’s political agenda [90]. As of the date of writing, the Eurasian political situation is seriously destabilized due to the Russia/Ukraine war and Western sanctions imposed on Russia and Belarus.

Energy dependency has also propelled the EU to develop renewable energy, diversify imported gas sources and develop an “integrated, flexible and liberalized market” [91; 92]. The EU in a sense is leading a multi-vector energy policy in partnership with other states. For example, in terms of oil supply, the EU is mostly partnering with the ex-USSR States and the Middle East oil-exporting States, while on LNG and natural gas, it is partnering with the US, Norway, and Algeria [87, p.27].

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<sup>14</sup> Non-EU ECT Contracting Parties are Japan, Switzerland, Iceland and United Kingdom

The EU has adopted several strategic documents<sup>15</sup> that proposed policy options for energy security. The EU has prioritized the goal of securing affordable and low-carbon energy [93]. In 2015, the EU Commission adopted Energy Union Package which contains a Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy [94]. In 2016, the EU Commission adopted a document package “Clean energy for all Europeans” [95]. According to this document the goal of the EU is to achieve at least 40% cuts in GHG emissions, at least 32% renewable sources of energy consumption, and at least 32,5% energy efficiency, all by 2030 [98]. This document contemplates the adoption of eight legislative acts [95]. One of them, adopted in 2018 was the following revision of the 2009 Renewable Energy Directive (the 2009 Directive) [96]. The revised 2018 Directive aimed to increase the use of energy from renewable sources to comply with the commitments of the EU under the 2015 Paris Agreement [96].

The Preamble of the 2018 Directive defines several fundamental rules for the EU Member States. First, the Directive recognizes different renewable energy potentials and different support schemes at a national level [96]. Nevertheless, EU Member States should design effective national measures for their respective contributions to the Union’s 2030 target for renewable energy and for the national targets that they have set for themselves [96]. Second, the policies of the EU Member States supporting renewable energy should be “*predictable and stable and should avoid frequent or retroactive changes*” [96]. Since policy “*unpredictability and instability have a direct impact on capital financing costs, [and therefore] on the costs of project development*” [96]. The third package addresses the lack of transparent rules and coordination between different EU and national authorization bodies, acknowledging that lengthy administrative procedures constitute a major barrier to international energy trade and development [96].

As ECT arbitral awards demonstrate that one of the problematic areas for investors and EU Member States is support for renewable energy schemes. The 2018 Directive encourages EU Member States to develop economic support schemes in order to reach the 2030 target [96, article 4 (1)]. In turn, EU Member States are required to ensure the application of support schemes in an open, transparent, competitive, non-discriminatory, and cost-effective manner [96, article 2 (4)]. Moreover, under the 2018 Directive, EU Member States are bound to ensure that support granted to renewable energy projects will not be revised in a way that negatively undermines the economic viability of such projects [96, article 6 (1)]. The EU Member States may adjust “*the level of support in accordance with objective criteria, provided that such criteria are established in the original design of the support scheme*” [96, article 6 (2)]. Furthermore, the provisions of the 2018 Directive establish the obligation of EU Member States to publish a long-term schedule outlining the expected allocation of the support over a 5-year period or, as a minimum, to produce 3-year forecast situations where budgetary planning requirements and the frequency of tendering procedures make 5-year projections impossible [96, article 6 (3)].

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<sup>15</sup> Single European Act (1986); 1996 and 1998 EU electricity directives; Renewable directives 2001 and 2003; Lisbon Treaty (2007); Clean Energy for all Europeans package (2019); European Green Deal.

Finally, EU Member States are obliged to assess support scheme effectiveness at least every 5 years and to take into account the effect of possible changes to support schemes [96, article 6 (4)].

The 2018 Directive defines a “support scheme” as:

*“any instrument, scheme, or mechanism applied by a Member State, or a group of Member States, that promotes the use of energy from renewable sources by reducing the cost of that energy, increasing the price at which it can be sold, or increasing, by means of a renewable energy obligation or otherwise, the volume of such energy purchased, including but not restricted to, investment aid, tax exemptions or reductions, tax refunds, renewable energy obligation support schemes including those using green certificates, and direct price support schemes including feed-in tariffs and sliding or fixed premium payments”* [96, article 2 (5)].

This definition of support schemes is very broad. The EU Commission provides the EU Member States with a wide range of options to apply different support schemes. Support schemes could include investment aid, tax exemptions, tax reductions, tax refunds, green certificates, and direct price support including feed-in tariffs and sliding or fixed premium payments.

Qualifying support schemes as a tax measure seems particularly attractive, because it may help such schemes to fall within Article 21 of the ECT which contains a carve-out for tax matters [2, p.269]. Article 21 of the ECT, however, does not automatically preclude investors from bringing claims relating to such measures. Arbitral jurisprudence shows that arbitral tribunals do not dismiss a case simply because the defendant State argues that the contested measure was a tax. Rather, they determine first if the measure is a true or a sham tax measure, which in the latter case would not be precluded by the carve-out.

Spain has raised a similar argument in a number of cases [97; 98; 99]. In the *9REN v. Spain* case, for example, a Luxembourg-based investor claimed that a 7% TVPEE reduces the incentive tariffs guaranteed under Spain’s FIT program [100, para 192]. Spain challenged the jurisdiction of the arbitral tribunal arguing that Article 21 of the ECT excludes taxation measures from the scope of the protection under the ECT [100, para 190]. The tribunal applied the traditional test of whether TVPEE is a tax or not [100, para 195]. Namely, whether TVPEE was a levy established by law, that imposed obligations on a defined class of persons, generated revenues, and whether these revenues were used for public purposes [100, para 195]. Despite several counter-arguments, the tribunal decided that the TVPEE qualified as a tax and that Article 21 of the ECT precludes the TVPEE issue from the consideration of the tribunal [100, para 207]. Therefore, potential renewable claims may relate to tax regulatory-related measures rather than pure regulatory or tariff measures [2; p. 269].

Another set (and increasing number) of investment disputes against EU ECT Contracting Parties in relation to the energy transition from fossil fuels to renewables are related to the closure and phase-out of coal plants. These disputes related to requests for compensation by affected investors due to regulatory measures of ECT Contracting

Parties on the reduction of GHG emissions. Several ECT Contracting Parties have adopted decisive measures related to the shutdown of coal plants that are regarded as the main sources of GHG.

Recent examples are the experience of Germany and the Netherlands. In the case of Germany, the national Parliament adopted the coal exit law in July 2020, setting out a roadmap for phasing out coal-based energy by the end of 2038 [101]. Pursuant to this law, it is expected that the last lignite mines and hard coal power plants to be shut down by that date [102]. The Law provides structured compensation to be paid to the affected mining companies [102, p. 179]. Specifically, prior to 2026, coal plant operators could obtain compensation by participation in an annual tender for compensation funding voluntary closure of coal plants [102, p. 179]. Starting in 2027, hard coal plants are to be shut down by regulatory order without compensation. The State provides economic incentivization for the early closure of coal plants. Although in principle supportive of the move from fossil fuels to renewables the European Commission last year started an investigation to determine if the compensation scheme violates EU laws on state aid [103].

Similarly, in the case of the Netherlands, on 11 December 2019, the Netherlands adopted a law prohibiting the use of coal for the production of electricity after 2030 [104]. The law targets five in-country coal-fuelled power plants. The Netherlands agreed to pay EUR 52.5 million compensation to Vattenfall to close the oldest plant [105]. However, it appears that the Netherlands has not been able to agree on compensation amounts for the closure of the other plants. As a result, affected investors RWE AG, RWE Eemshaven Holding, Uniper SE, and Uniper Benelux brought at least three separate claims against the Netherlands in ICSID alleging breaches of the ECT investment protection provisions [106].

France has also been taking regulatory measures to reduce fossil fuel production within its territories. In December 2017, the French Parliament adopted legislation ending O&G exploration and production by 2040 [107]. In 2019, the French President signed Law 2019-1147 which limits GHG emissions by the closure of coal plants and other highly polluting power plants to achieve the Paris Agreement commitments [108]. In April 2022 during the election campaign, President Emmanuel Macron declared that France will be “*the first green nation and abandon gas, oil, and coal*” [109]. O&G investors in France started to sell their assets and warned the French Government that they would bring arbitration claims under the ECT [110; 111].

Italy is taking similar legislative measures to reduce the exploration and production of O&G within its territory. In February 2019, the Italian Parliament passed Law 11/2019. It imposes a moratorium on exploration permits and new applications for production concessions for a period of 18 months [112]. During this period, the Italian Government will allocate areas for permitted O&G production taking into account environmental issues [112]. In light of this legislation, in September 2021 the Italian Ministry of Ecological Transition approved the Plan for the Sustainable Energy Transition of Sustainable Areas (PiTESAI) that liberalized gas exploration activities in the territory of

Italy [113]. PiTESAI limited exploration to gas only, excluding oil [113]. Accordingly, all exploration permits that were compatible with PiTESAI were to be revoked [112]. Any direct and consequential claims of investors arising from revoked licenses are to be compensated from funds generated by increased administrative revenue from hydrocarbon activities [112].

In early 2017, the UK-based energy company Rockhopper initiated an arbitration claim against Italy under the ECT in relation to the Ombrina Mare project [114]. The claim arose out of the decision of the Ministry of Economic Development not to award the Rockhopper a production concession for the Ombrina Mare project located within 12 miles of the coast of Italy [114].

The EU has put a strong focus on the development of renewable sources throughout the ECT modernization [115]. There have even been several warnings from the EU that it would withdraw from the ECT modernization when proposed revisions conflicted with the EU's principal policy of phasing out fossil fuels and transition to renewables [116]. There is about an alignment of new ECT investment protection provisions with the commitments made under the Paris Agreement [116]. ECT Contracting Parties agreed to incorporate a novel "flexibility mechanism" that allows them, based on the ECC decision, to carve out investment protection for fossil fuels in their territories where necessary for individual state's energy security and their progress towards agreed climate goals [117].

In the meantime, EU Member States will continue to take regulatory measures toward sustainable development. This may entail the adoption of complex regulatory measures, including renewable energy promotion and phasing out traditional fossil fuels. Instability within the energy sector caused by this transition will probably lead to an increase in regulatory risk for investors developing long-term energy projects within the EU state territories. At the same time, the EU will expect ECT investment protection provisions to apply not only to capital exporters for developing projects in ECT Contracting Parties, but also to capital importers. All EU ECT Contracting Parties will therefore be potential defendants in future investment claims involving the energy sector.

Between 2012 - 2015 ECT Contracting Parties faced an unprecedented number of claims from investors on RES due to support schemes' revisions [9]. ECT Contracting Parties cut FITs, reduced the number of hours of RES production<sup>16</sup>, or imposed additional taxes<sup>17</sup>.

It is obvious that the claims made against regulatory measures for renewable energy in Spain will have a considerable impact on future investment decisions of EU Member States. Moreover, the ECT arbitral awards on renewable incentives will have an impact on investors' investment planning. Attempts by EU ECT Contracting Parties to accelerate the energy transition may create a new risk – that sudden policy swings mean that renewable energy projects/products themselves might become commercially unviable for energy investors [2, p. 268].

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<sup>16</sup> Spain

<sup>17</sup> Czech Republic

## **1.2 The investment protection in the energy sector from MST to FET**

### **1.2.1 Pre - ECT period: CIL, early concessions, UN Resolutions and BITs**

*Equality.* The origins of the early evolution of the protection of foreigners' rights under international law date from earlier centuries in times when diplomatic protection was provided to aliens by their home state. Diplomatic protection as a concept in international law dates back to before the French Revolution when mass migration of citizens to foreign countries occurred [118]. As an early social institution, it was a form of clan organization when it deemed an injury to a clan member as an injury to the clan itself [118, p. 121]. Swiss philosopher, diplomat, and jurist Vattel E. wrote in his famous book titled “The Law of Nations” in 1758 that “*whoever uses a citizen ill, indirectly offends the state, which is bound to protect this citizen; and the sovereign of latter should avenge his wrongs, punish the aggressor, and, if possible, oblige him to make full reparation; since otherwise the citizen would not obtain the great end of civil association, which is, safety*” [119].

At this period, home states of foreign nationals used diplomatic protection and used it as a justification for a military intervention into a host state – so-called “gunboat diplomacy” [118, p. 121]. One of the most prominent examples of such practice is the Don Pacifico incident when the British military action was taken against Greece in 1850 [120]. As a result of the action, the British blockaded the Greek coast and seized Greek vessels [120, p. 13]. France made similar fulsome interventions into Mexico in 1838, the US into Santo Domingo in 1904, and Haiti in 1915 on the grounds of diplomatic protection [120, p. 13]. Another notorious example of misuse of diplomatic protection was the blockade of Venezuela by the combined forces of Italy, Germany, and Great Britain in 1902-1903 on behalf of various citizens, who had alleged claims against the Venezuelan government [120, p. 15]. This abuse of diplomatic protection raised significant criticism in international law. In this respect, Borchard E. concluded that there were two principal points on how to interpret diplomatic protection reasonably. The first addressed the status of diplomatic protection in the context of international law. He clarified that there is no legal duty incumbent upon the state to extend diplomatic protection in international law. If diplomatic protection were to be considered an international duty, it would be only a moral and not a legal duty [121, p. 29]. The second principal point was that the boundaries of diplomatic protection needed to be defined. He asserted the right of every State to exercise sovereignty and jurisdiction within its territory over all persons, including aliens. At the same time according to him, the home state could retain a surveillance role over its citizens abroad to see that their rights as individuals and as nationals were receiving the measure of recognition established by the principles of municipal and international law. A host state should observe MST [121, p. 29]. The MST was understood as a baseline - that is to say that the host state could not fall below this without incurring consequences and responsibility [121, p. 27]. In case of injury of their citizens abroad, the home state could determine at its discretion whether such injury to the citizen was sufficiently serious

and justified to warrant or to exercise diplomatic protection [121, p. 29]. Therefore, diplomatic protection was viewed as a complementary or reserved right, to be invoked only when the host state failed to conform to an MST [121, p. 28].

One of the radical views regarding diplomatic protection was put forward by two Argentinian statesmen, Calvo C. and Drago L., at different times. Both of them further obtained doctrine status. Calvo C. expressed the so-called “Calvo doctrine” in Paris in 1868. The essence of the Calvo doctrine was based on two concepts. The first is the concept of non-intervention and the second is that aliens and nationals enjoy equality (the equality principle) [122; 123; 124; 125]. In light of these two concepts, foreigners should claim their rights in domestic courts, and were not entitled to diplomatic protection by their home state or access to an international tribunal. The principle of equality was first introduced in civil codes by Bello A., the famous Venezuelan who drafted the Chilean Civil Code in 1855 [126]. Calvo C. further developed this theory in his book titled “Derecho internacional teórico y práctico de Europa y America” [127]. In this way, there was an attempt to eliminate the expansion of diplomatic protection.

The Drago doctrine took a narrow and particularly prohibited the use of force for collection of any public debts raised by the US and European countries. The Drago doctrine was advanced in 1902 and was intended to be a corollary to the Monroe doctrine [120, p. 14]. The concept of the Drago doctrine was further incorporated into the Porter Convention in 1907, which prohibited the use of force to collect any contract debts [128].

The application of the Calvo doctrine was thoroughly tested in several commission claims between the US and Latin American countries. In all of them, a central point of discussion was the exhaustion of local remedies prior to referring a dispute to a governmental commission. Before the US and Venezuelan Commission, the earliest cases were the Day and Garrison case, the Flannagan case in 1885, and the Woodruff case in 1903 [121, p. 801]. Further cases, such as *Illinois Central Railroad Company (the US) v Mexico and North American Dredging Company of Texas (the US) v Mexico* have contributed to the discussion on the validity of the Calvo clause [129; 130]. In nearly all of them, it was recognized that stipulation of exclusive jurisdiction of local courts in a contract could bar a claimant from bringing the case before a Commission. Still, exclusive jurisdiction clauses could not preclude the right of the claimant’s government to submit an international claim in case of denial or undue delay of justice. By 1926 in eight cases the validity of the Calvo clause was upheld, while in eleven cases, its performance was denied [131].

However, in reality, implementation of the Drago and Calvo doctrines was not as practical as expected and did not receive recognition from international lawyers [120, p. 14]. Several Latin American countries included the Calvo doctrine in their constitutions, legislation, and contracts with foreign companies. These clauses implied making all property in their territories subject to domestic law. Examples of such practices include Peru, Bolivia, Ecuador, and other Latin American countries [132]. According to such provisions, a foreigner who resides in a host state will accept the terms of national law

and understands the risks inherent in their acceptance. This ideology was well illustrated in correspondence between the Mexican Foreign Minister, Hay E. and US Secretary of State, Hull C. in 1938 concerning the expropriation of agricultural lands in Mexico owned by US citizens. In his letter dated 3 August 1938, the Mexican Foreign Minister referred to the first Pan-American Conference as “*vigorously maintaining the principle of equality between nationals and foreigners, considering that the foreigner who voluntarily moves to a country which is not his own, in search of a personal benefit, accepts in advance, together with the advantages which he is going to enjoy, the risks to which he may find himself exposed*” [133]. To strengthen his position Mexican Foreign Minister invoked Article 9 of the Convention on the Rights and Duties of States signed at Montevideo in 1933, which sets out that “*the jurisdiction of states within the limits of national territory applies to all inhabitants. Nationals and foreigners are under the same protection of the law and the national authorities and foreigners may not claim rights other or more extensive than those of the nationals*” [134].

This principle of equality became one of the central points of discussion during the Hague Codification Conference in 1930. One of the three issues addressed by the Conference was the responsibility of States for damages caused in their territory to the person or property of foreigners. In support of the equality principle, seventeen countries argued that when an alien comes to a host state, such alien must be prepared for all local conditions, including legislative and political ones [135]. However, this was restricted to remedies available to injured aliens. Twenty-one other countries, mostly western, took an opposite stand and argued that this was contrary to international law [126, p. 451]. All of this led to a gradual transition from invasive to a reasonable application of diplomatic protection and accelerated the evolution of international law rules on the protection of foreigners abroad.

*Denial of justice and MST.* International rules on the protection of the rights of aliens evolved in the 19<sup>th</sup> century in Western countries and the US. These were designed to protect own citizens who were investing abroad. The core tenet was the imposition of a set of minimum obligations over a host state to respect the rights and protect the property of aliens under international law [126, p. 451]. This ideology evolved in response to was due to the expansion of western economic powers, the spread of European colonialism, and American influence in Latin America and Asia. During the 19<sup>th</sup> century, there was an implicit international consensus among States on the existence of such rules without much practical application [126, p. 451].

In 1910 US State Secretary Root E. explicitly addressed such ideology<sup>18</sup> “*the natural course of development of the new world was leading to flow of labour and investment from one country to another for the search of [the] best market...[t]his process requires protection of rights of aliens in the territory of a host state that could be effectively exercised only by calling upon the government of another country for the performance of its international duty that conforms to the established standard of civilization*” [136].

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<sup>18</sup> Speech at the fourth annual meeting of the American Society of International Law

These standards include “*a standard of justice, very simple, very fundamental, and of such general acceptance by all civilized countries as to form a part of the international law of the world*” [136, p. 521]. Following Root’s approach, it follows that the need for the explicit protection of aliens abroad would only arise in states in which an insufficient degree of impartiality and independence was accorded to their own nationals. Root referred to Palmerston’s (Lord) speech in the Don Pacifico case where the British Government interfered only in cases of denial of justice and manifestly unjust decisions of foreign governments in relation to British individuals. Root’s speech addressed the issues of structure and content of an international standard, but could not substantiate the source of this international standard, not its applicability in practice [137]. This might have been caused by a lack of State and international adjudication practices. Over the course of the 19<sup>th</sup> and 20<sup>th</sup> centuries, various dispute resolution forums did define their own interpretation of the protection of the rights of aliens under international law. These cases generally addressed questions related to the protection of the rights of aliens from mistreatment, illegal arrest, lack of diligence, lack of investigation, insufficiency of government action, and denial of justice. In the Hopkins case, which concerned the issued money orders issued by the Huerta administration, the US/Mexico Commission was of the opinion that “*under the rules of international law applied to controversies of an international aspect a nation is required to accord to aliens broader and more liberal treatment than it accords to its own citizens under its municipal law*” [138]. In the Roberts case, which related to the illegal arrest of an American citizen, the US/Mexico Commission remarked on the mistreatment of Roberts during the entire period of imprisonment and demanded indemnity [139]. Although the cases considered did not directly concern the protection of investment and investors’ rights; they established foundations for further elaboration of rules for the treatment of aliens under international law. In the Neer case, for example, for the first time, the US-Mexico Commission attempted to establish the limit beyond which international delinquency of the host state may arise. In this case, the Commission recognized the difficulty of establishing a general formula for defining the boundary between international delinquency and poor implementation of power within national law. The Commission was of the opinion that “*in order to constitute an international delinquency the treatment of [the] alien should amount to an outrage, to bad faith, to wilful neglect of duty or to insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency*” [140].

By 1930, in terms of both substantive and procedural perspectives, there was a fairly reasonable understanding among states about the existence of MST to which all civilized States shall adhere. International courts also recognized this in their decisions. In the case of Certain German Interests in Polish Upper Silesia the Permanent Court of International Justice explicitly recognized the existence of a common or generally accepted international law respecting the treatment of aliens [141].

Nevertheless, it is worth mentioning that despite the application of the MST in adjudication practice, the framework of MST remained vague. The MST was regarded as a mild, flexible, and variable principle which varied depending on the circumstances [126, p. 458]. According to Root, MST was “a standard of justice” and “impartial justice”, which steadily gained acceptance in all nations [136, p. 528]. Concerns about MST were expressed at the Hague Conference that MST found its grounds on vague customary rules and general principles [142]. In its early days, the concept of MST was mainly associated with “denial of justice”. The term “denial of justice” gained wide applicability in diplomatic correspondence and international adjudication practice. But given the uncodified character of international law at that time, there was ambiguity about the scope of denial of justice [143; 144].

The term “denial of justice” has been used in various senses and was interpreted in various forms. In British, the US, and other States’ diplomatic correspondence, the term was used explicitly as the basis for diplomatic interposition where justice was denied [145]. In the academic sphere, and alongside the Borchard’s philosophy, Eagleton C. associated the term with the failure of a foreigner to obtain compensation for injuries caused by acts of either private parties or authorities [146]. In a report of the League of Nations Committee of Experts for the Progressive Codification of International Law experts Guerrero M. and Chung Hui W. approached the question of the scope of denial of justice in a limited context, only granting free access to the courts to defend those rights which national law accords them [147]. They concluded that a State is responsible for damages caused to foreigners when that state is found guilty of a denial of justice [147, p. 202]. In adjudication practice, denial of justice was a central matter in several early cases. This dissertation provides some notable examples.

The term was raised in the Antoine Fabiani case of 1905. In this case, the arbitrator, Berne, expounded that the term “denial of justice” meant “*any act of a judicial authority constituting a refusal to execute a sentence rendered executory, an illegal delay in the dispatch of business, a default to render orders and sentences within the terms established, an undue extension or reduction of the terms established by the law or any delay in the determination of process*” [148]. In the Neer case, Commissioner Nielsen adhered to the view that the term “denial of justice” should be applied in a broader sense than a wrongful act of judicial authorities [140, p. 62-64]. Similarly, in the Interoceanic Railway case, the Commission found that the term also had a broad meaning and includes all internationally illegal acts related to the administration of justice, irrespective of whether such acts were of judicial or non-judicial nature [149]. A broad interpretation of the term was also accepted by the Commission in the Janes case [150]. Decisions of international adjudication bodies were mostly divided into two groups on the subject of denial of justice – one which regards the principle as applicable only to judicial authorities, and another which extends its principle to include legislative and executive authorities as well. Indeed, in the 19<sup>th</sup> and early 20<sup>th</sup> century, the focus of adjudication practice and the law was not on the protection of property from expropriation but on MST. MST was a major issue in

IIL before the start of the 1920s expropriations in the Soviet Union and Mexico. The issue was whether the protection of the property of aliens against confiscation was included within the scope of MST. The such issue arose between the US and Mexico in the context of Mexican agrarian reforms. Then the focus of international law was shifted from MST to the protection of the property of aliens (expropriation/nationalization).

*Expropriation.* Simultaneously, during the 19<sup>th</sup> and 20<sup>th</sup> centuries, Western States made attempts to develop CIL rules to protect the property rights of foreigners in host states. The main principle was that there was an obligation of paying compensation for the expropriation of the property of a foreign by a host state. The principle was first raised in cases such as Upton, De Sabla, and Chorzow Factory [151; 152; 141].

The Soviet Union's policy of expropriation of foreign property without compensation prompted definitions of international standards and a framework for protecting alien property. In 1930, the Lena Goldfields ad hoc tribunal decision required the Soviet Union to pay compensation to the foreign claimant (English company) based on the concept of unjust enrichment [153]. On the other side of the Atlantic, this trend was followed by the US against the Mexican nationalization of the US interests in the agrarian and oil sectors. The US Secretary of State Cordell Hull C. wrote his famous letter to the Mexicans in which he referred to the rights of the state to expropriate under the rules of international law, but required "prompt, adequate and effective compensation" [154]. This statement further questioned the legality of expropriation. The western legal practice had developed the following three requirements for an expropriation to be lawful: 1) expropriation shall not be arbitrary and discriminatory; 2) shall be for a public purpose; and 3) accompanied by prompt, adequate, and effective compensation. This western position is well illustrated in the US Restatement of the Foreign Relations Law, which was promulgated by the American Law Institute in the 1930s and has subsequently been revised several times [155]. The period after the Second World War, the emergence of new States, the formation of the UN and the call for economic decolonization started a new era in the development of investment protection. All the while, developing states were challenging the western position. 1974 UN Resolution on a New International Economic Order intensified this polarity. The requirement for compensation had been by far the most controversial one. From 1960 to the - 1990s CIL rules on compensation were a key issue for the debate as whether an expropriation ought to be compensated. Most importantly, however, CIL could not practically provide adequate protection for investors and had no effective enforcement mechanism for the pursuit of claims against host states.

*Early concessions.* Historically, the protection of investments in the energy sector has been linked to the development of oil resources in the Middle East in the mid-20<sup>th</sup> century. As long as crude oil reserves were primarily concentrated in Middle Eastern States, many of which were under British and West European states' protectorates, investors were exclusively European and US IOCs.

Early relationships between host states and these IOCs were formalized under concession agreements for extracting petroleum reserves. These early concessions were

drafted in the colonial era and resulted from agreements between the rulers of Arab states and Iran and IOCs backed by their own home states. In this respect, concessions were in effect signed under a triangular relationship between the host state, IOC, and the IOC's home state. On the one hand, concessions protected the IOCs. On the other hand, such concessions were a kind of assurance against interference by the home state during the concession period, as it would be presumed that the arrangement provided sufficient safeguards for investors, such as access to international arbitration. Although the terms of concession agreements differed, their core features were similar. Principally these were: exclusive rights for oil exploitation in a large area, for a long duration, and with modest payments. The table below illustrates the principal concession terms in the Middle East as of 1950 [156].

Table 4 - The principal concession terms in the Middle East as of 1950

Country	Iran	Iraq	Kuwait	Saudi Arabia	Iran-1954
IOC	BP (AIOC)	IPC Group	KOC	Aramco	Consortium
Area, Th. Sq. Km	259	443	16	932	259
Year of Expiry	1993	2005	2025	1993	1993
Duration	60 years	75 years	92 years	60 years	60 years

Given the economically underdeveloped situations in the Middle East States and colonial rule, concession agreements were mainly designed to protect IOCs, including through two core protection mechanisms: 1) the internationalization of governing law clauses and the inclusion of international arbitration mechanisms into contracts; and 2) stabilization clauses.

*Internationalization.* To bypass the potentially arbitrary regulatory actions of host states, IOCs used international law as the governing law for concession agreements. In this way, early concession agreements were brought out of the control of national law and made subject to international law. IOCs commonly used two ways of applying international law to these contracts. Firstly, governing law was linked to principles of international law. Reference to principles of international law is explained not by the lack of legislation in the host state, but by the need for IOCs to be protected against unilateral and abrupt changes in national law [157, para 42]. Early international arbitration tribunals found that the reference to principles of international law was a sufficient criterion for the internationalization of a contract [157; 158; 159]. Secondly, international arbitration was incorporated as a dispute resolution forum in these contracts. Through this mechanism, IOCs obtained greater protection under international law by incorporating an international arbitration mechanism. The *Texaco v. Libya* tribunal noted that the inclusion of an arbitration clause leads to a reference to the rules of international law [157, para 44]. The tribunal in *Sapphire v. Iran*, a case that involved state interference with an oil concession,

was explicit in its conclusion that an indication that disputes would be submitted to international arbitration could imply the rejection of the exclusive application of Iranian law [159, p. 172]. The matter of internationalization of contracts was a central point of discussion in early arbitration disputes. In the *Texaco v. Libya* case, for example, the concession agreement provided that:

*“This concession shall be governed by and interpreted in accordance with the principles of [the] law of Libya common to the principles of international law and, in absence of such common principles, then by and in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals”* [157, para 23].

The tribunal explained the application of international law to the contract as follows: *“[T]he old case law viewed the contract as something which could not come under international law because it could not be regarded as a treaty between States, under this new concept treaties are not the only type of agreements governed by such law. And it should be added that, although they are not to be confused with treaties, contracts between States and private persons can, under certain conditions, come within the ambit of a particular and new branch of international law: the international law of contracts”* [157, para 23].

*Traditional stabilization clauses.* The inclusion of stabilization clauses became a common practice in early concession agreements and PSAs. There are various types of stabilization clauses. The scope of some stabilization clauses is broad, while the scope of others is narrow. Despite such differences in scope, all of them have pursued the principle of preventing the application of future changes in the host state legislation to the petroleum contract. A more direct form of stabilization clause, for example, was incorporated in Article 17 of the 1948 Aminoil concession:

*“...The Shaikh shall not by general or special legislation or by administrative measures or by any other act whatever annul this Agreement except as provided in Article 11. No alteration shall be made in terms of this Agreement by either the Shaikh or the Company except in the event of the Shaikh and the Company jointly agreeing that it is desirable in the interests of both parties to make certain alterations, deletions or additions to this Agreement...”* [160].

Given various ways of drafting stabilization clauses, they can generally be grouped into four types [161; 162; 163; 164].

1) Freezing. This type is commonly described as “handcuffs” to the host state to exercise its sovereign rights to change its laws [161, p. 70]. It is regarded as the strictest form of stabilization clause, and under such a clause, the host state agrees to freeze its legislative power pursuant to the contract terms [161, p. 70]. A common approach is “partial” freezing of the contract rather than the “entire” contract [161, p. 70]. In most situations, freezing applies to fiscal elements of the contract. Health, safety, and environmental matters were out of the scope of the freezing [161, p. 70].

2) Prohibition on unilateral changes. This type is commonly known as an “intangibility clause” [161, p. 74]. In contrast to freezing, this clause freezes provisions of the contract at the time of conclusion vis-à-vis further changes in the host state’s law unless the consent of both parties is obtained. Such clauses prevent unilateral changes by the host state [161, p. 74].

3) Rebalancing of benefits. This type addresses the stability of the contract differently, unlike the two above types. It envisages automatic adjustments or renegotiation of contract terms in the event that certain events occur. If the host state adopts a measure that is likely to have damaging consequences for the economic balance of the contract at the time of signing the contract, rebalancing of benefits has to occur [161, p. 75-76].

4) Allocation of burden. This type of clause foresees the allocation of the burden between contract parties due to changes in law affecting negatively the contract. This type of clause can be shaped differently; in most cases, the NOC takes part if not all of the burden-sharing [161, p. 80].

As noted, the history of such stabilization clauses goes back to the first half of the 20<sup>th</sup> century, when such clauses were included in the contracts concluded between the Middle Eastern States and Western IOCs. This pattern was continued by former Soviet Union states such as Azerbaijan, Kazakhstan, Turkmenistan and Russia where such clauses or new variations thereof were included in the petroleum contracts in order to preserve the original contract terms and conditions from any amendments to national law. However, the stabilization clauses in these later petroleum contracts have taken a softer form. For example, the Azerbaijan PSA relating to the Azeri Chirag Gunashli field includes the following economic equilibrium clause:

*“The rights and interests accruing to Contractor (or its assignees) under this Contract and its Sub-contractors under this Contract shall not be amended, modified, or reduced without the prior consent of Contractor. In the event that the Government or other Azerbaijan authority invokes any present or future law, treaty, intergovernmental agreement, decree, or administrative order which contravenes the provisions of this Contract or adversely or positively affects the rights or interests of Contractor hereunder, including, but not limited to, any changes in tax legislation, regulations, administrative practice, or jurisdictional changes pertaining to the Contract Area the terms of this Contract shall be adjusted to re-establish the economic equilibrium of the Parties, and if the rights or interests of Contractor have been adversely affected, then SOCAR shall indemnify the Contractor (and its assignees) for any disbenefit, deterioration in economic circumstances, loss or damages that ensue therefrom. SOCAR shall within the full limits of its authority use its reasonable lawful endeavors to ensure that the Government will take appropriate measures to resolve promptly in accordance with the foregoing principles any conflict or anomaly between such*

*treaty, intergovernmental agreement, law, decree, or administrative order and this Contract” [165].*

The role of the stabilization clause is widely discussed in international arbitration. In particular, some of the early arbitration awards considered the effect of stabilization clauses in light of fundamental principles and doctrines of international law. Stabilization clauses limited the legislative power of the host state. It has led to a confrontation between State sovereignty and the protection of the rights of IOCs.

It should be recognized that stabilization clauses are the strictest form of limitation of the legislative power of the host state. Moreover, a stabilization clause is a contractual mechanism rather than, for example, FET provisions.

In this respect, two early awards are important for consideration, namely *Texaco v. Libya* and *Aminoil v. Kuwait*. The tribunal in the former case came to the decision that “*a nationalization cannot prevail over an internationalized contract, containing stabilization clauses*” [157, para 73]. The tribunal recognized that “*neither the concept of sovereignty nor the nature of the nationalization measures taken against the plaintiffs provides any legal justification for these measures*” [157, para 79]. In the latter case, the tribunal concluded differently that stabilization clauses were not regarded as prohibitions on nationalization [166, paras 94-95]. The Aminoil tribunal came to the conclusion that nationalization was not inconsistent with the concession contract [166, para 102]. The tribunal explained that the stabilization clause “*no longer possess their former absolute character*”; therefore, the purpose of the stabilization clause was not to prohibit nationalization, but rather to prohibit any measures of a confiscatory character [166, para 102]. In a Separate Opinion, arbitrator, Fitzmaurice G. raised a number of interesting observations on this award. In particular, in his view, the purpose of stabilization clauses was not concerned with confiscation at all; rather it is designed to address any measure terminating the concession before its time [167, para 24]. In his opinion, the nationalization of Aminoil’s investment was unlawful and inconsistent with the stabilization clause included in the concession contract [167, para 24].

*UN General Assembly Resolution on sovereignty over natural resources.* Protection of investment in the energy sector has become especially important due to the adoption of UN Resolutions on sovereignty over natural resources. Beginning in the 1950-s, the UN General Assembly adopted four Resolutions on the recognition of sovereignty over natural resources. Namely:

1) Resolution 523 (VI) 12 January 1952 on Integrated economic development and commercial agreements:

*“Considering that under-developed countries have the right to determine freely the use of their natural resources and that they must utilize such resources in order to be in a better position to further realization of their plans of economic development in accordance with their national interests...The General Assembly recommends that ...provided that such commercial agreements shall not contain*

*economic or political conditions violating the sovereign rights of the under-developed countries...* [168].

2) Resolution 626 (VII) 21 December 1952 on Right to exploit freely natural wealth and natural resources:

*“The General Assembly...Recommends all Member States, in the exercise of their right freely to use and exploit their natural wealth and resources wherever deemed desirable by them for their own progress and economic development...”* [169].

3) Resolution 1515 (XV) 15 December 1960 on Concerted action for the economic development of economically less developed countries:

*“The General Assembly ... Recommends further that the sovereign right of every State to dispose of its wealth and its natural resources should be respected in conformity with the rights and duties of States under international law.”* [170].

4) Resolution 1803 (XVII) 14 December 1962 on Permanent sovereignty over natural resources:

*“The General Assembly...Declares that the right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the State concerned.*

*Nationalisation, expropriation or requisitioning shall be based on grounds and reasons of public utility, security or the national interest ...In such cases appropriate compensation in accordance with rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law... However, upon agreement by sovereign States and other parties concerned, settlement of the dispute should be made through arbitration or international adjudication.”* [20].

The common objective of these Resolutions was an explicit recognition of the rights of the host states over natural resources as an inalienable right. The adoption of these Resolutions was not a coincidence but was instead a continuation of decolonization. Decolonization initially provided political independence, while these Resolutions coupled it with economic independence [171]. A decade later the UN General Assembly adopted the Declaration on the Establishment of a New International Economic Order [172]. The Declaration sets out a new principle of relations between developed and developing countries [172]. It also reasserted that *“each State is entitled to exercise effective control over them [its natural resources] and their exploitation with means suitable to its own situation, including the right to nationalization or transfer of ownership to its nationals, this right being an expression of the full permanent sovereignty of the State”* [172, para 4 (e)]. The core of these Resolutions was the abolition of international law rules governing the expropriation and their replacement by domestic rules:

*“To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such*

*measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means”[173].*

Nationalization of petroleum resources and renegotiation of early contracts set the tone for further development of investment protection. Even early energy disputes transformed the nature of investment protection and developed mechanisms and solutions in the sector [174]. In the energy sector, a set of legal rules have been created based on international arbitration practice, international model petroleum contracts, petroleum legislation of host states and business practices. This has led to a creation of a specific regime *lex petrolea* [175; 176]. At present, *lex petrolea* reflects the common law of the international petroleum industry.

*BITs.* The lack of protection under CIL and uncertain foreign investment protection laws of host states have generally led developed States to conclude IIAs with developing States [177]. In the early 1960s, the World Bank and the International Monetary Fund took the lead in addressing the emerging international legal framework for foreign investment, pointing to its mandate and to the link between economic development, international cooperation and the role of private international investment [178]. The treaty regime’s objective was to protect the rights of investors and to establish responsibilities of host states for such protection [179]. To achieve this goal, classic IIAs incorporated standards of treatment such as FET, expropriation, NT, MFN and umbrella clauses. If the host state expropriates an investment, changes applicable to governing laws in relation to foreign investors, restricts the transfer of profits or takes discriminatory measures against a foreign investor, then the foreign investor may bring a claim for compensation of damages or deprived investment. These provisions have binding obligations on host states by constraining their national regulatory sphere [180].

The protection provided under IIAs covers the full investment process, from admission to post-establishment. The host state thus has an obligation to treat foreign investors not less favorably than its own nationals. This goal has been achieved through proper incorporated NT and MFN clauses.

The World Bank initiatives engendered a search for an effective dispute settlement mechanism and this resulted in the adoption of the ICSID Convention between States and Nationals of Other States, establishing the ICSID in 1965. It provided ICSID member state investors with a means of seeking a remedy before an ICSID tribunal.

The classic IIA regime of the last 10 years decade addressed only issues of foreign investment protection. The regime focused on investors’ rights and the responsibilities of host states [181].

Developed countries, as the leading exporters of capital, have driven the creation of this status quo. Their share constituted about 90% of global outward foreign direct investment until the beginning of the 21st century and now stands at around 80% [181, p. 31]. Historical records confirm that early political regimes refused equal legal capacity, rights, and treatment of foreigners in the same way as their own nationals [182]. Consequently, the principal objective of developed States in the creation of the new status quo has been to provide strong investment law protection to the investments of their home companies in host states.

At the same time, IIAs are understood to attract and promote foreign investment by reducing the discrimination and unpredictability of State actions [183]. Therefore, this regime was expected to contribute to the development of the host state's economy through the transfer of capital, technology, and skills.

However, the assumption that IIAs promote investment flow has been subject to analysis in numerous studies [177; 184; 185; 186]. These studies have produced conflicting assessments of the correlation between IIAs and foreign investment flow, thus positive effects of IIAs on the promotion of foreign investment have been thrown into question.

Under the BIT regime, over 3,000 BITs and MITs, including trade-investment partnership agreements have been concluded to date. The majority of current BITs and MITs were negotiated between the 1960 and 1990s based on a narrow investor protection model stemming from the 1962 OECD Draft Convention on the Protection of Foreign Property [179, p.35]. Currently, IIAs play a crucial role in providing protection to foreign investors in host states. In addition to performing this role, IIAs also force host states to make their regulatory framework more transparent, stable, predictable, and secure in relation to foreign investors [187].

### 1.2.2 ECT period

*Political and economic context for the conclusion of the ECT.* The current FET wording in ECT reflects the political and economic circumstances at the time of negotiation of ECT in the 1990s [6, p.1]. Negotiation positions of States affected the final incorporated FET wording. Tribunals took into account the political and economic context of ECT in the interpretation of FET under Article 10 (1) of the ECT. Therefore, it is important to carry out an analysis of these aspects for the dissertation's purpose.

The political context of the negotiation of ECT is manifold and needs to be examined from the differing perspectives of the negotiating states. Negotiations were primarily affected by two main factors: the overall political shifts associated with global energy projections, and the dissolution of the USSR [27, p. 68-69]. The formation of 15 new States in Eastern Europe and Central Asia in place of ex-USSR transformed world geopolitics. Independent Russia and Central Asian countries subsequently formed a regional intergovernmental organization - the CIS for cooperation in economic, political, and

military affairs and coordination of trade, finance, lawmaking, and security. Other former USSR states located in Eastern Europe joined the EU.

The considerable wealth of natural resources that had been controlled by the centralized USSR was partly inherited by newly independent States [188]. The majority of the energy and mineral abundance still lay within the borders of the “new” Russia, which accounted for 90% of the former Soviet Union’s oil output, and large quantities of gold, diamonds, and other metals [189]. After Russia, Ukraine and Kazakhstan, two of the wealthiest states in terms of natural resources, Azerbaijan was a primary service and supply center for the Soviet oil industry [189].

From early Soviet times, O&G reserves of the Caspian Sea attracted the close attention of IOCs. The coastlines of the Caspian Sea are shared by Azerbaijan, Iran, Kazakhstan, Russia and Turkmenistan. In spite of the historical achievements of the Soviet Union in the field of energy production, the energy industry inherited by the newly formed independent states was awash with problems in performance, efficiency, transportation, and utilization [190]. Capital shortages, outdated technology and equipment, rising production costs, and labour strikes also hindered industry development [190, p. 37-38]. Moreover, many energy-rich CIS countries are landlocked, making it difficult to transport energy products from production fields to European consumers. The very sudden dissolution of the Soviet Union had severe effects on the economies of newly-formed states, with a recession, inflation, a shutdown of production, and loss of jobs being the economic inheritance facing newly-formed states [190, p. 37-38]. On the other hand, the attainment of independence gave these States the right to exercise complete control over their own energy resources. Development of energy resources was seen as a viable (if not the only) exit route from disrupted economies towards economic growth, fiscal stability and increased inward investment [190, p.38].

In 1992, over 50% of global oil production and supply was controlled by Saudi Arabia, Iran, Iraq, United Arab Emirates, Kuwait, and Venezuela [27, p. 70]. At the same time, demand for energy continued to increase rapidly with economic and population growth around the world [27, p. 69]. The EU became a major net energy importer [27, p. 69]. The increase in oil prices in 1973 and 1979 initiated by OPEC members, the Gulf Crisis, rising instability in the Middle East after the Iraqi invasion of Kuwait, and intensified conflicts between the government and Islamic fundamentalists in Algeria influenced the changes to energy policies and strategies within the EU [27, p. 69]. Faced with threats to stable energy supplies, investment in the development of new reserves, development of alternative energy options, and energy efficiency and conservation became critical [27, p. 69-70]. Despite an increase in gas production in Norway and the UK, Western Europe’s depended on non-OECD gas imports increased exponentially. For the EU finding solutions was an immediate priority [27, p. 69-70]. In this sense, cooperation between the EU and the mineral wealthy former USSR states was seen as a win-win way of solving the energy supply problem [27, p. 105].

These were the political and economic factors in play at the time of ECT negotiations.

The former Dutch Prime Minister, Lubbers R., proposed forming a “European Energy Community” with Eastern Europe, including the ex-USSR states, at a summit of the European Council in Dublin in June 1990 [191; 192]. This was known as the “Lubbers Plan”. The plan proposed greater economic cooperation in the energy sector between Western and Eastern Europe, including the USSR states. This plan was well received by the ex-USSR states and regarded as a continuation of the USSR’s proposal on all European conferences on energy which had been made in 1977 [192, p. 156].

Hopes and expectations were high. All parties clearly understood the benefits of the new agreement [191, p. 137]. A draft text proposed by the European Commission in February 1991 served as the basis for discussion [193]. The text was submitted for discussion by not only the EU but also other OECD countries, including the US, Canada, Japan, Australia, and New Zealand. After a relatively short-term discussion, the charter was signed, in December 1991 [194]. It was decided to supplement the EEC with the treaty to define general rules for trade and cooperation, with specific protocols, and to conclude these negotiations by June 1992 [191, p. 140]. In the event, the negotiation lasted for three years. Participants described the discussions as difficult; problems were encountered on all sides [191, p. 146]. It was not as easy as it seemed to draw up a legal text that would be acceptable to all [191, p. 146].

Dore J. undertook a detailed analysis of the ECT negotiations [191]. She found that, firstly, there was a conflict between the political and economic interests of the involved parties. For example, the US saw the draft text as paving the way for EU monopolization of ex-USSR mineral resources, but wanted a slice of the cake and to be involved in the text negotiations [191, p. 139-140]. France and Belgium, meanwhile, insisted that only the EU and ex-USSR states should be involved [191, p. 140].

Dore’s second finding was that the legal system of ex-USSR states did not align with the international legal principles, mechanisms, and instruments in trade and investment regulations that had evolved in the Western tradition discussed earlier in this dissertation. Ex-USSR states negotiators had never encountered and simply did not understand what to the EU were basic principles of international trade [191, p. 137, 146]. Transition periods would be needed in some newly formed states [191, p. 145].

Dore further found that intense discussions and disagreements on the substantive investment protection provisions of the ECT existed not just between the broader groupings of what might loosely be termed Western countries and the ex-USSR states, but also between OECD countries and the ex-USSR states, and even within the OECD grouping itself. The US exit from discussions was in part driven by disagreement on investment protection clauses [191, p. 151; 195]. The EU draft terms did not align with US BITs [191, p. 151; 195, p. 199-200]. In this regard, Walde T. one of the participants in ECT negotiations later in a separate opinion for the *Nycomb v. Latvia* tribunal explained that given the haste to ensure the ECT was signed, the controversial issues were separated from the accepted ECT text for parallel negotiations for “Multilateral Agreement on Investment” [196]. However, without success the parallel negotiations were failed, therefore, the current

ECT's text is "*frequently not clear, not fully thought through and not fully consistent*" [196, p. 20].

Finally, Dore noted the difficulty of adopting the finally agreed ECT. National legislation in some countries would have to be changed in order for those countries to be able to adopt and implement the new ECT provisions. These were not simple changes. For example, in Russia, there was a conflict between Parliament and Government. The issue was discussed in *Yukos v. Russia* award. This conflict was mirrored in Kazakhstan. The ECT was ratified by the Decree of the President of the Republic of Kazakhstan based on the powers granted to him by the Parliament of the Republic of Kazakhstan during the parliamentary crisis of 1995-1996 [197]. Therefore, the issue of ratification and the legal status of the ECT remains controversial in Kazakhstan to this day. However, as the ECT was ratified under the extraordinary powers of the President of the Republic of Kazakhstan, its provisions should be binding on the Republic of Kazakhstan.

*Investment protection under the ECT.* The ECT is a multilateral treaty and is described as unique given its sectoral approach [198]. It is frequently characterized as a regional treaty since the main ECT Contracting Parties are EU member states and the CIS [198, p. 117; 199].

The ECT was concluded during the phase of "treatification"<sup>19</sup> of IIL [200]. Treatification was a response to the uncertainties and inadequacies inherent in CIL regarding investment protection [182, p. 41; 200, p. 155-156].

In general, scholars identify five possible drivers behind this treatification rush puzzle: "1) *foreign investment promotion*; 2) *relationship building*; 3) *economic liberalization*; 4) *encouragement of domestic investment*; 5) *improved governance and a strengthened rule of law*" [200, p. 158]. All of these explanations are applicable to the ECT.

Article 2 of the ECT states that the ECT establishes a legal framework for the promotion of long-term cooperation in the energy sector based on complementary and mutual benefits. In this vein, the ECT sets out a rules-based system in which the ECT Contracting Parties look to achieve objectives that they have jointly developed [201].

The ECT includes 8 parts (Part I – Definitions and Purpose; Part II – Commerce; Part III – Investment Promotion and Protection; Part IV – Miscellaneous Provisions; Part V – Dispute Settlement; Part VI – Transitional Provisions; Part VII – Structure and Institutions; Part VIII – Final Provisions), 50 articles, and 19 annexes. Its scope is broad and includes a wide range of economic activities, including trade-in energy, freedom of energy transit, investment promotion and protection, international dispute resolution, and improvement of energy efficiency. Each of these economic activities is covered in discrete part of the ECT.

In particular, Part II titled "Commerce" covers transit, trade-related matters, and the relationship between the ECT and the WTO Agreement. The provisions in this part impose commitments on ECT Contracting Parties to develop an open and competitive market for

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<sup>19</sup> Between the 1990s – and 2000s, approximately 1900 BITs and MITs were concluded. The term "treatification" phase was used by Salacuse J.

energy materials and products, alleviate market distortions and barriers, and facilitate the transit of energy materials and products and the transfer of technology. Further, Article 4 of the ECT identifies the ECT's legal relationship with the WTO Agreement. Note that while this may have seemed logical to Western countries, who were mostly members of the WTO, this was unfamiliar territory for ex-USSR states who were not. Article 4 of the ECT also establishes the principle of a non-derogation from the WTO Agreement. ECT wording provides for the application of the WTO Agreement in two ways: full and partial [202]. The WTO Agreement fully applies when both of the ECT Contracting Parties are WTO members. The WTO Agreements apply within limits specified by Annex W to the ECT when only one of the ECT Contracting Parties is a WTO member or between non-WTO members. In the latter case, the ad hoc trade regime applies under Article 29(2)(a) of the ECT. Annex W of the ECT lists non-applicable provisions of the WTO Agreement.

Part V sets out provisions for the settlement of disputes between an investor and an ECT Contracting Party in Article 26 of the ECT and between ECT Contracting Parties in Article 27 of the ECT. Article 26 of the ECT stipulates the dispute resolution mechanism to be used by an ECT Contracting Party and an investor of another ECT Contracting Party relating to an investment in the former area that concerns an alleged breach of an obligation under Part III. Whereas Article 27 of the ECT offers the opportunity to the ECT Contracting Parties to refer to an ad hoc arbitration on any disputes concerning the application and interpretation of the ECT provisions.

In reality, alignment of the political and economic interests of ECT Contracting Parties was not so easy to achieve. An important point of discussion was energy investment and its sources. Both West and East understood that substantial financial investment would be needed to produce and transport the energy from distant regions of the CIS. This would not be achieved without the involvement of commercial banks, development banks, financial institutions, and the self-financing of O&G companies. Involvement of each of these capital investors was predicated on building solidarity between involved parties, the fair sharing of risks and earnings, and the provision of guarantees of secure markets for producers, and consumers [27, p. 74-75].

For energy companies, two factors were critically important. Firstly, the return on their invested capital, and secondly stable arrangements to protect their long-term investments. On the other hand, the CIS countries were in a period of deregulation, commercialization, and privatization. There were high risks in every CIS country, including political instability, landlocked countries, remoteness of some energy reserves located regions, bureaucratic administration, etc.

The CIS countries and other ex-USSR members had undergone profound changes in social, economic, and political spheres. All were towards the bottom of country risk rankings [203]. The Centre for Cooperation with Economies in Transition<sup>20</sup> together with

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<sup>20</sup> The Centre for Co-operation with the Economies in Transition was created in March 1990, is the focal point for cooperation between the OECD and the Central and Eastern European countries and the Newly Independent States of the former Soviet Union.

Arthur Andersen & Co, surveyed companies in 1992 and 1993 about what actions needed to be taken by the governments of Central and Eastern European countries and the CIS. According to the results, half of the interviewed companies stated that political and economic stability were critical criteria for investors [203, p. 132].

Therefore, the ECT incorporated substantive investment protection standards like any other BIT, save for the fact that the ECT is a sectoral treaty [204]. Thus, the scope of *ratione materiae* of the ECT is limited to investments in the energy sector. Investment protection standards are incorporated in Part III of the ECT. Therefore, the alleged breach of Part III standards shall relate to Investment in the energy sector. Substantive investment protection standards are incorporated in Articles 10, 12, 13, and 14 of the ECT. Many substantive investment protection standards are consolidated in Article 10 of the ECT.

Article 10 of the ECT is a complex provision that includes twelve paragraphs. It comprises FET, most constant protection and security, non-discrimination, umbrella clause, NT and MFN. Article 12 of the ECT sets forth “Compensation for Losses”, Article 13 of the ECT “Expropriation”, and Article 14 of the ECT “Transfers Related to Investments”.

In turn, the ECT offers different options for remedy available to an investor for breaches arising out of Part III standards. These include courts or administrative tribunals of the host state, previously agreed dispute settlement procedures, and international arbitration. In Article 26 of the ECT, “*each Contracting Party gives its unconditional consent to the submission of a dispute to international arbitration*”. This provision builds “arbitration without privity” since the host state need not be a party to any prior arbitral agreement with a specific investor [205; 206]. The ECT does not contain a requirement for the exhaustion of local remedies, and provisions of the ECT seem to take priority over any dispute settlement clauses in investment arrangements [207; 208]. Currently, the ECT is the most alleged and breach found IIA [9].

### 1.2.3 Modern investment protection regime

Both the UNCTAD and the Commonwealth Secretariat have stated that sustainable development is the overriding goal of policy initiatives and drives a need for reform and reconsideration of IIAs [59, p. 3; 60, p. 8-9]. UNCTAD initiatives concerning IIA reform inter alia include: “*pursuit of sustainable development through responsible investment, placing social and environmental goals on the same footing as economic growth and development objectives; promotion of responsible investment as a cornerstone of economic growth and job creation; balanced host state commitments with investor obligations and promotion of responsible investment; the expression of the right to regulate of the host state; incorporation of concrete commitments in IIA to promote and facilitate investment for sustainable development; shielding host states from unjustified liabilities and high procedural costs; determination of the scope of investment, investors, and protection standards*” [59, p. 6].

One of UNCTAD's principal concerns is about unjustified liabilities and the high procedural costs of ISDS and the blurred borderline between investment protection and legitimate domestic policies [59, p. 40]. Along the same lines, the Commonwealth Secretariat study pointed out the evidentially weak link between entering into IIAs and increased foreign investment inflows to the host state [60, p. 7]. IIAs can make it difficult for host states to achieve essential public policy goals, including development goals and protection of environmental, human rights, and labor rights [60, p. 7]. It suggested that IIL should abandon its preoccupation with protecting the rights of investors and more intensely focus on sustainable development instead [209]. This, in turn, led to a reconsideration of the investment protection framework with a particular focus on alignment between the scope of investment protection standards and sustainable development objectives. There is a discussion of whether IIL rules impede climate protection and sustainable development [210; 211]. So far, there is less progress in finding a balance between investment protection and regulatory measures of States aimed at sustainable development.

In light of the shift towards sustainable development, an increasing number of States have revised substantive investment protection provisions in IIAs considering sustainable development-oriented reform elements [209; 212]. UNCTAD presented a Road Map for IIA reform in 2015 which is being implemented in three phases [213]. The Road Map covers areas: safeguarding the right to regulate while providing protection; reforming ISDS; promoting and facilitating investment; ensuring responsible investment; enhancing systemic consistency [213]. In 2015, UNCTAD also presented an Investment Policy Framework for Sustainable Development [214]. This document includes various provisions: *“hortatory language in the preamble of the IIA reserving the sustainable development; clarification of the scope of the substantive protection clauses; limited recourse to ISDS; carve-outs for policy measures in national treatment and most-favoured nation clauses; exclusions from the coverage of investments and exceptions for domestic regulatory measures aimed at pursuing legitimate public policy perspectives; omissions of FET and umbrella clauses”* [214, p. 85].

These provisions for sustainable development, including environmental, public health, and labour rights, have been incorporated into modernized IIAs and Trade Agreements which contain investment provisions in various ways. For example, the preamble of the recent Regional Comprehensive Economic Partnership Agreement recognizes three pillars of sustainable development and reaffirms the right of each party to regulate in pursuit of legitimate public welfare objectives [215]. The preamble of the Italian 2022 Model BIT recognizes that *“the provisions of this Agreement preserve the right of the Parties to regulate within their territories in order to achieve legitimate public policy objectives, such as public health, safety, environment, public morals, financial stability, social or consumer protection, and the promotion and protection of cultural diversity”* [216]. At the same time, the recently presented Canadian Model BIT of 2021 incorporates a separate robust formulation on the right to regulate for sustainable

development. Namely, *“the right of each Party to regulate within its territory to achieve legitimate policy objectives, such as with respect to the protection of the environment and addressing climate change; social or consumer protection; or the promotion and protection of health, safety, rights of indigenous peoples, gender equality and cultural diversity”* [217]. The Dutch 2018 Model BIT incorporates a separate article on sustainable development according to which, inter alia, *“the contracting parties are committed to promoting the development of international investment in such a way as to contribute to the objective of sustainable development”* [218]. Article 2 of this Model BIT incorporates the explicit right to regulate provisions: *“the provisions of this Agreement shall not affect the right of the Contracting Parties to regulate within their territories necessary to achieve legitimate policy objectives such as the protection of public health, safety, environment, public morals, labor rights, animal welfare, social or consumer protection or for prudential financial reasons... [t]he mere fact that a Contracting 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 expectation of profits, is not a breach of an obligation under this Agreement”* [218].

### **Findings and concluding remarks on Chapter 1**

This Chapter was important for this dissertation from two perspectives. Both of them are interrelated. First, Sub-Chapter 1.1 helped with an understanding of the features that cumulatively make the energy sector unique such as actors, stakeholders, nature, risks and its complexity. Developing energy resources to ensure a constant energy supply is vital for all actors and stakeholders in the energy sector. Increasing demands and strategic importance make the energy sector susceptible to a clash of regulatory rights and investment protection. The balance issue between regulatory rights and investment protection truly stems from the role of parties to energy transactions, state sovereignty over energy resources, the complexity of high-risk energy projects, investors’ private interests in profit generation within a safe legal and business environment and State’s public responsibilities to mitigate risks of pollution of the environment and to protect the public health and maintain energy security. Such understanding was a prerequisite for critical evaluation of the causes of the imbalance between regulatory rights and investment protection.

Based on two conducted case studies in this dissertation: Kazakhstan and the EU, it is seen ongoing global energy policy shifts. There are the ECT Contracting Parties’ emerging regulatory rights for sustainable development, such as the transition from traditional fossil fuels into clean-energy sources, environment, labor, and public health concerns. These have brought about changes in the type of regulatory measures adopted by ECT Contracting Parties. Based on international commitments, inter alia, ECT Contracting Parties have changed their energy policy. They have taken measures on the national level to mitigate climate change and foster sustainable development. The more common regulatory risk in the petroleum sector related to expropriating and directly

intervening in the contract rights of the investors has lessened overall, however, the risk of intervention in or expropriation of ownership rights remains in some ex-USSR states whose economies are still in transition. Instead, ECT Contracting Parties have started to implement complex regulatory measures that do not completely undermine investors' business model but rather diminish the expected rate of return. This same trend is expected to continue for the foreseeable future.

Second, sub-Chapter 1.2 analyzed the historical roots of the investment protection in the energy sector according to three periods: pre-ECT, ECT, and modern investment protection. The FET under Article 10 (1) of the ECT is a result of the development of investment protection mechanisms in IIL. IIL developed different investment protection mechanisms and the right to regulate norms before incorporating the FET into IIAs. For example, some delicts of FET, such as denial of justice and due process were one of the first mechanisms for investment protection developed under CIL during the 1900-1940s. Later tribunals considered these protection mechanisms as delicts of the FET. While stabilization obligations incorporated in the first petroleum contracts during the 1930-1970s have been later transplanted to the FET, as a result of an expansive interpretation of the FET. This public/private competition dynamic also underlies the inclusion of substantive investment protection obligations within the ECT, such as FET, but has a specific effect on the energy sector. In this respect, several doctrinal concepts shed light on historical aspects of investment protection in the energy sector.

The conclusion of the ECT as a multilateral treaty was a remarkable achievement in IIA evolution. The ECT was concluded during the "treatification" phase of IIL. The inclusion of investment protection provisions in ECT, for example, the FET, was especially due to the instability in the regulatory environment of ex-USSR states. Such protections were important for EU investors who were going to invest billions of dollars in the petroleum sector of the CIS.

Earlier IIAs, including ECT, however, mainly focused on investment protection. It made it difficult for host states to achieve essential public policy goals, including development goals and protection of environmental, human rights, and labor rights. In this vein, there is an emerging modern treaty regime balancing the host state and investor interests. It suggested that IIL should abandon its preoccupation role on investment protection and reserve a regulatory space for States' sustainable development and essential public policy goals.

## 2. THE ISSUE OF BALANCE BETWEEN INVESTMENT PROTECTION AND REGULATORY RIGHTS IN THE APPLICATION OF FAIR AND EQUITABLE TREATMENT UNDER THE ENERGY CHARTER TREATY

### 2.1 The issues of FET in IIL

#### 2.1.1 Ambiguous FET in IIL sources

FET is currently a widely incorporated treaty clause and few IIAs in force do not contain the FET. Widespread inclusion of FET in IIAs occurred after the 1960s. There is, though, no consensus about the origin of the literal wording of FET in IIAs. The majority view is that the use of the phrase “fair and equitable treatment” first appeared in the 1948 Havana Charter [199; 219; 220; 221]. The charter text contains one of the functions of the ITO, i.e., “*to make recommendations for and promote bilateral or multilateral agreements on measures designed to assure just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one Member country to another*” [222, art 11.2 (a)]. However, Weiler T. is of the opinion that “just and equitable” in the Havana Charter did not establish a substantive investment treatment standard [223]. Weiler T. refers to a commercial treaty<sup>21</sup> between the US and Ethiopia in 1951 as the first use of a substantive FET [223, p. 213]. Later, FET started to appear in the FCNs of the USA with Ireland, Greece, Israel, Nicaragua, France, Pakistan, Belgium, and Luxembourg [199, p.111]. In these FCNs, FET is found in the wording “equitable treatment”. Other FCNs between the USA and Germany, the Netherlands, Muscat, and Oman included the wording “fair and equitable treatment” [199, p.111]. From 1960 onwards, therefore, FET has been widely found in the text of BITs in different formulations. The incorporation of the FET in IIAs is associated with uncertainty around the MST and was intended to address this [223, p. 183]. However, as practice demonstrates, vague FET wording without full definition actually served to exacerbate this uncertainty. An unacceptable degree of vagueness about the real meaning of FET led to the expansion of the application of FET to various host state measures [3, p. 868].

The origin of this obscure wording of FET possibly may have derived in the US from the justiciability clauses of 18<sup>th</sup>, 19<sup>th</sup> and 20<sup>th</sup>-century commercial and mixed claims treaty practice [223, p. 190]. Possibly the earliest example of FET wording can be found in Article 9 of the 1674 Treaty of Westminster that stated: “*...and since it is on the mutual and undisturbed freedom of commerce and navigation that not only the wealth also the piece of both nations in the highest degree depends, nothing should be of more concern to both parties than a just and equitable regulation of trade, especially in the East Indies*” [224]. Many other examples of justiciability clauses followed the Treaty of Westminster [225; 226]. Common wordings used in these justiciability clauses are “justice, equity, the

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<sup>21</sup> Article VIII (1) of Treaty of Amity and Economic Relations (Ethiopia – U.S.) 7 September 1951 provides: “*Each High Contracting Party shall at all times accord fair and equitable treatment to nationals and companies of the other High Contracting Party, and to their property and enterprises; shall refrain from applying unreasonable or discriminatory measures that would impair their legally acquired rights and interests; and shall assure that their lawful contractual rights are afforded effective means of enforcement, in conformity with the applicable laws*”.

law of Nations” [223, p. 184]. These justiciability clauses were drafted as broadly as possible to give commissioners a wide ambit of discretion to make decisions in case of disputes [223, p. 184]. Wilson R. explains that in treaties of that time, the US employed open-ended wordings such as justice, equity, and the law of nations so as not to bind arbitrators by a narrow set of rules [227, p. 46-48]. Weiler T. also notes that the language of justiciability clauses envisages a fail-safe mechanism, which assures the justiciability of any claim in a future dispute [223, p. 190]. This approach was continued by Western drafters during the 20<sup>th</sup> century.

FET wording in the investment protection context can be traced in State Department documents and FCN treaties after World War II. With the election of President Truman H. in 1945, the US initiated a new foreign policy. This treated foreign investment as a means of promoting “fundamental freedoms” as well as prosperity and international security [228]. One of the first steps in this direction was the establishment of ITO and creation of the Executive Committee on Economic Foreign Policy. The report prepared by this organization suggested that the US should facilitate and encourage outward foreign investment flows [229]. Further, the report noted that such private investment should be facilitated in line with the principle of “fair and non-discriminatory treatment” to foreign investment. Also, the US Foreign Investment Policy Committee employed “just and equitable treatment” in the draft investment policy [228]. At the time the State Department was using the wording “just and equitable treatment” and “fair and equitable treatment” as general descriptors of the type of investment climate that it sought [228, p. 205]. The phrase “equitable treatment” was a way of describing the overall investment climate that should exist [228, p. 205]. During the subsequent negotiation of ITO provisions, the US also proposed “just and equitable treatment” of investment [228, p. 205].

At first, in FCNs, the wording “fair and equitable treatment” was used concerning specific activities, including the imposition of exchange controls and purchases by state companies. For example, Article XX of the US-China FCN states: “[i]f the Government of either High Contracting Party establishes or maintains a monopoly or public agency for the importation, exportation, purchase, sale, distribution or production of any article, or grants exclusive privileges to any agency to import, export, purchase, sell, distribute or produce any article, such monopoly or agency shall accord to the commerce of the other High Contracting Party fair and equitable treatment in respect of its purchases of articles the growth, produce or manufacture of foreign countries and its sales of articles destined for foreign countries” [231].

Moreover, Vandeveld K. notes that the emergence of “fair and equitable” wording in IIAs resulted from the reconceptualization of FCNs as IIAs [228, p. 189]. This reconceptualization was advanced by the foreign policy of President Truman H. after 1949. President Truman’s foreign policy, the so-called “Fair Deal”, proposed a new approach to the flow of investment to developing States. President Truman emphasized in his Inaugural Address: “[s]uch new economic developments must be devised and controlled to benefit the peoples of the areas in which they are established. Guarantees to

*the investors must be balanced by guarantees in the interest of the people whose resources and whose labor go into these developments. The old imperialism— exploitation for foreign profit— has no place in our plans. What we envisage is a program of development based on the concepts of democratic fair-dealing”* [232]. In this way, Truman’s foreign policy aimed to bring economic development to the entire world through technical assistance and private investment [233]. However, Russian commentators think otherwise. For example, Shenin S. noted that Truman’s policy stimulates private investment by implementation of neo-colonialism rather than meaningful technical assistance [234].

Pursuant to Truman’s policy, the State Department decided that the FCN treaty would serve as the BIT and in a short time reconstructed FCN treaties as treaties intended to promote foreign investment [228, p.191]. John Parke Young’s Committee on Foreign Investment Policy and NAC were directly involved in FCN treaties. In June 1949 the Committee advised that the drafting of a treaty shall be under five main headings: equitable treatment, reasonable freedom to operate and manage an enterprise, compensation for expropriation, withdrawal of funds, and taxation [235]. In terms of equitable treatment, the NAC outlined that “[US] investors shall be accorded non-discriminatory treatment” [236]. It further explained that this would mean that US investors would receive NT and MFN treatment [236]. Further, the NAC stated that equitable treatment provisions by “[US] investors shall at all times be accorded non-discriminatory, reasonable, fair and equitable treatment” [236]. Vandeveld K. suggested that the wording of equitable treatment in the NAC report embraces a set of principles that contained non-discrimination and reasonableness [228, p.191].

In 1948, FET was also incorporated in the draft of the Economic Agreement of Bogota between the South, North, and Central American States. Literally, Article 22 states “[f]oreign capital shall receive equitable treatment...” [237]. Furthermore, the concept of FET can be found in the 1959 Draft Convention on Investments Abroad (the Abs-Shawcross Convention) and the 1967 OECD Draft Convention on the Protection of Foreign Property. In both of these, the FET formulation simply requires that “each party shall at all times ensure fair and equitable treatment to the property of the nationals of the other parties...” [238; 239]. Further, FET was included in every IIA and has become one of the core investment protection standards sought by capital-exporting countries [199, p. 117]. The wording of FET is not uniform and varies treaty by treaty. Variations in precise wording may be grouped as (1) unqualified FET; (2) FET linked to international law; (3) FET linked to the minimum standard under customary international law; (4) FET with additional substantial content; (5) enunciation of FET in conjunction with notions of arbitrariness and discrimination; and (6) enunciation of FET with full protection and security provision [240; 241].

However, IIAs themselves do not provide a precise definition of FET wording. IIAs incorporate FET, except for some modern IIAs, but are usually silent about what constitutes a FET breach and are devoid of practical guidance on how to apply the

provision. It seems that FET was included in IIAs in a “copy and paste” from treaty to treaty. One may even question whether FET is a single standard or two separate standards. Treaty drafters left FET wording open to interpretation by arbitration tribunals in case of a dispute.

A number of academics have observed the vague normative content of FET and doctrinal concept in IIAs. Salacuse J. well described the open wording of FET in the way that “*the term is... without exaggeration, maddeningly vague, frustratingly general and treacherously elastic*” [132, p.294]. Dolzer R. observed that the open-ended language of FET “*gives rise to speculation which assumes that, if only properly argued, it will be possible to identify one or more aspects, individually or combined, which may amount to an act of violation*” [221, p.87-88]. Vasciannie S. has observed this, indicating that FET wording expects that definition of the standard “*will develop through the independent third-party determination of disputes*” [199, p.100]. Klager R. has viewed that FET “*represents a general clause, i.e., an open-textured clause phrased in especially broad terms, the search for an intrinsic literal meaning of its terms is naturally foredoomed*” [242, p. 42]. Muchlinski P. sees that in the interpretation of FET, a general point should be “*an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures being taken against its interests*”, therefore, FET interpretation depends on the interpretation of specific facts for its content [243, p.625]. Schreuer C. regarded FET as “*a legal concept that is susceptible to interpretation and application by a tribunal without an authorization by the parties to go beyond the law and to apply equitable principles*” [244, p.365]. Salacuse J. noted if we apply Hans Kelsen’s concept from his Pure Theory of Law (1934) FET seems “*as the grundnorm or basic norm of the investment treaty system*” [132, p. 291]. Sornarajah M. observed that FET is “*a law of recent vintage*” that was largely created through the interpretations of arbitral tribunals [245, p. 247]. Sornarajah M. highlighted the incorporation of legitimate expectations as a glaring example of “*expansionary activism*” of the FET scope [245, p. 247]. Tudor I. posited the view that the FET as a “standard” is an “*evaluation tool of the conformity of national law to international law*” [240, p. 437]. Therefore, as a standard it could have characteristics such as “*broad behavioural direction or; an indeterminate concept; a large margin of manoeuvre left to the arbitrator/judge and a very flexible character, which allows it to adapt to a variety of circumstances; a link between law and society; the reference point of which is average social conduct; a reference to the conformity national law/international law*” [240, p. 115]. In this way, she came to the conclusion that “*the vague and abstract notion of the FET becomes concrete and it is arbitrator who-in the case of FET – breathes life into the standard*” [240, p. 132]. Klager R. elaborated on the view that the construction of the FET shall be a treaty obligation [242, p. 319]. He posits that it gives certainty for States since the investment treaty norms as conventional norms represent a *lex specialis* and take precedence over arguments derived from the more general norm [242, p. 103]. Another approach to understanding the nature of FET is a rule of law. Vandeveld K. has elucidated this view by referring to

individual BIT provisions being regarded as a reflection of the rule of law [219, p. 53]. He explained his view that BIT places obligations on the states to respect the rights of foreign investors and therefore the rule of law [219, p. 53]. Schill S. has relied on a comparative public law approach to conceptualize the FET as a part of the rule of law [246, p. 154]. For this purpose, Schill S. has proposed to implement the approaches of the jurisprudence of the ECtHR and domestic law in the interpretation of the FET [246, p. 175]. It is clear that Vandevelde K. and Schill S. have attempted to facilitate the interpretation of the FET and conceptualize the FET theory [6, p.2; 219; 246]. However, linking the FET to the rule of law appears to have not yet found a solid basis and it is still at an immature stage [6, p.2]. Because there is no single approach to understanding the rule of law and what the rule of law requires. The rule of law is itself a heavily contested topic in international law [247].

Moreover, Diehl A. and Tudor I. held a standpoint that FET has effectively become a part of CIL [240, p. 53-84; 248, p. 10–11, 125–153, 175–179]. Some tribunals have supported this standpoint which considers that BIT has transformed the FET into CIL [249, para 62; 250, para 125; 251, para 210]. Diehl A. argues that FET should also be acknowledged as a GPL [248, p. 10-11, 125-153, 175-179]. Vasciannie K. and Sornarajah M. opposed this view and posited that FET has not passed the CIL threshold [245, p. 250; 199, p. 70]. The reason for this is the absence of a consensus between developed and developing countries in relation to FET [199, p. 102]. In its early stages, BIT practice was mostly advocated by developed countries as a means of obtaining greater protection for their companies. Accordingly, the contents of BITs were mostly determined by developed countries and the development of FET as a *lex specialis* rule was created by BITs [199, p. 160]. Importantly, CIL cannot be established by decisions of international tribunals, as they are not responsible for State practice [252; 253; 254]. Still, the increase in FET disputes in ISDS has led to a revision of BIT and ISDS practice. The ISDS crisis has called into question the nature of FET and increased questions about its application. Tribunals are hesitant to discuss the CIL nature of FET outside the discussion of MST under CIL [6, p. 2]. Hence, there is still no apparent agreement in arbitration practice [6, p. 2]. Some earlier IIAs include in FET norms the explicit reference to “international law”, and “principles of international law”. For example, NAFTA and France-Mexico BIT [255, article 4 (1); 256, article 1105]. Scholars and tribunals referred to MST in the interpretation of the reference to the principles of international law [242, p. 18].

Therefore, the discussed various theories do not shed light on the origin and meaning of the FET, and some of them rather confuse the understanding of the FET and lead to the expansion of the FET meaning. Based on the arbitral practice and academic study, an UNCTAD study attempted to capture the essence of FET. UNCTAD identified five elements of FET such as: “1) *prohibition of manifest arbitrariness in decision-making, that is, measures taken purely on the basis of prejudice or bias without a legitimate purpose or rational explanation; 2) Prohibition of the denial of justice and disregard of the fundamental principles of due process; 3) Prohibition of targeted discrimination on*

*manifestly wrongful grounds, such as gender, race or religious belief; 4) Prohibition of abusive treatment of investors, including coercion, duress and harassment; 5) Protection of the legitimate expectations of investors arising from a government's specific representations or investment inducing measures, although balanced with the host State's right to regulate in the public interest"* [241, p. 16]. Again here, this means that the content of FET is largely developed through arbitral tribunals.

It was only in modern trade agreements which included investment provisions the first steps towards a definition of FET were taken. One example is CETA. CETA FET provisions incorporate: *"1) denial of justice in criminal, civil or administrative proceedings; 2) fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings; 3) manifest arbitrariness; 4) targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief; 5) abusive treatment of investors, such as coercion, duress, and harassment"* [257, art. 8.10]. Whereas, the 2012 US Model BIT defined FET *"an obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world"* [258, article 5].

### 2.1.2 Undetermined FET in arbitral practice

FET has been a central point of several arbitration decisions under different IIAs. Various FET interpretations have been applied by tribunals. To date, there is no coherence in arbitration practice regarding the original meaning and scope of FET and the purpose of its incorporation in BITs.

Several tribunals have attempted to interpret the ordinary meaning of FET in accordance with "the ordinary meaning" interpretation based on Article 31 (1) of the VCLT. Article 31 (1) of the VCLT sets out that *"a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose"*. The *Saluka v. Czech Republic* tribunal stressed that the ordinary meaning of FET *"can only be defined by terms of almost equal vagueness"* [259, para 297]. The *MTD v. Chile* tribunal observed that FET in its ordinary meaning means "just", "even-handed", "unbiased", and "legitimate" [260, para 113]. The tribunals could not add any clarification to the definition of FET through the ordinary meaning approach. Instead, tribunals have recognized the flexible nature of FET and its adaptation to the circumstances of each case.

Tribunals did not succeed in interpreting the FET based on Article 32 of the VCLT *"supplementary means of interpretation, including the preparatory work of the treaty and circumstances of its conclusion applying to confirm an interpretation reached under Article 31 or where the interpretation according to Article 31 (a) leaves the meaning ambiguous or obscure, or (b) leads to a result which is manifestly absurd or unreasonable"* because *travaux préparatoires* of IIAs is silent on the meaning of the FET [19, art. 32]. In the *MTD v. Chile* case, Schwebel S. observed that *"the meaning of what*

*is fair and equitable is defined when that standard is applied to a set of specific facts*” [260, para 109]. The tribunal in *Waste Management v. Mexico* case rightly noted that “*the standard is to some extent a flexible one which must be adapted to the circumstances of each case*” [261, para 99]. Therefore, FET content has been developed case-by-case, and awards have created a body of FET jurisprudence [245, p. 252]. Arbitral awards can be compiled into two groups. One group of awards linked FET to MST. The second group of awards developed their own practice of FET beyond MST. This dissertation will discuss these two groups of awards successively.

The first group of awards developed mainly under North American arbitration cases. In particular, the US and Canada IIAs incorporate FET wording linked to MST. This approach has had strong backing from the US and Canada and was well established in the NAFTA practice. Early awards such as *Metaclad v. Mexico*, *S.D. Myers v. Canada*, *Mondev v. the US*, *Loewen v. the US*, *ADF v. the US*, *Methanex v. the US*, and *Pope & Talbot v Canada* have well-illustrated this point, but it is noted that they are not unanimous about the limitation of FET to MST.

In one of the earliest awards, *Metaclad v. Mexico*, the tribunal interpreted FET wording in Article 1105 (1) of NAFTA separate from the introductory phrase “*in accordance with international law*”; therefore, went beyond MST. The tribunal found that the absence of transparency in the regulation applicable to the operation of a hazardous waste landfill violates the FET under Article 1105 (1) of NAFTA [262, para 74]. The tribunal relied on NAFTA’s objective in the interpretation of FET, in particular, the provision of transparency [262, para 76]. On the other hand, in *S.D. Myers v. Canada* case, the arbitral tribunal was cautious and limited the FET to MST. In this case, the tribunal noted that the phrases “*...[FET] and ...full protection and security... cannot be read in isolation. They must be read in conjunction with the introductory phrase treatment in accordance with international law*” [263, para 264]. The *Pope & Talbot v. Canada* award concerning violation of FET due to the allocation quotas for softwood lumber found that the FET phrase in Article 1105 (1) of NAFTA required a higher standard than MST [249, para 110]. On the contrary, the NAFTA Commission released an Interpretation Note on 31 July 2001 and stated that FET does not require treatment in addition to or beyond that which is required by MST [264]. In support of this, the *Waste Management II v. Mexico* tribunal observed that “*the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process*” [261, para 98]. To a certain extent, *Waste Management II v. Mexico* award was a point of departure for other awards such as *Methanex v. the US*, *GAMI v. Mexico*, and *Glamis Gold v. the US* in the interpretation of FET under 1105 of NAFTA [265, para 12; 266, para 95-97; 267, para 559]. NAFTA awards demonstrate that

Contracting States attempted to limit FET to MST, while investors sought to expand FET beyond MST. In the *Glamis v. US* case, the claimant challenged the US' argument by explaining that “*there is no rule that fair and equitable treatment be defined solely by customary international law, rather than the “normal sources of international law”*” [267, para 550]. At the same time, the scope of MST itself has always been uncertain (see Chapter 1 of this dissertation which elucidated the development and scope of MST). Traditionally, MST scope includes denial of justice and due process. Though, in the *ADF Group v. the US* case, the US recognized that the CIL referred to in Article 1105 (1) of NAFTA is not “*frozen in time*” and that MST does evolve [268, para 179]. In this respect, MST scope expanded in line with a wide range of circumstances and disputes. It is clear that the difference between MST and autonomous FET lies in the level of protection offered rather than in the content inasmuch as delicts of MST and autonomous FET overlap.

The second group of arbitral awards interpreted FET in addition to or beyond MST. When tribunals realized that there is no way to interpret FET in terms of ordinary meaning, they developed a set of delicts of FET through arbitral practice. In the application of FET, the delicts most referred to by arbitral tribunals may include those: (a) arbitrary, discriminatory, unreasonable actions of the host state in relation to the investor, including a failure to act in good faith; (b) denial of justice and due process, including a failure to act transparently; (c) a failure to protect the legitimate expectations of the investor; (d) failure to provide stability and predictability in the regulatory framework. Tribunals developed a kind of “catch-all” clause that embraces a wide range of circumstances. These delicts are not exhaustive, but rather expansive and vague. These delicts are discussed below one by one.

*Arbitrary, unreasonable, discriminatory conduct.* The plain meaning of the FET shows that if there are arbitrary, discriminatory, or unreasonable grounds for the regulatory measure or treatment, then the FET has been violated [132, p. 316]. The terms “fairness” and “arbitrariness” are obviously mutually exclusive concepts; similarly, the terms “equitable” and “discriminatory” have mutually exclusive meanings [223, p. 295]. Historically, these standards were incorporated into the first FCNs and BITs at the same time as the FET [269, p. 818]. Some earlier IIAs, including the current ECT, include arbitrary or unreasonable measures as a separate delict beyond the FET [18, article 10 (1); 270, article II (2) (b)]. Even in the absence of explicit provisions, arbitrary or unreasonable measures are often regarded as part of the delicts of the FET [271; 272]. Recent IIAs often contain prohibition of arbitrary or unreasonable measures as a separate delict of the FET [257, article 8.10; 217, article 8; 216, article 4].

Arbitration practice generally confirms that these three standards could be a priori delicts of the FET. For instance, the *CMS v. Argentina* tribunal noted that “*any measure that might involve arbitrariness or discrimination is in itself contrary to the fair and equitable treatment*” [274, para 290]. The *Saluka v. the Czech Republic* tribunal overruled to distinguish between the FET and reasonableness and held that “*the standard of*

*'reasonableness' has no different meaning in this context than in the context of the 'fair and equitable treatment' standard with which it is associated, and the same is true with regard to the standard of 'non-discrimination' [259, para 460]. While the Alpha Projektholding v. Ukraine tribunal held that "in certain cases, discriminatory treatment may give rise to a violation of fair and equitable treatment, in most cases discriminatory government measures are more properly judged against the requirements of national treatment and most-favored nation treatment" [274, para 419]. Therefore, it is difficult to ignore the similarities between "arbitrary, discriminatory and unreasonable measures" and FET [132<sup>22</sup>, p. 293].*

Yet the meaning of these broad concepts has been mainly developed by arbitral tribunals and the terms are *"inherently malleable, and therefore susceptible of being appropriated as mere ciphers for subjective and idiosyncratic arbitral decision-making"* [223, p. 294].

Since the definition of arbitrary, discriminatory, and unreasonable treatment is missing in the text of IIAs, tribunals usually find difficulty in interpreting these terms. In several cases, the ELSI (ICJ) judgment was taken as the point of departure [275, para 131; 276, para 146]. The Court observed that *"arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law... [i]t is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety"* [277, para 128]. In the *Tecmed v. Mexico* award, the tribunal observed that *"...the foreign investor also expects the host State to act consistently, i.e., without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities"* [278, para 154].

Arbitrary treatment is usually considered in conjunction with discriminatory treatment. In the *LG&E v. Argentina* case, the tribunal analyzed whether the measures taken by Argentina in relation to a gas-distribution investor during a financial crisis were arbitrary and discriminatory. The tribunal referred to the ELSI judgment and stated that in order to establish when a measure is discriminatory, there must be *"(a) an intentional treatment (b) in favor of a national (c) against a foreign investor, and (d) that is not taken under similar circumstances against another national"* [276, para 146]. Confusion about discriminatory treatment arises from the overlap in the scope of MFN and NT. To this point, it should be stated that arbitrary and discriminatory elements may overlap with MFN and NT, but it does not mean that MFN and NT are part of FET [198, p. 133]. FET inherently precludes arbitrary and discriminatory measures against the host state [199, para 133].

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<sup>22</sup> Salacuse J. posited that *"the fair and equitable treatment also prevents discrimination against the beneficiary when the discrimination would amount to unfairness or inequity under the circumstances... A foreign investor might believe that even if a state promises protection under national and MFN treatment standards that level of protection is insufficient because nationals and investors from the MFN are themselves receiving inadequate protection. In such cases, the fair and equitable treatment standard in theory helps to ensure that the investor will receive a minimum level of protection based on notions of fairness and equity"* [132, p. 293].

Interpretation of unreasonable measures has been a continuing discussion point in ECT awards. The *AES Summit v. Hungary* tribunal observed that in order to assess whether the host state's action was unreasonable there should be two elements: “*the existence of a rational policy and the reasonableness of the act of the State in relation to the policy*” [279, para 10.3.7]. The existence of a rational policy is not enough, but also the challenged measure shall be reasonable [279, para 10.3.8].

Often in practice tribunals linked arbitrary conduct to bad faith or a failure to act in good faith. The whole idea of this element derives from the fact that the obligation between the host state and the investor has to be executed in good faith. Good faith is a broad concept and has been a subject of discussion from numerous different perspectives [280; 281]. In terms of IIAs, arbitral tribunals have concluded that bad faith would be a sub-delict of FET rather than an essential delict. The *Tecmed v. Mexico* tribunal found that “*the commitment of fair and equitable treatment .... is an expression and part of the bona fide principle recognized in international law, although bad faith from the State is not required for its violation*” [278, para 153]. In the *ADF v. the US* case, the tribunal noted that “*an assertion of breach of customary law duty of good faith adds only negligible assistance in the task of determining of giving content to a standard of a fair and equitable treatment*” [268, para 191]. The *Mondev v. the US* tribunal concluded that “*a state may treat foreign investment unfairly and inequitably without necessarily acting in bad faith*” [250, para 191].

*Denial of justice and due process.* Chapter 1 of this dissertation analyzed the historical development of denial of justice and due process. These investment protection mechanisms stand in the origin and development of MST. Later tribunals considered these protection mechanisms as delicts of FET.

Recent IIAs demonstrate that states unanimously and consistently incorporate the denial of justice and due process into the FET scope of the IIAs regardless of the EU and North American approaches [257, article 8.10; 218, article 9; 216, article 4; 217, article 8; 282, article 4]. For example, US 2012 Model BIT specifies that FET includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings by the principle of due process embodied in the principal legal systems of the world [258, article 5]. FET provisions of CETA also incorporate denial of justice in criminal, civil, or administrative proceedings, a fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings [257, article 8.10].

There is no doubt that both of them are fundamental concepts in legal systems and the most venerable international wrongs occupying the core of the FET [283; 269, p. 379]. In the context of FET, these two elements are linked to “procedural fairness”. The failure to respect “procedural fairness” by the host state could be considered as a denial of justice [132, p. 320].

The definition of the denial of justice is understood from broad, narrow, and intermediate meanings<sup>23</sup> [284]. Most of IIAs incorporate the intermediate meaning of the denial of justice which includes improper administration of criminal, civil, or administrative justice, including denial of access to courts, inadequate procedures, and unjust decisions. The intermediate meaning of the denial of justice includes both procedural and substantive forms [284, p. 670; 285, para 352; 286, para 431,442]. Both could be committed by any of the three branches of government [284, p. 670]. Relevant arbitration practice on the procedural denial of justice relates to access to the courts, undue delays, fair procedure, and the right to be heard in judicial or administrative proceedings [287]. Substantive denial of justice relates to “gross defects” in the substance of the court judgment, including misapplication of national law [284, p. 670; 288].

For example, in the *Loewen v. US* case, the tribunal considered a situation where the host state failed to provide adequate remedies and procedures before the court [275, para 96]. In the *Metaclad v. Mexico* case, the tribunal qualified the actions of the Municipal Town Council of Mexico on the improper provision of notice and invitation that further brought to the refusal of a construction permit as a breach of FET [262, paras 91-97]. In the *Middle East Cement v. Egypt* case, the tribunal considered the situation concerning the seizure and auction of a ship, without prior notice to the owner, as a FET breach under the Egypt and Greece BIT [289, para 143].

The procedural fairness or due process was broadened further by tribunals and as a result, this delict was complemented by the obligation to provide transparency in the administrative regulation of the host state.

For example, the transparency delict was a core subject of discussion in the *Metaclad v. Mexico* award. The tribunal referring to Article 102 (1) of NAFTA observed that:

*“[...] the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters. Once the authorities of the central government of any Party (whose international responsibility in such matters has been identified in the preceding section) become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws”* [262, para 76].

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<sup>23</sup>OECD provides definition of denial of justice from three senses: broad, narrow and intermediate. “*In the broadest sense it ‘seems to embrace the whole field of State responsibility, and has been applied to all types of wrongful conduct on the part of the State towards aliens’ it includes therefore acts or omissions of the authorities of any of the three branches of government, i.e., executive, legislative or judiciary. In the narrowest sense, it is ‘limited to refusal of a State to grant an alien access to its courts or a failure of a court to pronounce a judgment. There is also an intermediary sense, in which it is ‘employed in connection with the improper administration of civil and criminal justice as regards an alien, including denial of access to courts, inadequate procedures, and unjust decisions. The majority of the cases examined approach fair and equitable treatment in the intermediate sense and many also address in their analysis the concept of arbitrariness’* [284].

In the *Maffezini v. Spain* award tribunal found: “...the lack of transparency with which this loan transaction was conducted is incompatible with Spain’s commitment to ensure the investor a fair and equitable treatment in accordance with Article 4(1) of the same treaty” [290, para 83].

In disputes, transparency delict was limited to the transparency of rules and regulations and their availability to investors. The *Tecmed v. Mexico* award expanded the scope and added: “[...]so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations” [278, para 154]. The *GAMI v. Mexico* award also discussed the policy parameters of Mexico in terms of transparency [266, para 108-110].

Scholars also recognize that the failure of the host state to act transparently may violate FET. For example, Salacuse J. observed that transparency is regarded as an essential element of general good governance, and is important to investors [132, p. 313]. Dolzer R. provided a logical explanation observing that it is difficult to deem a non-transparent decision fair and equitable [221, p. 92].

The FET transparency concept is widely discussed in the ECT framework. The first sentence of Article 10 (1) of the ECT contains “[...] create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area” [18]. Drafters of the ECT explicitly indicated the importance of transparency in investment protection. It will be discussed in detail in the next sub-Chapter of the dissertation paper.

*Frustration of the legitimate expectations.* The frustration of legitimate expectations of the investor is one of the most controversial and widely discussed FET delicts in arbitration practice. From the beginning of this century, investors frequently started challenging the actions of the host states based on the frustration of legitimate expectations in the framework of FET. Tribunals have not reversed, but rather qualified legitimate expectations as a delict of FET. Prior to the rise of FET, the concept of legitimate expectations was considered in expropriation claims and can be found in EU and US national laws [132, p. 305-306; 291; 240, p. 164]. In terms of FET claims, the main idea of legitimate expectations is that the host state could not significantly frustrate or cancel the legitimate expectations of the investor, which are created in the investor's mind through its laws, regulations, and actions. Early tribunals viewed the concept of the frustration of legitimate expectations in the FET scope as follows:

The *Tecmed v. Mexico* tribunal considered that:

“[...]in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment [...]” [278, para 154].

The *CME v. Czech Republic* tribunal decided that:

“... breached its obligation of fair and equitable treatment by the evisceration of the arrangements in reliance upon which the foreign investor was induced to invest” [292, para 611].

The *Waste Management v. Mexico* tribunal observed:

“[...] In applying this standard [the fair and equitable treatment] it is relevant that the treatment is in breach of representations made by the host state which were reasonably relied on by the claimant” [261, para 98].

The *Saluka v. Czech Republic* tribunal stated:

“The standard of fair and equitable treatment is therefore closely tied to the notion of legitimate expectations, which is the dominant element of that standard [...]” [259, para 302].

The *Thunderbird v. Mexico* tribunal considered:

“[...] the concept of “legitimate expectations” relates, within the context of the NAFTA framework, to a situation where a Contracting Party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honor those expectations could cause the investor (or investment) to suffer damages” [293, para 147].

In each case, the tribunal first evaluated the investor's expectations to see whether the expectations were legitimate and reasonable, and practice developed limitations in this respect. Protecting legitimate expectations has been a core discussion point within ECT awards (the dissertation will discuss this in detail in this Chapter).

As a matter of background, not only in ECT but generally under other IIAs the main problem with awards relying on the concept of legitimate expectations is a lack of analysis and a lack of clarity on the origin of this concept as a delict of FET [294].

Currently, there are two main doctrinal approaches to understanding the concept of legitimate expectations in IIL. Namely, first, from the perspective of a principle of law in domestic legal systems and second, as a GPL, through the expression of good faith [287, p. 208; 295; 296; 297].

On the first approach, academics generally agree that the concept of legitimate expectations is not a creation of international law but stems from a variety of domestic legal systems [294, p. 94-95<sup>24</sup>; 287, p. 208; 298].

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<sup>24</sup> Potesta M. made a comparative analysis of different jurisdictions. He came to the conclusion that it may be difficult to provide a clear-cut answer to the question “has legitimate expectations achieved global recognition in domestic law systems”. He found the following “in German law, protection of legitimate expectations is linked to the fundamental principle of *Vertrauensschutz* (protection of trust), and its scope is particularly wide-reaching. The German position has likely influenced the development of the principle in EU law, where it is considered a general principle of EU law. Despite the clear recognition of the doctrine as a general principle of EU law, the situation is not completely uniform in the domestic legal systems of the EU Member States. In France, the principle has not gained acceptance as part of French administrative law (except in situations which fall within the scope of EU law) ...Traditionally, English law provided only procedural protection of expectations. The development of substantive protection of expectations under English law has been slow and difficult...judges have held that its operation remains confined to “exceptional situations”. The reason for this is that courts are generally cautious in assuming a role through their judicial review which belongs to the administrative decision-maker. Doctrines such as not-fettering, separation of powers and deference towards the administration’s balancing of individual and public interests

On the second approach, the concept is mainly substantiated by arbitral decisions. Without any strong basis for its application, since *Tecmed v. Mexico* award<sup>25</sup>, tribunals have widely applied the concept as one of the delicts of the FET [278, para 154; 293, para 147-148]. Indeed, from the perspective of a public international law perspective, it is difficult to substantiate this concept which seems to “*have been plucked from the air*” [299<sup>26</sup>]. IIA provisions and public international law concepts do not provide sufficient explanation for the application of the legitimate expectations concept as a separate delict of FET.

*Failure to provide a stable and predictable framework.* In addition to traditional stabilization clauses in petroleum contracts discussed in Chapter 1, the IIA practice has advocated another type of stability, through FET [300<sup>27</sup>, p.1]. This understanding was induced through various interpretations by tribunals referring to specific references in some IIA’s preambles to “stability” as well as in previous arbitral decisions [301, p.6]. This core tenet was widely invoked in the energy sector.

Some IIA tribunals, including those constituted under the ECT, consider the failure to provide stability and the frustration of legitimate expectations together<sup>28</sup>[302]. More

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*have consequence of limiting the courts’ power to find in favour of parties demanding substantive protection of expectations. Thus, courts will intervene only if there is a very serious imbalance between a person’s reasonable expectation and the wider public interest in a decision which will disappoint it... In Latin American countries, recognition of the principle appears to be at its infancy and its scope to date is fairly limited”.* Potesta came to conclusion that it may be difficult to provide a clear-cut answer to the question “*has legitimate expectations achieved global recognition in domestic law systems*” [294, p.94-95].

<sup>25</sup> The initial award which referred to good faith is *Tecmed v Mexica* case. Tribunal in that case linked FET to “*the good faith principle established by international law*” and concluded that FET required “*the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment*”. Another highly cited award is *Thunderbird v Mexico* case, “*the concept of ‘legitimate expectations’ relates, within the context of the NAFTA framework, to a situation where a Contracting Party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages*”.

<sup>26</sup> Sornarajah M. notes that as a general principle of law in domestic legal systems, “*legitimate expectations provides only procedural protection, requiring that an expectation created by administrative conduct should not be violated unless a hearing is given to the person who had that expectation. The principle has rarely been used as a substantive principle because of practical difficulties*” “*The use of a technique similar to administrative review in domestic legal systems on the ground that legitimate expectations were not respected has led to the suggestion that the law is now founded in public law rather than private law. This is not a new idea. Developing countries had stated that the foreign investment process was rooted in public law so that reliance could be made on changes within the state to justify interference with the foreign investment process*” [299].

<sup>27</sup> Gazzini T. found some IIAs which include general stabilization clauses except FET provisions. For example, in Article 11.3 of the 1996 Italy-Jordan BIT and Article 12 (3) of the 1998 Italy-Mozambique BIT which reads:

“*Whenever, after the date when the investment has been made, a modification should take place in laws, regulations, acts or measures of economic policies governing directly or indirectly the investment, the same treatment will apply upon request of the investor that was applicable to it at the moment when the investment had been carried out*” and Article 6 of the 1982 UK-Paraguay BIT:

“*Each Contracting Party shall in respect of investments guarantee to nationals or companies of the other Contracting Party the unrestricted transfer to the country where they reside of their investments and returns, subject to the right of each Contracting Party in exceptional balance of payments difficulties and for a limited period to exercise equitable and in good faith powers conferred by its laws existing when this Agreement enters into force*” [300].

<sup>28</sup> As ECT arbitration practice demonstrates investors usually bring with two heads of claims separately for legitimate expectations and stability obligation. For example, in *Blusun v Italy* case, stability obligation claim was brought under the first sentence of Article 10 (1) of the ECT, while legitimate expectations claim under the FET. In many other IIAs legitimate expectations are considered as a basis for the changes of regulatory framework at the time of investment.

precisely, they require stability in the legal framework on the basis of the expectations of the foreign investor [245, p. 272; 303; 304]. This approach was best represented in the *Tecmed v. Mexico* award, where stability was linked to the expectations of the investor at the time of entry [278, para 154]. Awards issued against Argentina such as CMS, Enron, and Sempra provided further impetus to this approach [273; 305; 306]. In particular, earlier awards such as *Occidental v Ecuador*<sup>29</sup> and *CMS v Argentina*<sup>30</sup> asserted that legal stability is an essential element of the FET, and linked to the FET through the protection of investors' expectations [303, para 183; 273, para 274]. Further ECT tribunals relied on these earlier awards and also found legal stability as an essential element of the FET [307, para 7.75; 102, para 483; 308, para 582; 309, para 532; 97, para 382].

The *CMS v. Argentine* tribunal in a dispute concerned the application of gas industry tariffs held that “*fair and equitable is inseparable from stability and predictability*” [273, para 276]. The tribunal explicitly elucidated this by referring to the preamble of the US-Argentina BIT that provides the basis for such an element [273, para 274]. The BIT preamble “*fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective use of economic resources*” [270]. The tribunal held that a “*stable and legal business environment is an essential element of fair and equitable treatment*” [273, para 276]. Moreover, the *CMS v. Argentina* tribunal found that:

“*It has also been established that the guarantees given in this connection under the legal framework and its various components were crucial for the investment decision...the Treaty standard of fair and equitable treatment and its connection with the required stability and predictability of the business environment, founded on solemn legal and contractual commitment*” [273, paras 275, 284].

The same understanding of FET was asserted by the tribunal in the *Occidental v. Ecuador* case. The tribunal stated that “*the stability of the legal and business framework is thus an essential element of fair and equitable treatment*” [303, para 183].

Other cases also contributed to the evolution of this interpretation. *Enron v. Argentina* tribunal also linked the stable framework to the legitimate expectations of the investor. The tribunal found that “*it is clear that the “stable legal framework” that induced the investment is no longer in place and that a definitive framework has not been made available for almost five years*” [305, para 267]. Similar conclusions about this link have been reached by other tribunals (in both energy and non-energy cases), including *PSEG v. Turkey*, *MCI Power Group v. Ecuador*, and *Parkerings-Compagniet AS v. Lithuania* [304, para 253-254; 310, para 278; 311, para 330].

Leading commentators identify regulatory stability and investors' legitimate expectations as a cornerstone and a central concept of investment protection, especially FET [287, p. 206, 208; 182, p. 286]. The contribution of the ECT awards to this approach

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<sup>29</sup> The tribunal in the *Occidental v Ecuador* case interpreted the FET as a strict obligation of regulatory stability. The Tribunal found a breach of the FET, as the tax framework under which the investment had been made and had been operating “*has been changed in an important manner by the actions adopted by the Ecuadorian tax authorities*”.

<sup>30</sup> The tribunal concluded “*stable legal and business environment is an essential element of fair and equitable treatment*”.

and their influence have been highly visible [2, p. 294]. The formulation of the stability in this way seems to shift the risks of the investors to the host state and the stability element of the FET would become risk insurance for the investor against regulatory change. Such an approach would have been even better than having a stabilization clause in the contract [245, p. 275]. These early decisions' substantiation of a requirement of stability in FET scope appears at best underdeveloped [301, p. 22].

## 2.2 The issues of FET in the ECT

### 2.2.1 The features of the FET under Article 10 (1) of the ECT

*The interpretation and delicts.* FET is incorporated in Article 10 (1) of the ECT along with other investment protection standards. Article 10 (1) of the ECT's first two sentences provide that:

*“Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area”*[18].

This formulation renders the FET in the ECT unique for two related reasons: First, FET is an unqualified standard of treatment, because it is expressed in the form of a broad standard without reference to CIL, principles of international law and associated additional limitations.

Secondly, and more importantly, it differs from other unqualified forms of FET solely due to the linkage between the second sentence and the first sentence. It is, in fact, this linkage which to some degree makes the FET formulation under the ECT unique<sup>31</sup>, as it imbues FET with characteristics such as stability, equitableness, and transparency which appear in the first sentence [309, para 533].

The first sentence on its own does not impose a distinctive binding obligation and liability on ECT Contracting Parties to accord a specific type of protection, rather, it is a kind of due diligence standard requiring ECT Contracting Parties to create conditions favorable for making investments [312; 313; 314]. As the *AES v. Kazakhstan* tribunal explained:

*“The Arbitral Tribunal is of the opinion that the first sentence of Article 10(1) of the ECT which refers to a duty of Kazakhstan to ‘encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments’ is an introductory sentence aimed at putting the further obligations laid out in Article 10(1) of the ECT into*

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<sup>31</sup> The presence of the first sentence explains the difference of FET under the ECT from other IIAs and would have an obligation in light of FET. From this perspective, the *Antin* tribunal interestingly noted: [*“reference to decisions on the stability of a regime based on treaties whose text is substantially different and where no specific obligation of stability is contained may be of no assistance in the interpretation of this specific feature of the ECT...It also contains a specific obligation—as opposed to a mere declaration in the preamble, and with language that suggests and imperative and not merely a recommendation—to encourage and create stable conditions for investments”*].

*perspective. As such, it has mainly programmatic character and does not provide for an independent standard of protection or right of action of a kind that is sufficiently specific to be relied upon by an investor. This is confirmed by the use of the terms “in accordance with the provisions of this treaty”, which precedes the obligation of encouragement on which Claimants rely, and further by the terms “[s]uch conditions shall include a commitment to accord at all times [...] fair and equitable treatment”, which indicates that the content of this principle is further described in the following sentences of this provision” [315, para 380].*  
[emphasis added]

Other tribunals have confirmed that conditions of the first sentence shall be taken into account when interpreting FET [316, para 173; 307, para 7.73; 309, para 533; 204, p. 179]. The *Plama v. Bulgaria* tribunal, for example, found that:

*“[...] the conditions are dependent on their accordance with the other standards...stable and equitable conditions are clearly part of the fair and equitable treatment standard under the ECT” [316, para 173].*

Several tribunals have observed that the first sentence shall be regarded as delicts of FET [307, para 7.73; 317, para 74; 318, para 646; 97, para 382; 319, para 764-766] and that the first sentence is not an autonomous standard for ECT Contracting Parties, but rather an illustration of the obligation to respect the legitimate expectations of the investor through the FET [318, para 646; 97, para 382; 319, para 764-766]. For instance, the *Isolux v. Spain* tribunal held that Article 10 (1) of the ECT does not contain:

*“[...] Article an autonomous obligation for the Contracting Parties to encourage and create stable and transparent conditions for the making of investments in their territory, the violation of which, per se, would generate rights in favour of investors of another Contracting Party. It would be absurd, for example, for an investor to sue a State for compensation for failing to promote stable and transparent conditions for investments in its territory if said failure were not the cause of the breach of another obligation to the investor, such as to grant the investment fair and equitable treatment, protection and security, etc.” [319, para 764-766].*

The claimant in the *Petrobart v. the Kyrgyz Republic* case invoked the first sentence as a separate obligation of the host state to create stable, equitable, favourable, and transparent conditions [320, para 25]. But the tribunal without focusing on the first sentence generally concluded that the respondent failed to accord FET [320, para 76].

It appears that drafters of the ECT may have intended to specify the content of FET back in the early 1990s. By incorporating the first sentence and interlinking it to the FET, drafters of the ECT most likely intended to emphasize the importance of stable, equitable, favourable and transparent conditions in the regulatory framework of ECT Contracting Parties. In this way, drafters deviated from the common unqualified form of FET and set a higher level of investment protection, possibly due to the specific set of political and economic circumstances in existence at the time of formulation, such as high political risk

in ex-USSR states, and the capital-intensive and long-term character of energy projects, which were discussed in Chapter 1 above. The plain meaning of the text seems to suggest that FET is a condition for creating a stable and transparent investment environment.

There is some support for this in the ECT's *travaux préparatoires*. It appears that in the earliest draft of the basic agreement for the EEC, these two sentences were placed in two separate paragraphs [321]. In a later version, they were combined into one paragraph and interlinked [322].

This kind of broad declarative wording is found in the preamble of the US BITs with several ex-USSR states<sup>32</sup>. For example, the preamble of the US-Kazakhstan BIT sets out: “Agreeing that fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources” [323]. [emphasis added]

Similar wording is found<sup>33</sup> in other second-generation US BITs. For example, in the preamble of US – Argentina BIT [271]. The *LG&E v. Argentina* tribunal attempted to interpret this preamble wording in light of object and purpose in accordance with Article 31 (1) of the VCLT. The tribunal observed that:

*“In entering the Bilateral Treaty as a whole, the parties desired to “promote greater economic cooperation” and “stimulate the flow of private capital and the economic development of the parties”. In light of these stated objectives, this Tribunal must conclude that stability of the legal and business framework is an essential element of fair and equitable treatment in this case, provided that they do not pose any danger for the existence of the host State itself.”* [276, para 124] [emphasis added].

Similar conclusions were made by other tribunals in light of interpretation of this wording [273; 303].

Another widely discussed issue in the determination of normative content of the FET under the ECT is whether Article 10 (1) of the ECT can be interpreted in light of the MST or whether it refers to an autonomous standard that can be interpreted on a case-by-case basis with reference to general notions of fairness and equity [324, p.213].

Tribunals are divided on this issue. For example, the *Blusun v. Italy* tribunal found that Article 10 (1) of the ECT incorporated FET under MST while the majority of tribunals found that FET under Article 10 (1) of the ECT went beyond MST [302, para 319 (3); 325, para 263; 326, para 263; 327, para 425; 324, p.213]. Taking the linked approach (i.e., FET linked to MST), there is a move towards proposing that even an autonomous form of FET should be equated<sup>34</sup> to MST [239; 329]. The unlinked approach has given arbitrators a very wide margin of discretion, resulting in an expansion of the FET scope beyond MST

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<sup>32</sup> US-Russian Federation, US-Kyrgyzstan, US-Kazakhstan, US-Armenia, US-Latvia.

<sup>33</sup> US-Ecuador, US-Turkey, US-Argentine

<sup>34</sup> This view was sustained by the commentary to OECD Draft Convention on the Protection of Foreign Property. However, taking into account the dispensable character of this Convention and Report, arbitral tribunals have inclined towards the latter perspective.

[241, p. 22]. This approach permitted arbitral tribunals to focus on the plain meaning of the term “fair” and “equitable” in interpretation.

In this sense, it seems that ECT Contracting Parties intentionally incorporated peculiar FET norms to provide protection for investors beyond the MST. Walde T. originally concluded that FET under ECT was derived from the US FCNs and BITs and was limited to MST, and it, therefore, provided a minimum level of protection to investors [313, p. 41]. However, years later this point was revised in Walde’s T. legal opinion for the *Nykomb v. Latvia* tribunal. Walde T. concluded that FET under ECT requires a high level of protection for investors and that the purpose of FET under the ECT differed from other BITs [196, para 34]. The matter was clarified because he considered<sup>35</sup> that investors in transition economies of most of the ECT Contracting Parties required greater protection [196, para 114].

Later other awards, for example, *Watkins v. Spain* and *Eiser v. Spain* concerning measures on RES support held that the FET under Article 10 (1) of the ECT was designed to address specific characteristics of investment in the energy sector, especially in its long-term and capital-intensive nature [99, para 541; 97, para 379]. Therefore, there should be no doubt that the FET under Article 10 (1) of the ECT goes beyond the MST and should be interpreted taking into account the context and purpose of the ECT.

In practice, tribunals under the ECT could not coalesce around a single set of delicts that gives a rise to the FET breach. So, they have found several delicts, including an obligation to act transparently and with due process and to refrain from taking arbitrary or discriminatory measures<sup>36</sup> or from frustrating the investor’s reasonable expectations with respect to the legal framework adversely affecting its investment [307, para 7.73-7.74; 309, para 532; 97, para 382; 326, para 260; 99, para 514].

In earlier ECT disputes involving traditional energy sources, investors mostly claimed violation of FET elements such as denial of justice, transparency, and stability of the legal framework [320; 325; 79; 279; 328]. For example, in the *Petrobart v. the Kyrgyz Republic* case, a claim arose out of a gas supply contract between the investor and the State gas company [320]. The tribunal did not analyze the meaning and scope of FET under Article 10 (1) of the ECT but rather focused on the relevant facts of the case. In this case, the tribunal found that cumulative and apparent measures of the Kyrgyz Government such as a President's Degree on reorganization of the State gas company, a letter of the

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<sup>35</sup> “The three standards in Art. 10 (1) express a common theme. This common theme is that the state is under an obligation to provide a “high” level of investment protection, which standards such as “fair”, “equitable”, “constant protection” and “reasonableness” being used. The “high” standard of protection suggests that the one difference of the ECT to many BITs is that it is in the main not focused on underdeveloped countries and their much greater difficulty to adopt good-governance conduct, but rather at transition economies in Eastern Europe preparing for accession to the EU from which a higher than normal governance standard can be expected”.

<sup>36</sup> It is important to note there are different positions concerning the relations between the third sentence of Article 10 (1) “unreasonable and discriminatory measures” and FET. *AMTO* tribunal noted that breaches of Article 10 (1) third sentence may also breach FET (para 74). *Stati* tribunal held that a breach of Article 10 (1) third sentence may not necessarily lead to further relief of damages in addition to FET breach (para 1256). *Plama* tribunal held that the unreasonable and discriminatory measures may be determined separately from the FET element (para 184). Therefore, there may be an overlap between the FET element and third sentence of Article 10 (1).

Vice-Prime Minister to the local court about postponement of the execution of judgment, and the placing of the State gas company into bankruptcy together led to the breach of FET [320, p. 26]. Direct interventions of the Kyrgyz Government and the denial of justice were held to qualify as an explicit violation of the FET [320, p. 26].

In the *Anatoli Stati v. Kazakhstan* case, for example, the tribunal agreed that FET under Article 10 (1) of the ECT needs to be considered against all of the facts [79, para 944]. The Stati tribunal found the FET had been violated based on a series of cumulative measures taken including the instruction of the President of Kazakhstan, the financial police' and tax committee's inspections, refusal of extension of the subsoil use contract, and other measures [79, para 949-1095].

In more recent renewable energy disputes, it has been delicts such as the frustration of legitimate expectations and a breach of stability of legal framework that have mostly been claimed by investors. The provision of a stable and predictable legal framework and frustration of legitimate expectations in the ECT are the most invoked, breach found and controversial delicts. According to the recent statistics of the ECT Secretariate for the period of the last 10 years, 91 claims were brought under these delicts [9]. Therefore, current ECT arbitration practice has now developed based on the correlation between the FET and the frustration of legitimate expectations, on the one hand, and the provision of a stable and predictable regulatory framework on the other hand. It was mainly due to the measures of ECT Contracting Parties to change the regulatory framework on RES. This sub-section below discusses these two delicts in detail.

*Provision of a stable and predictable framework.* The provision of “a stable and predictable framework” is substantiated under FET Article 10 (1) of the ECT from two perspectives:

First, the ECT's purpose<sup>37</sup> and EEC's objectives<sup>38</sup>, which seek to establish a stable and transparent legal framework for foreign investments in order to promote long-term cooperation in the energy sector [18; 194; 97, para 377-378]. The ECT is conceived as enhancing the stability of the legal regime relied upon by investors in making long-term investments [97, para 378]. Because of vague “ordinary meaning” of FET norms under Article 10 (1) of the ECT, tribunals interpreted the FET in light of object and purpose of the ECT in accordance with Article 31 of the VCLT.

Second, the role of the first sentence in Article 10 (1) of the ECT, the wording “stable conditions”. A number of tribunals took it as a distinct element of FET [316, para 173; 97, para 517]. Other non-ECT awards in the energy sector have held the view that stability is a crucial factor for long-term energy investments [303, para 183; 329, para 168; 330, para

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<sup>37</sup> Article 2 of the ECT “*This Treaty establishes a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter.*”

<sup>38</sup> Title II, Implementation: “*In order to promote the international flow of investments, the signatories will at national level provide for a stable, transparent legal framework for foreign investments, in conformity with the relevant international laws and rules on investment and trade.*”

517]. These two premises<sup>39</sup> led to interpretation of FET with a focus on stability of the relevant regulatory framework [97, para 379; 99, paras 497, 541].

As noted, these two delicts are invoked in several cases on RES measures against Spain, Italy and the Czech Republic. Tribunals made the same conclusions on the interpretation of FET norms under Article 10 (1) of the ECT. Several awards have been analyzed for the purposes of the dissertation. As an example, *Antin Infrastructure Services Luxembourg S.à.r.l. and Antin Energia Termosolar B.V. v. Kingdom of Spain (Antin v Spain)* case is demonstrated below in detail.

The claim arose out of RES sector reforms undertaken by the Spanish Government. The claim was submitted to ICSID in 2013. In 2018, the tribunal awarded EUR 112 mln for the breach of stability obligation and the frustration of legitimate expectations under FET Article 10 (1) of the ECT [309, para 748].

In 2011, the claimant comprising two companies registered in Luxembourg and the Netherlands made the investment in two operational concentrated solar power Andasol-1 and Andasol-2 plants located in Granada, southern Spain under RD 661/2007 Special Regime [309, para 70]. RD 661/2007 regime established various complex incentives<sup>40</sup> for investors, including fixed tariff or premium system [309, para 94]. In particular, Special Regime specified “*the amounts of both fixed tariff and the premium in euros per kilowatt hour that would be payable in respect of each hour of production, subject to a cap and a floor*” [309, para 559]. Subsequently, the respondent introduced several changes to the RES regulatory framework, which modified certain aspects of the Special Regime [309, para 103-105]. In 2013, the respondent adopted RDL 2/2013 “*in order to reduce the costs of Special Regime and hence avoid an increase in the access tolls paid by consumers*” [309, para 142]. Overall, the adopted changes led to revision of compensations, tariffs, and premiums of Special Regime. One of the main contentious matters was a revision of fixed tariffs and the introduction of “reasonable return” at 7,398% before taxes [309, para 562-563]. The claimant argued that “*the overall new regime caused a substantial reduction in the amount of electricity produced and consequently a reduction in the revenues of the Andasol Plants*” [309, para 140].

The tribunal following decisions of *Plama v. Bulgaria*, *Electrabel v. Hungary* and *Isolux v. Spain* tribunals concluded that a stability obligation incorporated in the first sentence of Article 10 (1) of the ECT is “*part of or is related to the FET under the Treaty*”; therefore FET under Article 10 (1) of the ECT comprises “*an obligation to afford*

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<sup>39</sup> *Watkins* tribunal, for example, refused Spain’s argument on reference to *Total v Argentina* award, substantiating that “*the decision in Total does not assist Spain’s arguments as it was not a decision pursuant to the ECT but pursuant to the 1991 France-Argentina BIT, which does not contain stability provisions for investors*”. In this way, *Watkins* tribunal specified that the FET under the ECT contains “stability” element in comparison with other IIAs. “*The ECT is distinct from BITs because the ECT is specific to the energy sector and also because the BITs do not contain the express obligations that are enshrined in Article 10(1).*”

<sup>40</sup> Incentives such as “*granted priority of access and priority of dispatch to the electric grid to RE producers over conventional energy producers; allowed RE production facilities subject to the Special Regime to use fuels for generation of electricity, insofar as the electricity produced by such fuel did not exceed 12% of the total production, if the facility sold energy through the Fixed Tariff option, or 15%, if the facility sold energy through the Premium option*”.

*fundamental stability in the essential characteristics of the legal regime relied upon by the investors in making long-term investments*” [309, para 529, 532]. In light of Article 31 of the VCLT, the tribunal observed that the term “stable” means “[n]ot likely to change or fail; firmly established”; “stable, therefore, neither means something close to immutable or something unlikely to change at any time” [309, para 528]. In this way, the tribunal held that FET under Article 10 (1) of the ECT “*comprises an obligation to afford fundamental stability in the essential characteristics of the legal regime relied upon by the investors*” [309, para 532]. The tribunal observed that the allegations of the claimant concerning the frustration of legitimate expectations are “*closely related to their claims about the stability of the legal framework*” [309, para 534]. The tribunal referring to *Charanne v. Spain* and *Eiser v. Spain* awards observed that:

“*[...] the specific obligation of stability of the conditions for investors under the ECT does not eliminate or strictly limit the regulatory powers of States nor does it prevent Contracting States from amending existing regulations, provided that the given State does not “suddenly and unexpectedly eliminate the essential features of the regulatory framework in place”*” [309, para 531].

Moreover, the tribunal agreed with the respondent that:

“*[b]ased on the text and context of the ECT, the Tribunal agrees with the Respondent in that the ECT limits the regulatory power of the signatory States, but does not cancel or “extremely limit” the State’s regulatory power*” [309, para 530].

The tribunal concluded that the stability under FET means that a “*regulatory regime specifically created to induce investments in the energy sector cannot be radically altered – i.e., stripped of its key features – as applied to existing investments in ways that affect investors who invested in reliance on those regimes*” [309, para 532]. Based on the factual analysis, the tribunal held that the respondent has breached Article 10 (1) of the ECT and failed to accord FET to the claimant’s investment [309, para 748].

The respondent contended that the disputed regulatory measures were adopted for public purposes to address tariff deficit and preserve the sustainability of the electricity system and that “*the State is entitled to exercise its sovereign power to amend its regulations to respond to changing circumstances*” [309, paras 555, 569]. The respondent substantiated the public purpose in the current economic context that fixed tariffs and premiums for special regime facilities are burdensome on the general State budget [309, para 142]. Alternative option was a new increase in the access fees paid by consumers of electricity, but it would directly affect household economies [309, para 142]. The respondent explained that facing this scenario and in order to alleviate this problem, “*the Government has considered adopting certain urgent cost-reduction measures which avoid consumers having to bear a new burden*” [309, para 142]. The tribunal observed that it is indisputable that a “*[t]ariff [d]eficit poses a legitimate public policy problem*” [309, para 570].

The respondent unsuccessfully challenged the award in an ICSID Annulment Committee. The respondent argued that the tribunal failed to state its reasons for its findings on liability, particularly, the interpretation of the stability obligation, noting that the award<sup>41</sup>:

*“[...] does not include a sufficiently clear reasoning for the Parties to know why, if the State maintains its regulatory power to adjust regulations to the economic situation for the purpose of general interest (point A), a State cannot, for these same reasons, make a significant modification to the regulation, changing essential characteristics thereof (point B)”* [331, para 242; 332, para 134].

Spain’s objection raises a fundamental question in IIL, which remains unanswered in the current IIL; that is if there is a public purpose regulation, then why should the host state should pay the compensation even if the impact of the measure is detrimental? A lack of clear content of FET under Article 10 (1) of the ECT and the preference that was initially given in the wording of Article 10 (1) of the ECT and EEC objectives’ to the protection of investors’ protection paved the way for tribunals to promote a strong notion of stability within ECT FET. But this strong notion of the stability obligation under FET norms Article 10 (1) of the ECT is theoretically and practically not sustainable. The creation of a “stable and predictable legal framework” was a result of the political and economic policies of the time when the ECT was concluded [6, p.1]. This declaratory wording of Article 10 (1) of the ECT was interpreted by tribunals as an “obligation to provide a stable and predictable legal framework obligation” and was improperly included in “catchall” FET norms.

That finding, however, is in tension with how investments in the energy sector have been historically protected. As explained in detail in Chapter 1, historically and even today, investments in the energy sector are protected by long-term contracts containing stabilization clauses. According to such clauses, the failure to preserve the more advantageous regulatory framework applicable to the investment at the time of making the investment or failure to observe contractual undertakings vis-à-vis the foreign investment may lead to a contractual breach, which modern tribunals take as a possible violation of an IIA [301, p. 6].

The tension arises when one notes that modern tribunals effectively use the FET under the ECT to openly grant to all foreign investors a stability protection that many States often only accord to individual investors after long and complex negotiations. A good example may be stabilization clauses in petroleum contracts. Generally, the author’s personal experience representing the Government of Kazakhstan in petroleum contracts suggests that the State is not generally inclined to commit to stability of legal regime, except on individually negotiated terms. For instance, in 2008, the Kazakh Government

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<sup>41</sup> For example, the respondent in *Eiser v Spain* Annulment Committee raised the same objection:

*“the Tribunal found that the Claimants had not been given any stabilization guarantees and that Spain had a sovereign right to regulate, including the right to change the regulatory regime for renewable energy. In spite of this first finding, the Tribunal, when awarding damages, assumed that there was a stabilization guarantee. This contradicts the earlier portion of the Tribunal’s reasoning”* [332, para 134].

took a decision to revoke the tax stabilization regime for petroleum contracts concluded earlier and to introduce new types of taxes [333]. Currently, the Kazakh Government is even prudent to provide individually negotiated stability to foreign investors without even speaking about the stability under the IIAs. Analysis of State and arbitral practice gives little substantiation to support the stability obligation in the scope of the new FET under the ECT.

The current transition from traditional energy sources to renewable under international obligations of the ECT Contracting Parties such as the Paris Agreement requires sufficient regulatory flexibility to implement measures. A broad notion of stability obligation may undercut those goals. In response to public concerns, the EU and Canada reformed the FET by clarifying that CETA investment protection standards do not offer a stable legal and business framework [334, p. 347-348]. CETA excluded a stable legal and business framework from the list of delicts under the FET. The 2019 Dutch Model BIT, 2019 Belgium-Luxembourg Economic Union Model BIT, and 2022 Italy Model BIT replicated the CETA approach. The EU position is clear and shows a retreat from the idea that FET contains a promise that the legal environment would remain unchanged. That is particularly clear in the 2015 Report on the public consultation on investment protection and investor-to-state dispute settlement in the Transatlantic Trade and Investment Partnership Agreement [335, p. 17]. The 2015 Report of the EU Commission shows the exclusion of stability obligations including legitimate expectations in the FET scope [335, p. 56]. The majority of respondents states considered that protection such as envisaged under the FET is not necessary or is already available in the EU law [335, p. 56]. Many of them stated that the risks triggered by the changes in legislation should be born exclusively by investors, as part of the risk intrinsic to their activities [335, p. 56].

*Frustration of legitimate expectations.* The protection of legitimate expectations was recognized as a central pillar of the FET under Article 10 (1) of the ECT in several awards [308, para 7.75; 102, para 483; 309, para 582]. As discussed above, the protection of legitimate expectations was closely linked to the provision of a stable and predictable framework. *The NextEra Energy Global Holdings B.V. and NextEra Energy Spain Holdings B.V. v. the Kingdom of Spain (NextEra v Spain)* award provides a suitable case study to demonstrate this point in detail. The analysis also covers other relevant awards.

The claim arose from the renewable energy sector reforms undertaken by the Spanish Government. The claim was submitted to ICSID in 2014. In 2019, the tribunal awarded EUR 290,6 mln for the breach of the frustration of legitimate expectations and stability obligation under FET Article 10 (1) of the ECT [308, para 37].

The claimants-investors from the Netherlands invested in a project for the construction of two concentrated solar power plants in Navalvillar de Pela in the autonomous community of Extremadura in Spain. The claimants contended that the Spanish Government completely and retroactively altered the remuneration regime applicable to the investments of the claimants after the substantial completion of the

construction of the solar power plants. The core claim was a frustration of legitimate expectations. In 2009, the claimant applied for registration of plants and in 2011-2012 the construction of plants proceeded under regulatory framework RD 661/2007, RDL 6/2009, RD 1614/2010 [308, para 169-173]. In 2013, the claimants obtained final registration of the plants in the state agency. During 2010-2013 the regulatory framework was changed several times leading to the dispute (RDL 14/2010; Law 2/2011; RDL 1/2012; Law 15/2012; RDL 2/2013; RDL 9/2013; Law 24/2013; RD 413/2014 and Ministerial Order IET/1045/2014) [308, para 451].

In total, the claimants put forward 9 objections concerning the change of regulatory framework: “1) RD 661/2007 and RD 1614/2010 have been abolished; 2) the regulated feed-in-tariff and the pool + premium option have been abolished”; 3) the market price remuneration is subject to a new 7% levy on revenue; 4) electricity generated through natural gas only receives the prevailing market price; 5) the revenue-based remuneration system has been replaced with a “retroactive system of payments based on installed capacity”; 6) Regulatory Framework III [new regime] produces unfair and inequitable results; 7) the remuneration is no longer payable for the life of the plant but is limited to a 25-year regulatory useful life; 8) indexation of the tariffs to the Consumer Price Index has been abolished; 9) the return has been reduced to 7.4 % pre-tax and is calculated over a cost base that excludes important costs” [308, paras 118-167].

Based on these regulatory changes, the claimants argued that the respondent failed to protect legitimate expectations. The tribunal held that:

First, it was not convinced that there was any legitimate expectations arising from the general regulatory framework [308, para 584]. Rather, the expectations were based on the legislation and that legislation can be changed [308, para 584]. But the tribunal relied on the specific statements and assurances made directly to the claimant by Spanish authorities [308, para 587]. The respondent contended that “*the statements evidenced no commitments on behalf of the Spanish government and, in many instances, they constituted a unilateral understanding of Claimants that had never been confirmed by the Spanish authorities*” [308, para 589]. The tribunal explained that “*Claimants could not have had the expectation that the RD 661/2007 regime was frozen and could not be changed. But the broader question is whether, in light of the assurances that they were given by Spain, Claimants had a legitimate expectation that the regime would not be changed in a way that would undermine the security that Claimants had in respect of the economic regime set out in RD 661/2007*” [308, para 591].

Second, regarding the reasonableness of the expectations, the tribunal noted that “*the use of terms such as “guaranteeing” and “preserv[ing] legal security,” in letters from a Spanish minister can reasonably be taken as statements that the Spanish government had no intention of making significant changes to the investment regime set out in RD 661/2007 and that this could be relied on by an investor*” [308, para 593]. The main issue was that in these letters there were no formal “commitments” by the Spanish government that the regulatory framework would not change [308, para 592]. However, the tribunal

held that “*legitimate expectations can exist in the absence of actual formal commitments*” [308, para 592].

Third, in determining the frustration of legitimate expectations, the tribunal further indicated fundamental and radical changes in the regime that substantially impacted the investment of the claimant [308, para 599]. Ultimately, as noted, the tribunal found Spain liable for a FET breach.

Later, Spain tried to annul the award for failure to state reasons and other deficiencies, relying on two main facts. First, the EU law does not guarantee the cancellation or change of the provided subsidies, therefore, the tribunal did not explain “*how the Claimants could have had legitimate expectations of the petrification of subsidies contrary to EU law and other applicable legislation*” [308, para 333]. Second, the absence of formal commitment by the Spanish government as discussed above. Spain relied on the *Charanne v. Spain* and *Isolux v. Spain* awards, where tribunals had held that the absence of “*specific formal immutability commitments*” does not give rise to legitimate expectations of immutability [308, para 336]. However, the ad hoc Annulment Committee held that the tribunal provided reasons for the existence of legitimate expectations and substantiated that the “*Committee’s mandate does not include how the Tribunal determined the legitimate expectations*” [336, para 353-355].

*NextEra v. Spain* case is an example of how the assessment of frustration of legitimate expectations is controversial in practice. NextEra tribunal relied on the letter from the state agency to the investor. But the letter did not include specific formal commitments from Spain that a regulatory framework would not change. Nonetheless, the tribunal found a FET breach and awarded EUR 290,6 mln damages.

The assessment of legitimate expectations in practice is a contentious matter and there is no uniform approach. There are various assessment criteria that were elaborated in ECT practice. The first criterion is the type of guarantee given by the ECT Contracting Party. Tribunals proceed from an identification of the origin of the expectation, which can be explicit or implicit [337, para 360 (2); 326, para 320; 307, para 7.78; 338, para 360]. In relation to explicit expectations, there are two groups. The first group is start from the point that legitimate expectations are based on general legislation [318, paras 665-681; 98, paras 499-500; 327, para 485; 309, para 552; 99, para 495]. In this situation, the investor must demonstrate that it has exercised appropriate due diligence and that it has familiarized itself with the existing laws [98, para 494; 326, para 351]. The second group considers that legitimate expectations can be created by specific representations such as a stabilization clause in a contract [339, paras 491-493, 504, 508; 302, para 319 (5)]. The rationale behind this is that a stabilization commitment incorporated in law is as much subject to change as all the other dispositions of the law in question [98, para 504]. In this respect, an enforceable legitimate expectation would require a clear and specific commitment [100, para 295]. Therefore stabilization provisions provided in general legislation, or political announcements, such as press releases and others, cannot create legitimate expectations [98, para 507].

The second criterion is legitimacy and reasonableness of expectations. As concluded by a number of tribunals, not all expectations of the investor can be seen as “legitimate”, and only legitimate expectations are protected under the FET [326, paras 261, 350; 316, para 219; 338, para 360 (6)]. Expectation is subjective and whether or not it is “legitimate” must be objectively assessed [326, para 261; 309, para 538]. The frustration of a legitimate expectation establishes a wrongful act by the State. The frustration of a non-legitimate expectation does not establish the wrongfulness of the state’s action [326, para 261].

In several cases against Spain, investors argued that they had a legitimate expectation to earn a reasonable return on their investment [326, para 399]. For example, the RREEF tribunal concluded that the guarantee of “reasonable return” or “reasonable profitability” was the main specific commitment of Spain vis-à-vis the investors in the Special Regime [326, para 384]. The RREEF tribunal stated that the threshold of proof as to the legitimacy of any expectation is high and only measures taken in clear violation of the FET will be declared unlawful and entail the responsibility of the State [326, para 262]. In ECT arbitration practice, the “reasonable return” issue was specifically raised in Spanish cases because the Spanish law guaranteed the “reasonable return” of the project. It should be noted that the “reasonable return” may be applicable for a reasonably good project but could be inapplicable if the project is not economically viable.

The third criterion is the timing of alleged legitimate expectations, which must be assessed against the background of information about the conduct of the host state that the investor knew or should reasonably have known at the time of the investment [307, para 7.78; 326, para 324; 99, para 517].

The fourth criterion is an examination of the radicalness of the alteration of regulations. FET under Article 10 (1) of the ECT indicates that regulatory regimes cannot be radically altered if, when applied to existing investments, give rise to the deprivation of investors who relied on a continuance of existing regimes [97, para 382]. This means that to constitute a breach change in the regulation shall be in an unexpected and radical form [327, para 502].

The ECT tribunals apply the protection of legitimate expectations based on the arbitral practice and without analysis of the origin of this delict. As a matter of background, not only in ECT but generally under other IIAs the main problem with awards relying on the concept of legitimate expectations is a lack of analysis and a lack of clarity on the origin of this concept as an element of FET [294, p. 89,121]. Many states, as discussed, do not believe that it is part of the MST. Arbitral decisions, however, suggest that some tribunals may continue to consider it when applying the FET. It is therefore important to discuss how it may feature in the context of the proposed FET provision and possible consequences thereof, particularly for the state’s right to regulate.

As discussed in sub-Chapter 2.1 IIA provisions and public international law doctrinal concepts do not provide sufficient explanation to apply legitimate expectations concept as a separate delict of FET. Several commentators and arbitrators have expressed their

doubts<sup>42</sup> about the standard status of legitimate expectations in the FET scope [299, p. 1055, 1056, 1071; 245; 340, paras 3, 15; 341, p.28]. They criticised the Tecmed award as establishing an unrealistically stringent and utopian standard which holds the states to the highest good governance norms [283, p. 645-646; 341<sup>43</sup>, p.28]. The US has taken the position that legitimate expectations of the foreign investor does not constitute a part of the law relating to IIAs [299, p. 1060]. In a third-party submission in the case *Grammercy Funds Management v. Peru* and *Lone Pine Resources v. Canada* the US stated<sup>44</sup> that the concept of legitimate expectations is not a component of an element of FET under MST that gives rise to host state obligation [342, para 38; 343, para 26]. In particular, the US noted “*an investor may develop its own expectations about governing its investment, but those expectations impose no obligations on the State under the minimum standard of treatment*” [342, para 38]. Along with the US, Canada has taken the position to limit the FET to MST, therefore, explicitly excluding the legitimate expectations from the FET of the Model BITs [217, art.8]. CETA followed the Canada approach with some modifications. Particularly, CETA excluded legitimate expectations from the list of delicts under the FET but maintained it in a separate paragraph as a factor that may be taken into account during the determination of an FET breach [257, art. 8.10; 344<sup>45</sup>, p. 107]. The 2019 Dutch Model BIT, 2019 Belgium-Luxembourg Economic Union Model BIT, and 2022 Italy Model BIT replicated the CETA approach. In fact, CETA created a trend for future European IIAs. In response to public concerns on legitimate expectations, the EU and Canada reformed the FET by clarifying that CETA investment protection standards do not offer a protection of legitimate expectations [334, p.348].

The FET wording under CETA is largely the result of the interpretation practice of Article 1105 of NAFTA [344, p. 105]. In the case of legitimate expectations, for example, *Mobil v. Canada* tribunal concluded that the host state’s failure to protect legitimate expectations does not constitute a breach of the FET standard, but it is rather a “factor” to be taken into account when assessing whether or not other well-established elements of the FET have been breached [345, paras 152-153; 344, p. 107]. Specific criteria for legitimate expectations incorporated in Article 8.10.4 reflect the tribunal’s contemplation

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<sup>42</sup> For instance, a separate opinion of arbitrator Nikken P. in *Suez v. Argentina* case stated “*the assertion that fair and equitable treatment includes an obligation to satisfy or not to frustrate the legitimate expectations of the investor . . . does not correspond, in any language, to the ordinary meaning to be given to the terms “fair and equitable”*”.

<sup>43</sup> Douglas Z. commented that “*the Tecmed standard is actually not a standard at all; it is rather a description of perfect public regulation in a perfect world, to which all states should aspire but very few (if any) will ever attain*”.

<sup>44</sup> For example, US Submission US Department of State in *Grammercy Funds Management and Grammercy Peru Holdings LLP v. the Republic of Peru*: “*The concept of “legitimate expectations” is not a component element of “fair and equitable treatment” under customary international law that gives rise to an independent host State obligation. The United States is aware of no general and consistent State practice and opinio juris establishing an obligation under the minimum standard of treatment not to frustrate investors’ expectations. An investor may develop its own expectations about the legal regime governing its investment, but those expectations impose no obligations on the State under the minimum standard of treatment. The mere fact that a Party takes or fails to take an action that may be inconsistent with an investor’s expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result.*”

<sup>45</sup> Dumberry P. noted that in the earlier draft, the EU had proposed to put legitimate expectations along the list of stand-alone elements. This proposal was rejected by Canada, who proposed a language very similar in Article 8.10.4 CETA.

of the Thunderbird<sup>46</sup> award [293, para 147; 344, p. 108]. These criteria were also stated in Glamis and Bilcon awards [267, paras 621,622, 802; 346, paras 445, 455]. In general, NAFTA tribunals took a limited approach in the determination of the violation of the FET [344, p. 107]. Both North American and EU approaches are forming the state practice by excluding the protection of legitimate expectations from the scope of the FET.

Therefore, there is no basis for the inclusion of this delict into the FET. Tribunals could take it into account as an additional factor during the determination of breaches of other elements. But the legitimate expectations of the investor should be assessed based on the circumstances and conditions of the economy when the investor entered the host state. It means that the investor shall consider objective factors in the host state and the global energy policy. In particular, the determination as to whether the expectations were legitimate depends on all of the circumstances, including “*not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host state*” [283, p. 644]. Particularly, the legitimate expectations shall arise from clear and specific representation or commitment and shall require a case-by-case analysis, fact-based taking into account the factors, laws, and regulations of the ECT Contracting Parties.

### 2.2.2 Regulatory space within the scope of FET

*Regulatory space in CIL and IIAs.* In modern IIAs provisions preserving the right to regulate are widely used, and appear in manifold forms. CIL also recognizes the right to regulate. Four main types that IIAs and CIL preserve the right to regulate are discussed in this section.

#### 1) The right to regulate in expropriation clauses:

There is a recognition of the right to regulate for matters of public interest in expropriation clauses. This right is crucial and stems from the CIL. Under CIL, States are permitted to expropriate the assets of foreign investors without incurring international liability if such expropriation is non-discriminatory, for a public purpose, and in accordance with due process of law and on payment of compensation [347, p. 92; 348]. In the same vein, investment treaties have expressly incorporated exceptions to the expropriation clause. The standard expropriation provision affords the state regulatory freedom to expropriate the investment for a public purpose under conditions of legality [347, p.91]. New generation treaties have introduced express exceptions in expropriation clauses. These are designed to protect a state’s right to take measures aimed at protecting legitimate public welfare objectives such as public health, safety and the environment without such measures constituting indirect expropriation [258; 217]. Some commentators have posited that such provisions reflect the police power doctrine in international law,

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<sup>46</sup> Four elements definition adopted by the Thunderbird tribunal (1) conduct or representations must have been made by the host State; (2) the claimant must have relied on such conduct or representations to make its investment; (3) such reliance by the claimant on these representations was “reasonable”; and (4) the host State subsequently repudiated these representations therefore causing damage to the investor.

which recognizes that a state has the power to restrict private property rights without compensation in pursuance of a legitimate purpose [349, p. 90-91].

Even though most IIAs do not explicitly contain exceptions to the protection of property, tribunals recognize that host states have the power to restrict private property rights without compensation in pursuance of a legitimate purpose [278, para 119; 265, Chapter D para 7]. Tribunals explain the application of police power doctrine where host states have the power to restrict private property rights without compensation in pursuance of a legitimate purpose so long as the measure taken with this purpose is reasonably balanced in relation to the regulation's effect on the investment [278, para 119; 265, Chapter D para 7; 349, p. 76].

Furthermore, the right to regulate may also be protected pursuant to some of the CIL notions known as the "circumstances precluding wrongfulness". The International Law Commission Articles on Responsibility of States for Internationally Wrongful Acts enumerates six such circumstances [350]. These are: consent, self-defense, counter measures, force majeure, distress and necessity [350, article 20-25]. Not all of them are applicable to IIL [351, p. 237]. Self-defense, necessity and force majeure clauses are commonly invoked in investment disputes. In practice, a good example of the use of these defined circumstances can be seen in arbitrations arising from the Argentine financial crisis of the early 2000s [305; 306; 276; 330].

CILs self-defense or necessity clauses are applicable to both circumstances in which the IIA contains a provision for necessity or self-defense and in situations in which IIAs are silent [352, p. 324]. The only circumstance in which treaty rule may replace customary rule is if the treaty specifically indicates that it replaces customary rules, or if the treaty provision and the customary rule are in such direct conflict that they cannot co-exist [352, p. 324].

## 2) The right to regulate in general exceptions clauses:

Such a clause typically provides that "*the provisions of this Treaty...shall not preclude any Contracting Party from adopting or enforcing any measure (i) necessary to protect human, animal or plant life or health [...]*"[18, article 24]. It includes a list of areas, which are subject to exceptions. Despite the differences in drafting of general exceptions clauses, modern IIAs usually incorporate the general exceptions modelled on Article XX of GATT and/or Article XIV of GATS [353, p. 273].

However, there is increasing uncertainty on the role and proper application of general exceptions to investment protection provisions. States have (implicitly or explicitly) incorporated such general exceptions in order to achieve specific policy objectives without breaching IIA obligations [353, p. 277]. However, general exception clauses are usually open-textured, broad and without interpretative guidance. In general, where IIL disputes have managed to balance trade and non-trade objectives explicitly, ISDS practice has not used exceptions effectively [354, p.363-364]. The main questions are to what extent general exceptions can safeguard the host state's regulatory space and whether general exceptions operate as permissions or as defenses.

One commentator has argued that general exceptions should be viewed as permissions that limit the scope of substantive treaty obligations and not as defenses invoked to justify prima facie unlawful conduct [355, p. 2825]. Another argued that whatever the reasons may be for the inclusion of general exceptions, there remains uncertainty about how IIA tribunals interpret these on the basis of precedents taken from ITL exceptions and their application to investment protection obligations [353, p. 277]. In WTO, panels have demonstrated a narrow interpretation of Article XX of GATT, have placed the burden of justification for invocation on the party invoking Article XX of GATT, and have not examined Article XX of GATT exceptions unless invoked [356]. In arbitration practice, indeed, there is a lack of practice on application of the exceptions clause to substantive investment protection standards, particularly those of FET or MST. Respondents fail to invoke them properly and tribunals either overlooked them or adopted interpretations that lessened their impact, probably because FET or MST is considered as a minimum or is already seen as a balancing test [6, p. 3; 354, p. 364; 182, p. 319; 351, p. 147]. Perhaps for this reason contracting parties to CETA made clear that “General exceptions” do not apply to FET or expropriation [257, article 28.3; 355, p. 2840]. Similarly, the first paragraph of Article 15 of 2022 Italian Model BIT titled “General Exceptions” begins: “[s]ubject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors” [216, article 15]. In this manner, Italy clearly specifies and limits the application of “general exceptions” to investment protection, and it seems that these exceptions are conditional to bona fide exercise of regulatory measures.

### 3) The right to regulate in carve-out clauses

IAs include carve-out provisions for certain State measures. Usually, these provisions carve out an entire policy area or sector from the scope of an IIA, e.g., sovereign tax power, procurement of state enterprises, etc. Carve-out provisions frequently incorporate the wording “do not apply”<sup>47</sup>, “shall not apply”<sup>48</sup>, “no claim may be brought”<sup>49</sup>, “nothing in this treaty shall create rights or obligations on the contracting party”<sup>50</sup>, etc., and are therefore more prescriptive than general exceptions [256; 357; 358; 18].

For example, Article 22 of the Singapore-Australia Free Trade Agreement (SAFTA) states: “[n]o claim may be brought under this Section in respect of a tobacco control measure of a Party” [358].

### 4) Emerging provisions to preserve right to regulate in modern IAs

This dissertation defines this type of provision, “emerging right to regulate” provisions, as typically found in recent IAs. It is noted that more recent IAs<sup>51</sup> widely

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<sup>47</sup> Article 1108 (1) NAFTA carves out prudential measures

<sup>48</sup> Article 27 Norway Model 2015 BIT carves out linguistic and cultural diversity, cultural and audiovisual policy

<sup>49</sup> Article 22 of Singapore-Australia Free Trade Agreement (SAFTA) carves out tobacco sector

<sup>50</sup> Article 21 of the Energy Charter Treaty

<sup>51</sup> UNCTAD provides the statistics that all IAs concluded in 2020 and 2021 contain reform-oriented provisions aimed at preserving regulatory space and promoting sustainable development.

incorporate the right to regulate of the host state over the investment of foreign investors where such regulation is proposed for the reason of a legitimate public purpose, including environmental protection and sustainable development [212; 213; 359]. The right to regulate is included in the preamble and the main text of the IIAs [217, 218]. There are different versions of the right to regulate wordings in recent IIAs.

For example, the FTA between EFTA and Ukraine of 2010 contains the following the right to regulate provisions:

*“1. Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure consistent with this Chapter that is in the public interest, such as measures to meet health, safety or environmental concerns or reasonable measures for prudential purposes.*

*2. A Party shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor of a Party or a non-party”* [360, article 4.8]. [emphasis added]

Similar wording is found in Article 12 of the 2012 US Model BIT:

*“The Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental laws. Accordingly, each Party shall ensure that it does not waive or otherwise derogate from or offer to waive or otherwise derogate from its environmental laws in a manner that weakens or reduces the protections afforded in those laws, or fail to effectively enforce those laws through a sustained or recurring course of action or inaction, as an encouragement for the establishment, acquisition, expansion, or retention of an investment in its territory.*

*Nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns”* [258]. [emphasis added]

The 2004 US Model BIT included a short but softer version of this clause. For example, instead of saying, “shall ensure” the 2004 Model BIT used “strive to ensure” [361, p. 806]. This wording was strengthened in the 2012 version of the US Model BIT [361, p. 806]. A similar approach was taken in the 2015 Norwegian Model BIT [357, article 12]. However, this provision appears to be a “self-judging” clause, based on wording such as the host state “considers appropriate to ensure” [132, p. 490]. The wording “otherwise consistent with this Treaty” suggests that the invoked regulatory measures do not violate the treaty in other respects [361, p. 806]. In any case, it seems, such IIA clauses do not release the States from liability where such measures are in contradiction with substantive investment protection obligations; in such cases, these measures shall not be in contradiction with other provisions of the IIA.

The wide incorporation of the right to regulate appears in EU IIAs and EU member Model BITs. It needs special attention for the purposes of this dissertation. EU has traditionally played a central role in the conduct of the energy charter's affairs. Often it has the ability to export its own view of rules and regulations [362; 363; 364]. The EU's proposed approach to revision of the ECT therefore is likely to prevail. To be sure there has been some setback in recent months. Some of the wealthiest members of the EU such as France, the Netherlands and Spain have pulled out of the ECT negotiations, because it does not comport with their objectives with respect to climate change [11;12]. That also shows that the scope of the right to regulate exceptions in the proposed EU draft was not satisfactory or adequate from their perspective, which makes it even more important to analyze these provisions.

Preserving the right to regulate has been an important EU policy [365]. The 2011 EU Resolution on the future European international investment policy highlighted the importance of the right to regulate [366]. It especially flagged that:

*“while focusing extensively on investor protection, it should better address the right to protect the public capacity to regulate and meet the EU's obligation to exercise policy coherence for development”, “stresse[d] that future investment agreements concluded by the EU must respect the capacity for public intervention”, “call[ed] on the Commission to include in all future agreements specific clauses laying down the right of parties to the agreement to regulate, inter alia, in the areas of protection of national security, the environment, public health, workers' and consumers' rights, industrial policy and cultural diversity”* [366, paras 6, 23].

The EU Council adopted the document titled “Conclusions on a comprehensive European international investment policy” stressing that:

*“in keeping with existing practices by the Member States and in accordance with Article 205 of the Treaty on the Functioning of the European Union and Article 21 of the Treaty on the European Union, the new European international investment policy should be guided by the principles and objectives of the Union's external action, including the rule of law, human rights and sustainable development as well as taking into account the other policies of the Union and its Member States. The European investment policy must continue to allow EU and the Member States to adopt and enforce measures necessary to pursue public policy objectives”* [367].

The EU-South Korea FTA is probably the first EU document explicitly referring to the right to regulate, indicating “[c]onsistent with this Chapter, each Party retains the right to regulate and to introduce new regulations to meet legitimate policy objectives” [368, article 7.1 (4)]. In July 2012 the EU Commission observed that the main principles of the regulatory clauses of the EU FTA shall also encourage EU investment policy [369, p.2]. In 2015 the EU Commission conducted an “Online public consultation on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and

Investment Partnership Agreement” [335]. The majority of respondents (academics, government organizations, law firms, etc. almost 150 000 respondents) mentioned concern about ensuring the right to regulate in EU IIAs [335, p. 18]. In parallel, the EU made the first steps to incorporate the right to regulate in EU IIAs. One of them is CETA which was negotiated at a time of increased hostility and criticism of IIL and ISDS [370, p. 149]. CETA incorporated a new approach to the right to regulate while maintaining the exceptions clause and the right to regulate in the expropriation clause [257, art. 8.15, 8.12]. The preamble of CETA states:

*“[...] provisions of this Agreement preserve the right of the Parties to regulate within their territories and the Parties' flexibility to achieve legitimate policy objectives, such as public health, safety, environment, public morals and the promotion and protection of cultural diversity” [257].*

The “Investment Protection” Section D of CETA starts from Article 8.9 “Investment and regulatory measures”. Article 8.9 of CETA sets out:

*“1. For the purpose of this Chapter, the Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer protection, or the promotion and protection of cultural diversity” [257].*  
[emphasis added]

Further, this Article elaborates:

*“2. 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” [257].*

In this respect, CETA incorporates the right to regulate in the preamble and in the main text of Section D “Investment protection” Article 8.9 rather than in a separate clause as used in the old IIAs [257]. After CETA, other EU FTAs and EU member Model BITs contain the emerging right to regulate provisions.

Article 2.2 of EU-Singapore FTA:

*“The Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, social services, public education, safety, environment or public morals, social or consumer protection privacy and data protection and the promotion and protection of cultural diversity” [371].*

The 2019 Dutch Model BIT is another example of a treaty which specified the right to regulate for sustainable development purposes in a separate Article [218, article 6]. Article 6 of the Dutch Model BIT sets out:

*“3. The Contracting Parties recognize that it is inappropriate to lower the levels of protection afforded by domestic environmental or labor laws in order to encourage investment.*

*4. A Contracting Party shall not adopt and apply domestic laws contributing to the objective of sustainable development in a manner that would constitute unjustifiable discrimination or a disguised restriction on trade and investment” [218].*

The 2022 Italian Model BIT incorporates several Articles on sustainable development, including corporate social responsibility, the environment, climate change, and labor [216, articles 19,20,21,22,23]. For example, Article 21 sets forth:

*“1. The Parties recognise the importance of taking urgent action to combat climate change and its impacts, and the role of investment in pursuing this objective, consistent with the United Nations Framework Convention on Climate Change (UNFCCC) and the purpose and goals of the Paris Agreement adopted by the Conference of the Parties to the UNFCCC at its 21st session (the Paris Agreement), and with other MEAs and multilateral instruments in the area of climate change.*

*2. Each Party shall:*

*(a) effectively implement the UNFCCC and the Paris Agreement adopted thereunder, including its commitments with regard to its Nationally Determined Contributions;*

*(b) promote investment of relevance for climate change mitigation and adaptation; including investment concerning climate friendly goods and services, such as renewable energy, low-carbon technologies and energy efficient products and services, and by adopting policy frameworks conducive to deployment of climate-friendly technologies” [216].*

These sustainable development provisions incorporate soft wordings such as “*recognize the importance*”, “*emphasize*”, “*shall not lower*” and “*effectively implement*” etc. rather than binding obligations. Such provisions make clear that the contracting party should not apply domestic laws for sustainable development in an unjustified discriminatory manner. Thus, the provisions do not discharge the contracting party’s duty to compensate in cases where the measures would breach the investment protection provisions of the treaty.

Commentators who interpreted CETA’s right to regulate provisions came to the conclusion that the emerging right to regulate provisions operate to prevent “regulatory chill” rather than releasing from liability [372, p. 171; 373, p. 236; 374]. One commentator observed that both wording in the preamble and the main text of the “Investment Protection” Section reflect a soft right to regulate, not the strict right to regulate” [372, p. 171]. It means the right to regulate in the CETA text serves only as an interpretative tool and does not appear to provide a concrete actionable right [372, p. 171]. Other commentators on these provisions of CETA concluded that the right to regulate provisions do not prevent tribunals from awarding compensation; but rather they are not empowered to enjoin states from amending or withdrawing legislation [373, p. 236; 374].

Therefore, such clauses generally require that state parties should refrain from encouraging investment by lowering the protections provided in national environmental laws [372, p. 162]. Hence, the right to regulate could play the role of preventing the “regulatory chill” [373, p. 236]. The EU Commission in the concept paper explained that:

*“An operational provision (an Article) which will refer to the right of Governments to take measures to achieve legitimate public policy objectives, on the basis of the level of protection that they deem appropriate. Such provision is recognition of the right of domestic authorities to regulate matters within their own borders which exists already under international law. It allows setting the right context in which investment protection standards are applied”* [375, p. 6].

Titi C. observed that in *stricto sensu* the right to regulate as a concept in IIL should allow derogating international commitments without incurring a duty to compensate [351, p. 33; 372, p. 163]. But it is debatable whether incorporation of the emerging right to regulate in IIAs would exclude a duty to compensate. In determining the compensation or the breach of investment protection provisions, the tribunal should take into account these provisions in order to find whether the contracting party has implemented legitimate regulatory measures recognized in the main text of the treaty. The emerging right to regulate provisions in modern IIAs seems to supplement “the general exceptions” clauses in protecting the regulatory space of the host states. But even a combination of “general exceptions” and “the emerging right to regulate” does not seem fully exempt from responsibility for regulatory measures aimed at the protection of public interests and sensitive areas of the host state. It is also important to note that despite the fact that the general exception provisions were borrowed from WTO practice, tribunals under IIAs could not apply the experience of WTO panels because of differences in compensation mechanisms, parties to disputes, and the overall differences between IIA and WTO agreements. This dissertation posits that without minimizing the normative significance of these provisions, these provisions do not safeguard the legitimate public purpose measures of States. One of the reasons for the decision of France, Spain and the Netherlands to leave the ECT was dissatisfaction with efforts to reform the ECT, particularly, compensation for public policy measures.

*ECT Exceptions.* The current version of FET under Article 10 (1) of the ECT does not include explicit exceptions to safeguard the ECT Contracting Parties’ right to regulate for the public interest [6, p. 3]. Elsewhere, the ECT itself does specify carve out in Article 21 of the ECT “Taxation” and general exceptions in Article 24 of the ECT “Exceptions”.

Article 24 of the ECT “Exceptions” contains a list of exceptions inspired by the exceptions from trade rules that are contained in the 1994 GATT [376, p. 322]. These exceptions are adapted to the investment and other non-trade rights under the ECT, which are basically distinct from those in the GATT [377, p.22; 376, p. 328].

The explicit definition of these exceptions provides ECT Contracting Parties with the option of derogating from the ECT rules for various reasons [6, p.3]. Article 24 of the ECT creates exceptions to exceptions (claw-backs). Article 24 (1) of the ECT carves out

the application of the provisions of this article to Articles 12 “Compensation for losses”, 13 “Expropriation”, and 29 “Interim Provisions on Trade-Related Matters”. Finally, the exception “necessary to protect human, animal or plant life health” (Article 24 (1) (i)) does not apply to Part III of the ECT) [376, p. 328; 324, p.213].

Publicly available practice regarding reliance on exceptions in light of Article 24 of the ECT is almost non-existent [376, p. 329]. In practice, Article 24 of the ECT has been raised only once as a basis of a defence to the alleged breach of FET violation. In the *Watkins v. Spain* case, Spain raised Article 24 of the ECT, but could not explain how it applies to FET [99, para 496; 6, p.3; 324, p.213], and therefore, the Watkins tribunal did not take this into consideration [99, para 496; 324, p.213]. The Watkins award does not describe the arguments of Spain and counter-arguments of the claimant concerning Article 24. There are two possible reasons for this: first, the exhaustive list of exceptions contained in Article 24, which covers specific areas and it is difficult to subject regulatory measures taken by Spain for the purposes of renewable energy regulation to the scope of Article 24; second, an arbitral practice that general exceptions do not apply to FET or MST, since it is already provided minimum treatment.

Contrary to Article 24 of the ECT “Exceptions”, Article 21 of the ECT “Taxation” exception has been more effective. Article 21 of the ECT carves out taxation measures taken by ECT Contracting Parties from the scope of certain provisions of the ECT, including investment protection standards [6, p.3]. The application of this Article to FET was discussed at length in the Spain arbitration awards on RES. For example, in the Eiser case the claimant argued that Spain’s 7% levy on the value of electric energy production created by Law 15/2012 (TVPEE) was intentionally framed as a tax under Spanish law in order to disguise a breach of Spain’s commitments to the claimants and avoid liability under the ECT [97, para 250-272; 6, p.3]. The Eiser tribunal held that the TVPEE has characteristics typically associated with a legitimate tax [97, para 266]. In particular, TVPEE was established by law, imposes obligations on a defined class of persons, generates revenues going to the State, and these revenues are used for public purposes [97, para 266]. On this basis, the tribunal held that it does not have jurisdiction to decide the claimant’s claim concerning the inconsistency of the TVPEE with Spain’s obligations under Article 10 (1) of the ECT [97, para 271]. The Eiser tribunal recalled the Yukos award stating that a carve-out under Article 21 of the ECT is applicable only to bona fide taxation measures which are motivated by the purpose of raising general revenue for the State [97, para 268; 6, p.3].

Earlier in the *Plama v. Bulgaria* case concerning the purchase of shares in a local oil refinery by a Cyprus company, among other claims, the claimant argued that the amendments made to Bulgarian tax legislation, which resulted in the claimant being liable to pay company income tax, breached FET [316, para 265]. Rescheduling of Nova Plama’s debts in its Recovery Plan resulted in artificial profit, which became taxable and thus created a new obligation for the Claimant [316, para 256-273; 6, p.3]. Bulgaria replied that ECT Contracting Parties do not accept an obligation under Article 10 (1) of the ECT

with respect to tax in accordance with Article 21 of the ECT [316, para 260]. The tribunal held that after the restructuring of the debt in Nova Plama, Bulgaria had to modify tax law to eliminate the tax consequences [316, para 265]. The tribunal held that Article 21 of the ECT excludes from the scope of the ECT's protections tax measures taken by ECT Contracting Parties, with certain exceptions, one of which is that, if a tax constitutes or is alleged to constitute an expropriation or is discriminatory, the investor must refer the issue to the competent tax authority, which the Claimant did not do [316, para 266].

In both of these examples, tribunals found that there was no sufficient evidence to sustain the claims and asserted that Article 21 of the ECT reserved for ECT Contracting Parties' options in respect of tax measures [6, p.3].

*Proportionality.* It is argued that FET itself is also a flexible standard by nature, which allows for the balancing of the interests of the host state and foreign investors [246, p. 170; 6, p.3]. Tribunals have relied on the proportionality analysis during the determination of the FET breaches.

Proportionality in ISDS is adopted on a case-by-case basis at the discretion of tribunals. The *Tecmed v. Mexico* tribunal paved the way for other tribunals to resort to this notion [278, para 139, 145, 147; 378<sup>52</sup> para 311-312; 276<sup>53</sup>, para 195; 6, p.4]. Some academics are keen on proportionality analysis as a means of balancing the competing interests of foreign investors and the host state [379, p. 33; 349, p. 96; 380, p.345; 381; 382; 383; 384]. They believe that proportionality analysis facilitates addressing questions left open by ambiguity in a treaty's wording and thus would have an impact on outcome of the case [383, p. 121; 6, p.4]. The concept of proportionality stemmed from public law and was developed in order to balance rights in different legal systems. Specifically, proportionality stemmed from German public law and was expanded to other national legal orders within and outside Europe [384, p. 42; 6, p.4]. It was subsequently transplanted into a large number of public law systems across the globe and can now be considered to represent a true principle of comparative public law [379, p. 46; 6, p. 4]. In domestic legal systems, on the one hand, proportionality is regarded as "a meta-constitutional rule"; on the other hand, it is considered as "a neutral, rational decision-making tool" of conflict resolution between individual rights and highly sensitive public interests of states [385, p. 95; 386, p. 574; 6, p.4]. In any case, under domestic legal orders,

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<sup>52</sup> *Azurix v Argentina* tribunal endorsed the reliance of the *Tecmed* tribunal on the proportionality case law of the ECtHR in which held that "a measure depriving a person of his property [must] pursue, on the facts as well as in principle, a legitimate aim "in the public interest", and bear "a reasonable relationship of proportionality between the means employed and the aim sought to be realized". This proportionality will not be found if the person concerned bears "an individual and excessive burden". The Court considered that such "a measure must be both appropriate for achieving its aim and not disproportionate thereto".

<sup>53</sup> *LG&E v. Argentina* tribunal also relied on the *Tecmed* tribunal's view and said that "With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed. The proportionality to be used when making use of this right was recognized in *Tecmed*, which observed that whether such actions or measures are proportional to the public interest presumably protected thereby and the protection legally granted to investments, taking into account that the significance of such impact, has a key role upon deciding the proportionality".

the main function of proportionality is to provide for an appropriate balance between individual rights and public interest [384, p.2; 6, p. 4].

There is no general rule calling for the application of proportionality in ISDS. In ISDS, proportionality analysis is different from the three-tier test as applied in the ECtHR and the WTO [6, p.4]. In ECT arbitration practice, for example, the notion of proportionality is invoked in order to strike a balance between the effects of the measure on the investor and significance of the affected rights to the state and its right to regulate [6, p. 4].

In the ECT framework, proportionality was first used by the *Electrabel v. Hungary* tribunal in which reference was made to the *Saluka v. Czech Republic* decision [385, para 165; 6, p. 4]. It was subsequently used as a case precedent in other tribunal decisions. Unfortunately, these tribunals did not explain the grounds for the application of proportionality in their decisions [6, p.4]. It should be noted that earlier tribunals under the ECT were timid in the application of proportionality and even to some extent confused [6, p.4]. The ECT text is silent on the application of proportionality in FET disputes [6, p.3]. Therefore, the question arises whether it is legitimate to apply proportionality in FET disputes under the ECT and whether it is effective [6, p.4]. In light of the broad FET formulation under the ECT, proportionality has, to a certain extent, succeeded in striking a balance between regulatory rights and investor rights [6, p.4]. To some extent it has also allowed flexibility in regulatory rights of the ECT Contracting Parties [6, p.4].

In this context, there are attempts by academics to show that proportionality could be integrated into ISDS either through external or internal norms [384, p. 100; 6, p.4]. In the case of external norms, this could occur either through a general principle within the meaning of Article 38(1)(c) of the ICJ Statute or via the principle of systemic integration reflected in Article 31(3)(c) of the VCLT [384, p. 100; 6, p.4]. In the case of internal norms, proportionality can be integrated with the relevant treaty itself, without a need to resort to external norms [384, p. 120; 6, p.4].

If tribunals apply proportionality to the FET, it needs to take a cautious approach in order to limit a judicial law-making role for arbitrators in the application of proportionality [349, p. 102; 6, p.4]. As noted by a commentator, in the application of proportionality analysis there is a thin line between investment arbitration's function as a tribunal and its role as a court of review overseeing the legality of the internal public administration of a State [245, p.289]. Another commentator noted that proportionality would allow arbitral tribunals to prioritize values in a given situation, therefore tribunals may engage in a direct balancing of the rights of investors and the host state in proportionality [386, p. 160; 387; 6, p.4]. The ad hoc committee in the *MTD v Chile* annulment decision held that “[...] the vagueness inherent in such treaty standards as “*fair and equitable treatment*” [should not] allow international tribunals to second-guess planning decisions duly made in accordance with that [national] law” [388, para 107]. In addition to proportionality analysis, a number of academics recently suggested the use of a margin of appreciation as a feasible means of aligning competing interests [381, p. 719; 382, p. 214-215]. The

margin of appreciation is relatively little known in FET disputes [6, p.5]. ECT tribunals referred to a margin of appreciation in the scope of FET, but have so far been reluctant to implement it extensively in ISDS [302, para 319 (4); 389, para 589; 6, p.5].

*Deference to regulatory rights.* Regardless of the lack of exceptions for ECT Contracting Parties' regulatory space in the FET under Article 10 (1) of the ECT, tribunals, in line with earlier awards, have acknowledged that a legitimate right of ECT Contracting Parties to regulate need to be considered when assessing compliance with FET [316, para 177; 302, para 319 (4); 6, p.4]. Some ECT tribunals have tried to curb FET delicts by referring to the deference to the right to regulate of the ECT Contracting Parties [307; 385; 328]. Others, however, have not considered restraining broad interpretations of FET such as the idea that FET includes a right to stability, hence precluding regulation, as they are not explicitly mentioned in the ECT text, and in any event, tribunals are not bound to follow the other arbitration decisions [99]. Some tribunals even explicitly acknowledge that the protection offered under the FET is not equivalent to the classic strictly drafted stabilization clauses, which are widely incorporated in petroleum contracts; unlike such clauses, the FET leaves space for the host state to regulate in the public interest, otherwise the stability element [279, para 9.3.29].

Other tribunals have developed tests to ascertain whether there is a connection between rational public policy objectives and reasonable policy measures adopted by ECT Contracting Parties [385, para 165; 389, para 589; 302, para 319 (4)]. Several tribunals have set additional criteria for the claimant's objections to the legality of such measures, arguing, for example, that such measures would frustrate the legitimate expectations element of FET. These approaches have not been consistent or legitimized yet, simply developed case by case.

Overall, the treatment of the right to regulate under the ECT, particularly in connection with FET, is unsatisfactory. Despite the fact that the tribunals have not questioned ECT Contracting Parties' right to regulate for public needs, they have observed that the ECT Contracting Parties need to implement regulatory measures within the international legal framework that they accepted when adhering to the ECT, including the obligation to provide compensation for the breach [97, para 425]. It is particularly difficult to draw a borderline between the normal exercise of regulatory rights and a breach of FET.

The approach that was mostly applied by ECT arbitral tribunals is to set a limitation on powers to alter the regulatory framework after the entering of the States into the ECT if the changes would be unfair, unreasonable, and inequitable and so undermine the legitimate expectations of the investor [99, para 521].

This approach includes a two-part test: a) rational public policy objective and b) a reasonable act of policy in relation to that policy. In the ECT context, this test was first used by the tribunal in the *AES v. Hungary* case [279]. However, in this case, the tribunal applied this test in relation to allegations of unreasonable or discriminatory measures, not FET breach, which constitutes a separate breach under Article 10 (1) of the ECT.

In the case *Electrabel v. Hungary*, for the first time, an ECT tribunal employed the test in relation to a FET breach. In *Electrabel's* case, the claim arose inter alia from Hungary's termination of a power purchase agreement between Dunamenti - a subsidiary of *Electrabel* and the State-owned electricity wholesaler MVM [307, para 2.5, para 6.1]. Hungary took the measure as part of the State's program for liberalizing its electricity market to comply with EU laws on State aid [307, para 6.4, 6.5].

The *Electrabel* tribunal considered that the application of FET under the ECT allowed for a balancing exercise by the ECT Contracting Party in appropriate circumstances [385, para 165]. The *Electrabel* tribunal reaffirmed the balancing exercise by relying on the *Saluka* tribunal's approach [385, para 165]. The ECT Contracting Party, inter alia, is not required to elevate unconditionally the interests of the foreign investor above all other considerations in every circumstance [385, para 165]. In the *Electrabel* case, and in other cases tribunals have followed the argument of *Saluka v. the Czech Republic* under various BITs [259, para 304-308].

The two-part test in the *Electrabel* approach involved in defining proportionality between the effects of the measure and the affected rights and interests of the investor [385, para 179; 6, p.4]. Two elements are important in this: the existence of a rational policy and the reasonableness of the measures taken [385, para 180]. In addition, there needs to be an appropriate correlation between these two elements [385, para 179].

The *Electrabel* tribunal found that the legitimate policy objective of Hungary was to protect the State budget and that this was legitimately achieved through alignment of its electricity sector with the EU market and the elimination of distortions to internal and external competition [385, paras 214-215]. The balancing exercise replicated the well-known proportionality analysis [385, para 179]. Recognition of regulatory rights of ECT Contracting Parties under FET has been further illustrated in other cases [389, para 589; 302, para 319 (4)].

*RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à r.l. v. Kingdom of Spain and Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. the Republic of Albania (RREEF v. Spain)* awards provide a suitable case study to demonstrate this point in detail. The analysis also covers other relevant awards.

Certainly, there are various versions and methodologies of proportionality/balancing analysis in practical application. In the jurisprudence of various domestic and international courts, proportionality analysis comprises three sub-elements such as the principle of suitability, the principle of necessity, and the principle of proportionality stricto sensu [349, p. 98]. Of particular note is the discussion that took place in the *RREEF v. Spain* case. Spain in that case had reconsidered earlier agreed incentives in form of feed-in tariffs in order to address a tariff deficit<sup>54</sup> [326, para 116]. *RREEF* argued that the measures taken had limited effect on the accumulation of the tariff deficit, and claimed that reducing feed-in tariffs for Concentrated Solar Power and wind, while heavily impacting foreign

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<sup>54</sup> The Tariff Deficit is a shortfall of revenues in the electricity system which arises when the income generated by the Spanish Electricity Sector is insufficient to cover the costs associated to the system.

investors, was not a suitable and proportional measure of achieving the stated aim [326, para 439]. RREEF gave examples of other alternative and less harmful measures such as a) raising electricity prices b) introducing a fuel tax c) adopting a tax on CO2 emissions d) profiling of FITs [326, para 440]. Spain disagreed and took the position that the burden of proof on proportionality and rationality should be allocated to RREEF [326, para 454]. Spain substantiated this argument by stating that macroeconomic control measures were reasonable and proportionate and adopted for justified reasons including “(a) the legal obligation of maintaining the economic system in accordance with the reasonable rate of return principle at all times for the investors, avoiding the over-remuneration that would be contrary to EU law, (b) the existence of a public interest in the sustainability of the SEE, in a context of serious international crisis and with a severe reduction in energy demand encountered by the RE Sector, which reduced revenues in the SEE and brought economic imbalance to the SEE, together with increased costs in RES (c) impossibility of transferring all the burden of the economic imbalance onto consumers” [326, para 453].

Spain further contended that the alternatives proposed by RREEF did not take into account Spain’s public interests and compliance with EU legislation. In particular, the supply of electricity was to be carried out at the lowest possible cost for the consumer, and Spain was moreover obliged to correct over-payment situations in accordance with EU Competition Law [326, para 459].

The RREEF tribunal, for its part, held that proportionality is a weighing mechanism that seeks a fair balance between competing interests and principles affected by the regulation, taking into account all relevant circumstances [326, para 465]. In the view of the RREEF tribunal, reasonableness in the exercise of regulatory power includes a legitimacy<sup>55</sup> of purpose, necessity, and suitability [326, para 464]. The legitimacy of purpose represents the interests of the society, necessity implies the existence of a pressing social need, and suitability makes it possible to achieve the pursued legitimate objective [326, para 464]. The tribunal held that Spain enjoyed room for manoeuvre in conducting its economic policy, the tribunal abstained from taking a position on the existence of other or more appropriate possible measures. However, Spain’s this room for manoeuvre is not unlimited and FET in this case clearly limits state discretion.

In the *Mamidoil v. Albania* case, the tribunal took a straightforward and more simple approach to the reasonableness of measures and a breach of FET under Article 10 (1) of the ECT more simply. The claimant’s core business was related to the transport, storage, and trade of petroleum products and the claimant agreed with the Albanian Government to establish a tank farm in Durres port [328, para 140]. The Albanian Government later reconsidered plans for the reconstruction of Durres, including the claimant’s operating permit due to safety, environmental, and public policy concerns [328, para 215]. The tribunal held that “*the obligations of States under investment treaties cannot be appraised*

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<sup>55</sup> “*Legitimacy of purpose*” implies the measure represents interests of the society as a whole and does not alter the substance of the rights affected by the regulation. “*Necessity*” implies the existence of a pressing social need. The threshold for “*necessary*” is more demanding than the one for “*useful*” or “*desirable*”. “*Suitability*” implies the measure must make possible to achieve the legitimate objective.

*with only a view to the protection of foreign investors' rights*" and *"fair and equitable standard brings foreign investors into the normative sphere of rational policy in the general interest"* [328, para 614]. Therefore, the tribunal allowed balancing the rights of the claimant and the respondent. The tribunal believed that the improvement and modernization of Durres port were *"at the heart of policy preoccupations and planning priorities of the Albanian Government"* [328, para 722]. In this line, the tribunal gave *"weight to the legitimate interest of the Albanian Government to modernize the infrastructure in the general interest, which ultimately encompasses all foreign investors' interests"* [328, para 723]. With respect to the stability of the legal and business environment, the tribunal accepted the transitional nature of the Albanian economy [328, para 626]. The tribunal held that *"an investor may have been entitled to rely on Albania's efforts to live up to its obligations under international treaties, but that investor was not entitled to believe that these effort would generate the same results of stability as in Great Britain, USA or Japan"* [328, para 626].

Finally, there is no consistent approach to the application of proportionality and arbitral tribunals have exercised discretion in choosing their relevant approach. One group of tribunals has followed the approach embodied in the Electrabel award, while another group of tribunals has chosen the limitation of the scope of FET. For instance, the Watkins tribunal rejected Spain's position on applying the Electrabel approach, referring to the agreement of the parties on the application of this approach in the Electrabel case [99, para 496]. The Watkins tribunal implied that in the Electrabel case the claimant explicitly accepted that the FET under Article 10 (1) of the ECT allowed for a balancing exercise by the host state in appropriate circumstances and, in particular, the host state was not required to unconditionally elevate the interests of the foreign investor above all other considerations in every circumstance [99, para 496; 385, para 125, 165].

### **Findings and concluding remarks on Chapter 2**

This Chapter analyzed five fundamental aspects of the dissertation, namely: the ordinary meaning of FET, the normative content of FET, the doctrinal concept of FET, specific features of FET under the ECT and the regulatory space in the FET scope.

The Chapter concludes that the current FET situation represents a serious issue for the ECT framework and IIL. The lack of theoretical underpinnings, particularly doctrinal concepts and constant evolution of the FET scope have posed difficulties in sustaining the balance between regulatory rights and investment protection. The issue directly stems from uncertainty around the origin of FET and the literal meaning of the FET. The historical evolution of the FET theory is controversial in IIL. Ambiguity and controversy about FET have created different schools of thought in IIL. FET has been reviewed from the perspective of CIL, GPL and autonomous treaty standards. Some academics propose linking FET with the rule of law.

There is no single view on doctrinal concepts and sources of FET which is a source of uncertainty. The origin of this obscure wording can be traced back through historical

treaties, for example, the justiciability clauses of 18<sup>th</sup> and 20<sup>th</sup>-century commercial and mixed claims treaty practice and the US FCNs. Therefore, the development of FET as a *lex specialis* rule was created by BITs and FCNs and the incorporation of FET in IIAs was associated with the elimination of the uncertainty around MST.

But these treaties do not provide a response to the ordinary meaning and normative content. This vagueness was a hurdle in the interpretation of the FET according to Article 31 and Article 32 of the VLCT. The “ordinary meaning” interpretation condition in Article 31 of the VLCT does not help to interpret the FET. *Travaux preparatoires* of IIAs are also silent on the FET meaning, therefore, tribunals could not rely on Article 32 of the VLCT. FET was included in IIAs in a “copy and paste” manner from treaty to treaty. Therefore, the normative content of FET is largely formulated based on the interpretation in light of the “object and purpose” of the treaty under Article 31 of the VCLT and arbitration practice case by case. Different interpretations by tribunals under various IIAs created a jurisprudence of FET. Tribunals have avoided touching on the doctrinal concepts of the FET and rather focused on the fact-specific nature of the FET. They have rather interpreted the FET in light of the context, object, and purpose of the IIA. Tribunals have not engaged in a textual analysis of the FET clause in IIAs but simply referred to how this requirement has been generally understood under arbitral practice, even though the cases are not a binding source in international law. This has led to a lack of coherence with regard to clause and unmanaged expansion of the scope. Precedents have played an essential role in the formation of FET. The expansion of the content of the law beyond the intention of IIA parties raises the legitimacy of this exercise in international law.

In relation to the ECT, the FET wording under Article 10 (1) of the ECT and generally ECT provisions were formulated taking into account political and economic circumstances at the time of the conclusion of EEC and ECT in the 1990s [6, p.1]. The FET wording under Article 10 (1) of the ECT originally derives from the US BIT practice. Similar wordings are found in other US BITs. The dissertation found that expansive interpretation of the vague FET norms under Article 10 (1) of the ECT by tribunals in light of EEC’s and ECT’s object and purpose, arbitration practice, and recognition of declaratory sentence of Article 10 (1) of the ECT as a “FET delict” created a strict obligation for ECT Contracting Parties to provide a stable regulatory framework and protect legitimate expectations in the national legislation for investors. It paved the way for tribunals to promote a strong notion of stability within ECT FET. But this strong notion of stability obligation under FET norms Article 10 (1) of the ECT is theoretically and practically not sustainable. The creation of a “stable and predictable legal framework” was a result of the political and economic policies of the time when the ECT was concluded [6, p.1]. This declaratory wording of Article 10 (1) of the ECT was interpreted by tribunals as an “obligation” to provide a stable and predictable legal framework obligation” and was improperly included in “catchall” FET norms.

Two examined Spanish awards demonstrate well that tribunals are not able to deal with a conflict between investment protection and the right to regulate for public policy

purposes. The objection of Spain to rendered awards raises a fundamental question in IIL regarding the liability of States for bona fide public purpose measures. The current IIL norms do not provide a response to this objection. Different mechanisms of the right to regulate in the ECT and CIL do not effectively work to safeguard the public policy objectives of the ECT Contracting Parties. As a result, the broad application of FET norms burden ECT Contracting Parties with multi-million awards on the way to progress climate-change obligations and protecting other public policy goals; therefore, the treatment of the right to regulate of ECT Contracting Parties for public purposes is unsatisfactory in the current ECT. Accordingly, the FET needs to be as much as possible to be defined and circumscribed in a treaty clause, rather than being left to be interpreted in light of other sources which open the door for ambiguity (such as the CIL norm, the GPL, the rule of law).

### 3. REVISING BALANCE BETWEEN INVESTMENT PROTECTION AND REGULATORY RIGHTS IN FAIR AND EQUITABLE TREATMENT UNDER THE ENERGY CHARTER TREATY

#### 3.1. The anatomy and construction of new FET under the ECT

The Chapter will take as its starting point the relationship between the FET and MST before moving on to proposing solutions to identified discrepancies. Chapters 1 and 2 discussed various doctrinal sources of FET. The new construction of FET should be crafted based on the doctrinal concept that the FET is a treaty obligation. This is substantiated by the fact that the development of FET as a *lex specialis* rule was created by BITs and FCNs and the incorporation of FET in IIAs was associated with the elimination of the uncertainty around MST.

Recent IIA practice shows that some states<sup>56</sup> discarded the FET from the scope of IIAs, other IIAs<sup>57</sup> made clarifications to the scope, while others<sup>58</sup> raised the threshold of breach indicating that FET does not require more than MST. In sum, there is no consensus on the future of FET among scholars<sup>59</sup>, arbitral tribunals<sup>60</sup> and states<sup>61</sup>.

Generally, there are currently two doctrinal approaches in the recent IIA practice on the reconceptualization of the FET [6, p.2-3]. One is the US, or North American approach, which limits FET to MST with a non-exhaustive list of delicts [256; 258; 390, p. 30-31]. The other is the EU approach which has a closed list<sup>62</sup> of FET elements and an explicit right to regulate [257; 390, p. 29-30].

From the perspective of the former, the US<sup>63</sup> and Canada<sup>64</sup> narrowed the scope of FET as much as possible, bringing the FET back into alignment with the origins of MST

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<sup>56</sup> For example, South Africa, Russia, India.

<sup>57</sup> For example, the EU Trade Agreements with investment protection.

<sup>58</sup> For example, the US IIAs.

<sup>59</sup> Dolzer R., Salacuse J., Yannaca K., Reinisch A., Schreuer C. concluded in the same line that FET is evolving standard and the scope of FET shall be based on the arbitral practice. Almost all of them concluded that we should keep FET in IIAs and the scope of FET shall include all elements developed by arbitral tribunals with specific limitations.

<sup>60</sup> Chapter 2 discussed different interpretation of the FET and expansion of the FET scope.

<sup>61</sup> Recent concluded IIAs demonstrate different approaches in relation to the FET wording. For example, Article 11 of Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area (2009) FET wording contains denial of justice only; Indian Model BIT (2015) in Article 3 (1) FET has been replaced by treatment in accordance CIL; The US (2004) and Canada (2021) approach that limits FET to MST with clarification of the scope.

<sup>62</sup> The Comprehensive and Economic Trade Agreement between the EU and Canada (CETA). Article 8.10 of CETA contains:

“(a) denial of justice in criminal, civil or administrative proceedings;

(b) fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings;

(c) manifest arbitrariness;

(d) targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief;

(e) abusive treatment of investors, such as coercion, duress, and harassment”.

<sup>63</sup> For example, Article 5 of US-Rwanda 2008 the US-Rwanda treaty concerning the encouragement and reciprocal protection of investment contains: “Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security .... fair and equitable treatment includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world”.

<sup>64</sup> Canada 2021 Model BIT also follows the US approach, but with a broader list of elements:

“A Party breaches this obligation only if a measure constitutes:

[218; 390, p. 30-31; 391]. The main rationale for this approach lies in their NAFTA experience when investors brought several claims<sup>65</sup> under Chapter 11 of NAFTA against them at the end of the 1990s and the beginning of the 2000s [249;250;251;265]. From the perspective of the latter, the EU approach is reflected in the EU's recent agreements with Canada, Singapore and Vietnam [257; 371; 391; 392; 390, p. 29-30]. The EU approach contains a broader closed list of elements of FET than the North American approach [6, p.2; 390, p. 29-30]. This dissertation posits that a separate closed-list FET using the EU approach without linking to MST would be a reasonable way of solving the ECT uncertainty and balancing issues. The rationale behind the position set forth below is that an ECT Contracting Party could be held liable only if it breaches a limited set of delicts. This closed list of delicts would eliminate uncertainty for both ECT Contracting Parties and investors.

### 3.1.1 FET and the MST

As explained in Chapter 2, there are divergent views on the relationship between FET and MST. The MST which was created in CIL largely on the basis of US practice in Latin America. In fact, some commentators suggest that tribunal decisions, in practice, do not distinguish between MST and FET [246, p. 154]. The use of precedents by tribunals even led to the indifference between MST and autonomous FET [246, p. 153-154].

The EU's proposed FET language for the modernized ECT, which is similar to the CETA's and provides the inspiration for this dissertation, in fact, does not refer to MST or link FET to MST at all. However, the list of elements or delicts subsumed under its FET provision closely mirrors the much narrower interpretation given by NAFTA tribunals which is also reflected in subsequent US Model treaties [334, p. 347]. FET in CETA is regarded as MST, in its current form, with a different name [344, p. 103]. FET in CETA truly reflects a codification of MST elements based on past arbitral awards [373, p. 256]. By omitting reference to the term MST, however, CETA attempts to control and diminish<sup>66</sup> risks associated with uncertainties inherent to the vague notion of MST [241, p. 28]. This approach found in recent EU IIAs such as CETA 2016, the Dutch Model BIT 2019, the Belgium-Luxembourg Economic Union Model BIT 2019, and Model Italy BIT 2022.

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- (a) denial of justice in criminal, civil or administrative proceedings;
  - (b) fundamental breach of due process in judicial and administrative proceedings;
  - (c) manifest arbitrariness;
  - (d) targeted discrimination on manifestly wrongful grounds such as gender, race or religious beliefs;
  - (e) abusive treatment of investors, such as physical coercion, duress and harassment; or
  - (f) a failure to provide full protection and security.”

<sup>65</sup> Weiler T. made some observations on the origin of the FTC Interpretation Note to Article 1105 of NAFTA. Weiler T. noted that the cases *Pope & Talbot v Canada*, *SD Myers v Canada*, *Methanex v the US* compelled to the US and Canada to change their investment protection policy under NAFTA which led to the limitation of FET scope to MST. He provided historical facts when the FET is not limited to MST, then abruptly NAFTA Parties drafted Interpretation Note [223].

<sup>66</sup> See also UNCTAD, suggesting that an explicit link between FET and MST would prevent the expansive interpretation of the FET and assists in preserving the right to regulate [6, p.2].

A specific link in the treaty language between the two standards, in fact, could be problematic in a number of ways. First, the MST is itself evolving, indeterminate and lacks clearly defined content [241; 6, p. 2]. In defining MST, decisions of the *Neer*, *Robert*, and *Hopkins* cases played a pivotal role [240, p. 67; 252<sup>67</sup>, p. 561; 6, p. 2]. In particular, the *Neer* tribunal defined the MST as outrage, bad faith, willful neglect of duty and insufficiency of governmental action [140, para 61 f; 6, p. 2]. Since the *Neer* decision, the commonly identified delicts of MST to date are denial of justice, lack of due process, lack of due diligence, and instances of arbitrariness and discrimination [182, p. 238; 6, p. 2]. Reliance solely on an MST approach might result in differing tribunal decisions on what is or is not covered by CIL and may not bring the desired greater clarity on the scope of the FET. Our contemporary understanding of MST, therefore, is formed by a series of old decisions without discerning whether these decisions derived from CIL or autonomous treaty standard [246, p. 153].

Secondly, the assertion of MST for foreign nationals under CIL has a long and contentious history [252, p. 557; 6, p. 2].<sup>68</sup> Early international cases applying MST involved physical maltreatment of aliens and their property. Reliance on the MST may have been justified in a period when there were no other provisions for the protection of aliens' property, but today's IIAs, however, incorporate FET and other standards of protection for aliens [240, p. 65; 6, p.2].

Until NAFTA, and despite the fact that FET was used in a significant number of IIAs, it had not been analyzed by tribunals since it was never the main basis for any claim [299, 1045]. It was only in the late 1990s that FET started regularly appearing as a basis for a treaty breach [299, 1045]. From 1999, arbitral tribunals have sought to fill what was an unclear concept of the FET without knowing the intention of the parties to the IIAs [299, 1045]. The intentions of State parties to IIAs are often unknown.

In a nutshell, there is a deadlock over the further relationship between MST and FET. It seems that the most reasonable way forward for FET should be to give it a similar meaning as the current MST practice, without explicitly linking it to MST [340]. Historically, the MST is a product of capital-exporting countries and its existence has been challenged by many developing countries [223, p. 184; 199, p.144]. Yet FET may exist as a separate treaty standard based on the practice which we have as of today taking into account historical origin and development. The identified delicts of the FET in arbitral practice are more or less clearly accepted and there is some understanding of what they mean. The FET is simply the modern expression of the MST [283<sup>69</sup>, p. 638; 244]. Therefore, the revised FET under the ECT should be separated from the MST and the new construction of FET should truly reflect the meaning of FET such as a denial of justice,

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<sup>67</sup> Schwebel S. posits that the *Neer* award is far from the FET standard [6, p.2].

<sup>68</sup> In this context, Schwebel S. in his observation deduced that *Neer* award had nothing to do with the treatment of foreign investors and investment and did not address FET [6, p.2].

<sup>69</sup> Academics also noted the controversial view quoting Schreuer C. "it is inherently implausible that a treaty would use an expression such as "fair and equitable treatment" to denote a well-known concept such as the "minimum standard of treatment in customary international law"". Academics noted "if the parties to a treaty want to refer to customary international law, it must be presumed that they will refer to it as such rather than using a different expression".

arbitrariness or unreasonableness, discrimination and abusive treatment. In this way, the dissertation proposes to follow the EU approach with several modifications.

### 3.1.2 Possible delicts subsumed under new FET

The preferable way to revise FET in order to preserve the state's right to regulate would be via clarification of FET delicts. If FET contains a more precise set of delicts with a reasonably clear scope, it is highly likely that legitimate public purpose regulatory measures would not be captured within its scope. As noted, delicts of the FET have been identified in arbitral practice, to some extent taking into account scholarly writings as subsidiary sources of teachings and jurisprudence, as enshrined in Article 38 of the ICJ Statute [269, p. 369]. The contribution of the "jurisprudence" of international tribunals to the specification of the FET is not inconceivable. In a similar vein, considering "jurisprudence", academics' contributions, and State practice in IIAs, this sub-section expounds on the analysis of possible delicts subsumed under the new FET of the ECT.

*Denial of justice.* This dissertation proposes to incorporate the denial of justice in the new FET as set forth below:

*"(a) denial of justice in criminal, civil or administrative adjudicatory proceedings"*

The main rationale for the inclusion of the denial of justice to the FET in the modernized ECT is to provide certainty to the ECT Contracting Parties and investors and avoid the various interpretations in arbitration practice. There is no doubt that the denial of justice is a fundamental concept in legal systems and the most venerable international wrong occupying the core of the FET [283, p. 668; 269, p.379]. In the context of FET, the denial of justice is linked to "procedural fairness" [132, p.320]. The historical origin of the denial of justice were discussed in detail in Chapters 1 and 2. In order to clarify the precise content of these delicts in the context of the proposed FET text and its possible shortcomings, several comments are in order.

First, the proposed wording is based on the definition of denial of justice from an intermediate-level meaning that covers improper administration of criminal, civil, or administrative justice in adjudicatory proceedings, including denial of access to courts, inadequate procedures, and unjust decisions [283]. The intermediate meaning of the denial of justice includes both procedural and substantive forms [283, 284; 285, 286]. Relevant arbitration practice on the procedural denial of justice relates to access to the courts, undue delays, fair procedure, and the right to be heard in judicial or administrative proceedings [287, p. 218]. Substantive denial of justice relates to "gross defects" in the substance of the court judgment [283, para 670; 288, p. 309]. Substantive denial of justice could be embraced by the proposed wording in exceptional cases if manifestly unjust judgement is delivered against the investor and the investor is subjected to arbitrary and discriminatory treatment [393, p. 90; 394<sup>70</sup>, p. 82]. But substantive denial of justice would

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<sup>70</sup> For example, Paulsson J. posits the view that the denial of justice is always procedural.

not entail an appellate review of national law [394<sup>71</sup>, p. 82; 325<sup>72</sup>, para 274; 250, para 127; 287, para 441; 345, para 167]. It is obvious that any international review cannot assess the correctness of judicial or administrative outcomes rather, it would assess whether the result is in conformity with international law or whether the process by which it was held corresponds to international standards [269, p. 383]. Moreover, a breach of other rules of IIL by domestic courts is not a denial of justice, but a direct violation of relevant obligation, for example expropriation [393, p.99; 394, p. 106].

Second, the proposed wording covers only adjudicatory proceedings, not other proceedings. The breach of due process in administrative proceedings, including a lack of transparency<sup>73</sup>, for example, could be compensated through the arbitrariness or unreasonableness delicts discussed below in order [287, p. 217; 299, p. 1077]. While the breach of due process in criminal proceedings is directed at physical persons either management or employees of a company, raising the possibility of denial of justice involving unlawful criminal investigation, prosecution or charge could be compensated through abusive treatment delict which is discussed also below in order.

In practice, for example, situations often occur where a breach of due process could occur resulting from a refusal of granting a license, permission rights, improper motives, the lack of transparency in audits, or investigations of state or supervisory bodies, inconsistency in the procedure, serious negligence, undue delays, a lack of proper notification, etc. In such cases, the author posits the view that the conduct of the state organs or agencies shall be appealed in domestic courts in due course. Unless a domestic court makes a decision on these matters, the state responsibility at the international level would not be theoretically acceptable [299, p. 1076]. Practically, the domestic courts are better suited to review the decisions or conducts of state organs than the arbitration tribunals. For example, in the *ADF v. USA* case, the tribunal asserted that “the tribunal has no authority to review the legal validity and standing of the U.S. administrative law” [268, para 190]. Investors frequently refer to due process in administrative proceedings. Yet in practice it is difficult to define the scope of what kind of procedure is deemed fair or not.

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<sup>71</sup> The borderline between “gross defects” and “misapplication of national law” was described by Paulsson J. “*if a judgment is grossly unjust, it is because the victim has not been afforded fair treatment. That is the basis for responsibility, not the misapplication of national law in itself*”.

<sup>72</sup> For example, in the ECT case, *Liman Caspian Oil v. Kazakhstan*, the tribunal emphasized that “*an international arbitration tribunal is not an appellate body and its function is not to correct errors of domestic procedural or substantive law which may have been committed by the national courts. The Tribunal stresses that the threshold of the international delict of denial of justice is high and goes far beyond the mere misapplication of domestic law*”. Several other tribunals have held that they do not act as courts of appeal when hearing a claim of denial of justice *Mondev v. USA; Arif v. Moldova; Mobil Investments Canada Inc. and Murphy Oil Corporation v. Canada*.

<sup>73</sup> Recent IIAs incorporate the lack of transparency as an element of due process. For example, the CETA. Academics such as Dolzer R. and Schreuer C. argued that fair procedure and transparency are an elementary requirement of the rule of law and a vital element of FET. While Sornarajah M., for example, argued that “*rules [lack transparency] on which liability is being created are not based on international law principles but rather on notions that are imported from possibly faulty understandings of English and US administrative law. These principles cannot be imported into a treaty through a wide interpretation of the fair and equitable treatment standard in investment treaties. In addition, arbitral tribunals were not created under investment treaties to sit in judgment on the manner of the exercise of discretionary power by domestic administrative organs... It would appear that the tribunals are beating back the trend to argue that all administrative irregularity should be regarded as unfairness under the treatment standards*”.

It leads to the difficulty by tribunals in consideration of conduct of administrative organs of the host state. However, we should acknowledge that it is not a task of tribunals to prescribe a specific form of administrative or judicial fairness in host states [242, p. 227]. Therefore, in order to reduce pressure on the exercise of the administrative sovereign power of the host state, it is practicable to review the conduct of administrative state organs in domestic courts. In case domestic courts would breach the denial of justice, then international wrongs could be raised to the FET level under the ECT. It would help to examine the concept of denial of justice by tribunals from the totality of circumstances [283, p. 672].

Third, the proposed wording of denial of justice suggests that irregularities would constitute a breach of the denial of justice subject to the exhaustion of local remedies provided that this is not futile. International practice generally recognizes that reasonable, available, and effective steps should first be exhausted in the domestic court system [269, p. 390]. Moreover, it is noted that the classic circumstance in which the denial of justice manifests is the existence of a final judgment of the host state that is grossly and inordinately unjust [394<sup>74</sup>, p. 245; 299<sup>75</sup>, p.1074-1075]. In this manner, the exhaustion of local remedies and the finality of judgment rule helps to establish at what stage an international wrong in the form of denial of justice has occurred [269, p.388]. In fact, a number of tribunals have suggested that the exhaustion of local remedies is a pre-condition for the denial of justice breach [395, para 164; 396, para 232; 397, para 450]. The proposed wording suggests that investors do not have to strictly follow the exhaustion of local remedies if the pursuit of the remedy in the domestic legal system is wholly futile [269, p. 391-393; 398, paras 274, 276; 399; 400]. The futility shall be determined by tribunals case-by-case, “whether a remedy is reasonably available, in terms of either adequacy or efficacy” [394, p. 116]. That is, the one-sided assertion by the claimant or legal counsel or the respondent should not give a conclusion on futility [394, p. 116]. The current ECT text does not require exhausting local remedies in the Contracting Parties’ domestic courts, and investors can go directly to arbitration following the prescribed procedures in Article 26 of the ECT [18, article 26]. However, it does not mean that a claim of denial of justice, as this technical concept is known in international law, is ripe to bring. Exhaustion is an integral or inherent part of the denial of justice without which the delict would not crystallize. As to measures by non-judicial branches, in all States, one can challenge the actions of non-judicial branches in some courts or administrative tribunals. Therefore, there is a possibility of exhaustion, save for a situation of futility.

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<sup>74</sup> Paulsson J. “States are held to an obligation to provide a fair and efficient system of justice, not to an undertaking that there will never be an instance of judicial misconduct. National responsibility for denial of justice occurs only when the system as a whole has been tested and the initial delict has remained uncorrected . . . The very definition of denial of justice encompasses the notion of exhaustion of local remedies. There can be no denial of justice before exhaustion”.

<sup>75</sup> Sornarajah M. “This is a high standard for the foreign investor to satisfy. It is a reason why there has been a need to resort to the hitherto dormant standard of fair and equitable treatment. it would be difficult to see how in terms of strict international law responsibility could arise for an administrative fault unless a domestic court had finally denied a remedy in respect of that fault.”

*Manifest arbitrariness, unreasonableness and discrimination.* This dissertation proposes to incorporate the arbitrariness or unreasonableness, and discrimination in the new FET provision of the new ECT as set forth below:

“(b) *manifest arbitrariness, including unreasonableness and discrimination of similarly situated investors or investments*”

The general meaning of FET and arbitration practice generally confirms that these three standards could be a priori delicts of the FET. The three standards of arbitrariness, unreasonableness, and discrimination lie at the heart of the concept of FET. Thus, at least they ensure that investors and investments are protected against treatment by the host state, which even if not expropriatory, is still unacceptable because it is arbitrary, unreasonable, discriminatory, and unfair.

In Chapter 2, the author discussed in detail how international tribunals have interpreted the terms arbitrariness, unreasonableness and discrimination. Those interpretations would guide the interpretation of these terms in the context of the new FET. Therefore, the author clarifies the scope of the proposed wording.

In relation to arbitrariness or unreasonableness<sup>76</sup>, the proposed wording clarifies that arbitrary or unreasonable conduct could embrace both procedural and substantive arbitrariness. From a procedural perspective, the issue of arbitrariness could be a consequence of a procedural irregularity and in practice, the term could be closely linked to the due process<sup>77</sup> element [401; 402]. From a substantive perspective, arbitrariness focuses more on whether the measures in question fail to meet some criterion<sup>78</sup> of rational decision-making [276, paras 158, 162; 259, para 460; 403].

For example, to illustrate procedural and substantive arbitrariness, let us assume that a government agency requires the subsoil user (a foreign investor) to surrender part of the oil production zone and to conduct the decommissioning of production wells on this zone due to environmental concerns. In making such a decision, the government agency makes the decision based on discretion, prejudice and personal preference and without an appropriate environmental audit by experts as prescribed by the legislation and,

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<sup>76</sup> Some treaties use the word “unreasonable” instead of “arbitrary”. Some treaties use the word “unreasonable” instead of “arbitrary”. For example, Article 10 (1) of the ECT also uses the word “unreasonable”. Some tribunals noted that two terms are interchangeable (See, for example, *National Grid plc v. The Argentine Republic* [400, para 197]). Newcombe A., Paradell L. note that there is less authority for the proposition that the term “arbitrary” is to be equated with “unreasonable” term referring to *Waste Management Inc v. United Mexican States* [182, p. 250; 261, para 98]. Newcombe A., Paradell link substantive arbitrariness to rationality or proportionality and procedural arbitrariness to denial of justice, lack of due process and lack of due diligence. Recent IIAs use the term “arbitrariness” in the scope of FET rather than “unreasonable” (Article 8.10 CETA; Article 8 Canada Model BIT 2021; Article 4 Italy Model BIT 2022; Article 9 Netherlands 2019 BIT).

<sup>77</sup> See, for instance, *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*. According to *Genin Tribunal* the issue of arbitrariness as a consequence of a procedural irregularity [401, para 371]. According to *OI European v. Bolivarian Republic of Venezuela tribunal* “It is not easy to define what arbitrary is. The fundamental idea of arbitrariness is that legality, due process, the right to judicial remedy, objectivity and transparency in the State’s management are replaced by privilege, preference, bias, preclusion and concealment” [402, para 494].

<sup>78</sup> Several tribunals examined whether the measure alleged to be unreasonable or arbitrary was the result of a rational decision-making process. The examination includes the existence of a genuine public purpose and of a reasonable relationship between the aims pursued by the state and the value of the taken measures. See, for example, *Ronald S. Lauder v. The Czech Republic LG&E Energy Corp v. the Argentine Republic; Saluka Investments B.V. v. The Czech Republic* [276, paras 158, 162; 259, para 460; 403, paras 222, 230].

accordingly, wilfully disregards the due process. In this situation, the government agency (and the State by attribution) may be liable for a breach of procedural arbitrariness. If the government agency has not, in fact, sought to further the legitimate public purpose goal of protecting the environment, but is actually aiming to release the territory in order to for example facilitate its re-sale, the government agency may be liable under substantive arbitrariness because of the absence of a legitimate public purpose goal. That is to say, if such a measure inflicts damage on the investor without serving any apparent legitimate purpose, it could be assessed as an unreasonable or arbitrary measure.

Another example of procedural arbitrariness might be the situation where a subsoil user (a foreign investor) submits an application to extend the term of an oil production contract, and that submission is made in line with legal requirements. A government agency that considers the application handles it in a discriminatory or prejudicial manner, or disregards prescribed procedures and defined timelines. As a result, the term of the oil production contract expires, and the subsoil user has to stop production, incurring losses while the government agency is still trying to make its decision on the application. Depending on the applicable legislation and level of discretion that government agencies may enjoy, such scenarios could breach the proposed FET.

However, the proposed wording does not call for a breach of arbitrariness or unreasonableness standards based on a mere error in application of a legislation or proper procedure by the government agency. The proposed wording adds the adjectives “manifest” (i.e., blatant) arbitrariness or unreasonableness. In this way, the wording sets a high threshold for “arbitrary conduct” echoing the Judgment of ICJ in *ELSI*<sup>79</sup> “*arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law [...] [i]t is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety*” [277, paras 121-122]. The investor has to demonstrate that the host state’s conduct is “*beyond a merely inconsistent or questionable application of administrative or legal policy or procedure to the point where the action constitutes an unexpected and shocking repudiation of a policy’s very purpose and goals, or otherwise grossly subverts a domestic law or policy for an ulterior motive*” [404, para 293]. Mere errors in the application of the law and an unfriendly attitude to the foreign investor do not constitute arbitrary conduct [283, p. 650]. In this sense, recent IIAs incorporate the adjective “manifest” to the term “arbitrary” [257; 216; 217; 218]. NAFTA arbitration practice significantly contributed to the development of this wording. NAFTA tribunals have consistently maintained the view that “something more” than simple illegality is required to constitute arbitrary conduct [266, paras 91, 103, 104; 267, paras 617, 803, 817].

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<sup>79</sup> Many arbitral tribunals have taken the *ELSI* Judgment as guidance on determining the “arbitrary” measure. See, for instance, *Azurix Corp. v. The Argentine Republic*: “The Tribunal finds that the definition in *ELSI* is close to the ordinary meaning of arbitrary since it emphasizes the element of wilful disregard of the law” [378, paras 392, 393]. *Joseph Charles Lemire v. Ukraine*: Tribunal found that the underlying meaning of “arbitrary” was “*that prejudice, preference or bias is substituted for the rule of law*” [398, para 385].

In relation to discrimination, the proposed wording aims to clarify the scope of discrimination as an element of the new FET.

First, the proposed wording of the FET considers discrimination in situations where discrimination may take place when the host state makes an arbitrary or unreasonable distinction between similarly situated investors or investments.

The application of the terms “discrimination” and “discriminatory” is confused in the IIA context. Because the IIAs usually do not specify the term, it is unclear what type or types of discrimination are prohibited. In the IIA context, at least three relevant types of discrimination can be identified:

1) discrimination that is prohibited by international human rights law with respect to individuals, if it is based on factors such as race, sex, and religion [182, p. 251]. This type of discrimination was the subject of some NAFTA cases [261<sup>80</sup>, para 98]. NAFTA tribunals found that Article 1105 of NAFTA embraces some types of specific “discrimination” such as “sectional or racial prejudice” [261, para 98; 346, para 152; 405, para 502]. CETA has endorsed this approach and included it in the FET closed list [344, p. 112]. Other Model IIAs such as 2019 the Netherlands and 2022 Italy followed this approach.

2) discrimination relating to the status of the investor or investment based on nationality. For example, national law could limit State aid for foreigners in certain sectors [344, p. 112]. Typically, the MFN and NT obligations deal with nationality-based discrimination in IIAs and are designed to ensure that foreign investors or investments receive no less favorable treatment than either nationals or investments of the host state or third-party states [344, p. 112].

Moreover, this type of discrimination would allow that national law shall be applied without distinction on nationality unless the distinction is expressly provided in the law [344, p. 112]. If national courts apply national law in a discriminatory manner based on the nationality of the foreign investor, then on these grounds the foreign investor could invoke a claim referring to a denial of justice [344, p. 112].

3) discrimination may take place when the host state makes an arbitrary or unreasonable distinction between similarly situated investors or investments. This third type of discrimination is proposed to be incorporated into new FET clause.

Second, the proposed scope of discrimination takes a sectoral approach to as its basis of comparison. The comparison of different sectors is not relevant and may lead to uncertainty in practice. Too broad an approach was taken in cases such as *Enron v. Argentina*, *BG v. Argentina*, and *Sempra v. Argentina* which the tribunals held that inappropriate distinction between different sectors of the economy may amount to discrimination [305, para 282; 306, para 319; 406, para 354-360].

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<sup>80</sup> See, for instance, *Waste Management II* tribunal noted that *S.D. Myers*, *Mondev*, *ADF*, *Loewen* cases under NAFTA suggest that the MST of FET ‘is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair... is discriminatory and exposes the claimant to sectional or racial prejudice...’ [261, para 98].

Judgment about discrimination must be based on sensible comparisons. Even within the energy sector, comparison needs to take into account the specifics of the subsectors such as petroleum, nuclear, renewable and electricity. This limited approach is reflected in a number of ECT and non-ECT cases. For instance, *Nycomb v. Latvia* under the ECT and *Saluka v. the Czech Republic* non-ECT case took a limited sectoral approach for the basis of comparison. In the *Nycomb* case concerning the refusal of a higher price for generated electricity in the claimant's power plant, the tribunal used two other electricity generation companies for the basis of comparison [407, section 4.3.2]. In the *Saluka* case concerning, among other things, the provision of state aid for banks, the tribunal took three other domestically owned banks at the relevant times for the basis of comparison [259, para 313]. The *Electrabel v. Hungary* tribunal noted that “(i) comparators should be materially similar; (ii) there must be no reasonable justification for differential treatment” [307, para 175].

Third, the proposed concept of discrimination supposes that discriminatory intent is not a requirement for a finding of discrimination and the fact of unequal treatment would be sufficient. This position is generally supported by tribunals, which held that discriminatory intent is less significant than the impact of discriminatory conduct [303, para 177; 408, para 321; 307, para 7.152].

Fourth, discrimination significantly overlaps with concepts of arbitrariness or unreasonableness [182, p. 252]. In practice, during the interpretation of the proposed wording alleged regulatory measures should be considered from the perspective of the totality of these three delicts.

*Abusive treatment.* This dissertation proposes to incorporate the abusive treatment in the new FET as set forth below:

“(c) abusive treatment such as harassment, duress, or coercion”.

First, by proposing this wording, this dissertation posits that there is sufficient arbitration practice and academic writing to include abusive treatment as part of the FET delicts. Several tribunals have found that FET may apply in situations of abusive treatment such as harassment, duress, and coercion [409, para 519; 410, para 123]. Based on arbitration practice, recent IIAs have incorporated abusive treatment as a delict of the FET [216; 217; 218; 257].

Second, the proposed wording is a more specific emanation of the good faith element of the FET [269, p. 427]. The abusive treatment however delict is more specific and substantiated in practice than the good faith.

Third, the importance of this delict was recognized particularly in capital-intensive sectors, and large long-term investments such as those in the energy sector [283, p. 662]. Foreign investors in these sectors can particularly be vulnerable to government pressure, harassment, or other intimidation tactics [283, p. 662].

Fourth, abusive treatment in the proposed wording can take different forms. Commonly, it might involve the direct or indirect intervention of government agencies and take place in oral or written form. The list of conduct qualifying as abusive treatment

differs<sup>81</sup> from treaty to treaty [257; 216; 217; 218]. Harassment, duress, or coercion are three delicts of abusive treatment that are generally accepted in practice. For example, tribunals have found abusive treatment in case of unreasonable pressure by a government agency to reach certain goals, deliberate politically motivated State campaigns, threatening the termination of the contract writing letters, inadmissible pressure to accept or execute agreements or renegotiate the contract terms, and unlawful governmental interference with contractual relations are some examples [411, para 221; 410, para 123; 328, para 134; 412, para 273-275]. A prominent example of abusive treatment and the politically motivated campaign is the *Stati v. Kazakhstan* case, in which the tribunal held that various measures of coordinated harassment by state institutions constituted a breach of the FET under Article 10 (1) of the ECT [79, para 1095]. Such harassment measures included inspections of the companies of the claimant by seven different Kazakh agencies, including the General Prosecutor's office and Financial Police [79, para 1085-1092]. In this case, all of these harassment measures were part of further expropriation of the investment [79, para 1085-1092].

Fifth, regarding the threshold of the breach, the proposed wording posits that a mere unfriendly attitude of government agencies to the foreign investor does not constitute abusive treatment, abusive treatment should be demonstrated in the forms of inadmissible pressure, threatening, interference, etc.

### 3.1.3 Reservation of space for regulatory measures

Proposed preamble wording:

*“RECOGNIZING the right of the Contracting Parties to regulate within their territories in order meet public policy objectives, including but not limited to the protection of the environment, public health, consumer rights, climate-change mitigation, energy security”.*

In the main text of the new ECT in Part III, it is proposed to incorporate a separate article “Investment and Regulatory measures” before Article 10 of the ECT or a separate paragraph in Article 10. The proposed article or paragraph should preserve the right to regulate. Therefore, it is proposed the paragraph:

*“For greater certainty, the bona fide exercise [footnote] of Contracting Parties’ right to regulate within their territories to achieve public policy objectives, including but not limited to the protection of the environment, public health, consumer rights, climate-change mitigation, energy security should not be treated as a breach of the fair and equitable treatment obligation”*

*“Footnote wording: the determination of whether there is bona fide exercise requires a case-by-case and fact-based consideration”*

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<sup>81</sup> For instance, Article 8.10 CETA; Article 8 Canada Model BIT 2021; Article 4 Italy Model BIT 2022 include harassment, duress and coercion. While Article 9 Netherlands 2019 BIT include harassment, coercion, abuse of power, corrupt practices or similar bad faith conduct.

The proposed right to regulate norms is theoretically and practicably justified in the new ECT framework.

As discussed in Chapter 2, various reservations of regulatory space incorporated in IIAs would not satisfactorily safeguard the interests of States, except in case of carve-out clauses that operate to exclude the entire sector or policy area from the scope of the IIA. General exceptions provisions borrowed from ITL have actually added uncertainty in the application of exceptions. This dissertation posits that carve-out clauses are not applicable because States might try to use measures that appear to protect the environment or public health as a cover for illegitimate purposes. Considering the political risk, the long-term, capital-intensive nature of the energy sector, and often “obsolescing bargains”, carve outs might not be appropriate for regulatory measures under discussion here. Rather this dissertation proposes the incorporation of the right to regulate with strict nature that not only operates as a guard against “regulatory chill” but may also limit the liability arising from the breach of FET. This dissertation, therefore, proposes a careful approach towards protecting the right to regulate, by incorporating it in the preamble too. This will allow striking a balance in tribunals’ interpretation of FET obligations and the right to regulate in the main ECT text.

In comparison with the current ECT which omits<sup>82</sup> the right to regulate, this proposed positive language, taking into account Article 31.1 of the VCLT which refers to the interpretation in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose, would help to explicitly incorporate the intention of the ECT Contracting Parties with regard to the right to regulate [6, p.3]. The proposed preamble wording takes into account objectives of the IEC<sup>83</sup> signed in 2015 and regulatory measures sensitive to the regulatory space of the ECT

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<sup>82</sup> Article 2 of the current ECT contains a manifold purpose that is directed to establish a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the EEC [17; 6, p.3]. Title I of the EEC contains a long list of objectives [194; 6, p.3]. They group the development of trade in energy, and cooperation in the energy field, including the formulation of stable and transparent legal frameworks creating conditions for the development of energy resources, energy efficiency, and environmental protection. Title II of the EEC, in turn, includes implementation actions to attain the objectives [194; 6, p.3]. The goal of formulation of stable and transparent legal frameworks is enshrined within the implementation scope. It served as a basis to address uncertainties of the FET scope in a number of cases [194; 6, p.3]. At the same time, the cumulative objectives of the EEC are regarded as implicitly referring to the economic development of Contracting Parties [194; 6, p.3]. However, the economic development objective was not given an explicit form in the EEC and the ECT objective, but rather it was enshrined in the preamble of the EEC [194; 6, p.3]. It is maybe one of the reasons for the interpretation in favor of investors when tribunals have sought to resolve interpretative uncertainties of the FET scope [6, p.3].

<sup>83</sup> Title I, IEC, “*Recognising the global challenge posed by the trilemma between energy security, economic development and environmental protection, and efforts by all countries to achieve sustainable development; Recognising the sovereignty of each State over its energy resources, and its rights to regulate energy transmission and transportation within its territory respecting all its relevant international obligations*”

Particularly, the objectives of the International Energy Charter:

*“The signatories are desirous of sustainable energy development, improving energy security and maximizing the efficiency of production, conversion, transport, distribution, and use of energy, to enhance safety in a manner which would be socially acceptable, economically viable, and environmentally sound.*

*Recognizing the sovereignty of each State over its energy resources, and its rights to regulate energy transmission and transportation within its territory respecting all its relevant international obligations, and in a spirit of political and economic cooperation, they decide to promote the development of efficient, stable and transparent energy markets at*

Contracting Parties (as discussed in this dissertation) [64]. Specifically, the proposed preamble wording acknowledges the rights of the ECT Contracting Parties to regulate the investment of the investors of other ECT Contracting Parties within their territory in order to meet legitimate policy objectives.

The proposed positive preamble language does not create obligations or limit the investment protection provisions but rather it provides an interpretative tool and signals to tribunals the intention of the ECT Contracting Parties. Moreover, it means that investor protection obligations are not absolute under the ECT [414]. The incorporation of both the right to regulate and investment protection purposes in the preamble is designed to lead to more balanced interpretative results.

The protection of the public interests should be one of the primary purposes of ECT Contracting Parties. In this context, the new ECT investment protection framework should be established based on the right to regulate as the centerpiece. It is seen that the reservation of rights is designed to allow the implementation of measures that are necessary to protect vital public interests which apply to the specific energy sector. In order to prevent abuse of this reservation, it should be clarified that the measures must be applied in a non-arbitrary manner.

The burden of proof on the investor is to prove that the measure is not exercised in a bona fide manner and is abusive, targeted discrimination, and blatant arbitrariness. The measures that are not treated as legitimate and bona fide do not give rise to the obligation to compensate those affected.

The proposed wording of the right to regulate embraces the reservation for various regulatory measures including the protection of public health, safety, the environment, climate-change mitigation, adaptation, and social or consumer protection, the importance of which were discussed in Chapter 1. The ECT Contracting Parties shall reserve a sufficient right for regulation in the modernized ECT framework for purposes of public policy objectives. The new FET shall be aligned with the regulatory rights of the ECT Contracting Parties.

The proposed right to regulate may provide tribunals with the right to apply a balancing exercise or proportionality analysis. The dissertation is cautious in proposing to incorporate proportionality in the ECT framework since there are fewer theoretical and

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*regional and global levels based on the principle of non-discrimination and market-oriented price formation, taking into account environmental concerns and the role of energy in each country's national development.*

- *promotion of a sustainable energy mix designed to minimize negative environmental consequences in a cost-effective way through:*
    - i. *market-oriented energy prices which more fully reflect environmental costs and benefits;*
    - ii. *efficient and coordinated policy measures related to energy;*
    - iii. *use of renewable energy sources and clean technologies, including clean fossil fuel technologies;*
  - *achieving and maintaining a high level of nuclear safety and ensuring effective cooperation in this field;*
  - *promotion of cooperation to reduce, as much as possible, gas flaring and venting;*
  - *sharing of best practices on clean energy development and investment;*
- promotion and use of low emission technologies.*

practical limitations for its inclusion which are discussed in Chapter 2. Yet, it is possible that proportionality may be applied by tribunals at their discretion as a “tool” in balancing the breach of delicts of the FET and the right to regulate.

### **3.2. Application of the proposed FET provision to various measures of ECT Contracting Parties**

Based on the proposed FET wording and the right to regulate provisions, this sub-Chapter would like to test hypothetically different public policy measures under these provisions in order to examine the effectiveness of the proposal:

the new FET wording:

*“(a) denial of justice in criminal, civil, or administrative adjudicatory proceedings;  
(b) manifest arbitrariness, including unreasonableness and discrimination of similarly situated investors or investments;  
(c) abusive treatment such as harassment, duress, or coercion.”*

preamble wording:

*“RECOGNIZING the right of the Contracting Parties to regulate within their territories in order meet public policy objectives, including but not limited to the protection of the environment, public health, consumer rights, climate-change mitigation, energy security”.*

*the right to regulate as a separate Article:*

*“For greater certainty, the bona fide exercise [footnote] of Contracting Parties’ right to regulate within their territories to achieve public policy objectives, including but not limited to the protection of the environment, public health, consumer rights, climate-change mitigation, energy security should not be treated as a breach of the fair and equitable treatment obligation”*

*“Footnote wording: the determination of whether there is bona fide exercise requires a case-by-case and fact-based consideration”*

*Measures to protect the environment.* Emerging environmental concerns of the ECT Contracting Parties discussed in Chapter 1 require them to implement measures to protect environmental interests. These measures include a wide range of regulatory actions, such as moratoriums or bans on issuing new exploration or exploitation licenses in environmentally sensitive areas, prohibitions for using certain types of drilling technologies, and heavy penalties for pollution, gas emission<sup>84</sup>, or excessive flaring, as well as promoting or possibly even subsidizing investments in certain types of energy resources, e.g., renewable sources.

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<sup>84</sup> For instance, the Decision of the Specialized Interdistrict Economic Court of Atyrau dated 29 April 2014 imposed the most significant penalty on AGIP KCO and NCOC Consortium (Eni, Total, Shell, ExxonMobil, Inpex, CNPC, KMG) – Operators of Kashagan O&G field in Kazakhstan in the amount of 134 billion KZT tenge – around 744 million USD dollars at the time of imposition. NCOC appealed the decision based on the argumentation of the excessive and discriminatory character of the penalty but did not achieve success. After several rounds of negotiations with the Government of Kazakhstan and the threat of arbitration, the Consortium signed a Settlement Agreement with the Kazakh Government.

As an example, two years ago, an interesting case was initiated in the Kazakh courts [415; 416]. The case has been appealed all the way through the Supreme Court, but the investor has not initiated international arbitration because the Supreme Court ruled for the investor. The circumstances of the case, however, typify what a foreign investor in a major extractive industry project may face. Therefore, the author will use it with some modifications, to test whether it would trigger the protections under the proposed FET wording if the Supreme Court had ruled against the investor.

The investor in this case is operating a major oil field under a PSA, which has strategic importance to the Kazakhstani economy. During an unscheduled environmental audit, the local environmental agency found excessive levels of wastewater discharges (production and household waste) with pollutants entering the storage ponds. From storage ponds, the wastewater evaporates. This is an environmental and public health issue because this wastewater holds several hazardous chemicals, including methane, which are byproducts of oil production. When the wastewater evaporates, it pollutes the air. When the wastewater soaks away, it pollutes groundwater.

During the first unscheduled environmental audit, the agency imposed a relatively small fine of USD \$3000 and ordered the modernization of the water treatment facility in line with the requirements of the state's Environmental Code. The local environmental agency did not set a deadline for the modernization of the facility. Instead, it monitored the level of hazardous wastewater once a month. The investor started feasibility and design studies for the modernization of the water treatment facility and found that it is needed to construct two new water treatment facilities to achieve full compliance with the agency order and that this would take two years.

During a second environmental audit, the local environment agency again found an excessive level of chemicals in the discharge and was required to halt discharging of the wastewater. The investor disagreed with the agency's results of the inspection. There was clearly a disagreement between the investor and the local environmental agency on the allowable amount of excess chemicals under the legislation of Kazakhstan.

Moreover, the investor stated that in order to cease wastewater discharge, it would be necessary to cease oil production until the completion of the new wastewater treatment facilities. This oil field produces 17% of the total oil production in Kazakhstan and generates billions of dollars in profit for the investor.

The local environmental agency disagreed and sought recourse through the national court for enforcement of its decision. The court considered the case with the involvement of environmental experts. The court undertook a balancing exercise to assess the consequences of the wastewater pollution and the oil field shutdown. The court decided in favor of the investor, substantiating its decision on the basis of several facts: 1) the excessive level of chemicals in wastewater does not entail greater negative consequences for the environment than the consequences of stopping all production activities for oil and gas production at the field; 2) As a result of the shutdown of the field, all gas in the system and equipment would be sent for flaring or be released into the atmosphere, which might

have a more negative impact than the wastewater; 3) the investor was taking measures to improve the qualitative composition of wastewater through the construction of the prescribed new facilities; 4) the regulatory framework of the Republic of Kazakhstan lacks methodological documents and instrumental methods for determining the impact of pollutants on the atmospheric air from wastewater discharge sources; 5) more than 40 contracting companies and more than ten thousand employees are involved in the field production and shutdown would lead to redundancies associated with negative socio-economic consequences.

The local environmental agency appealed the court's decision to the Supreme Court. The Supreme Court did not uphold the appeal.

In fact, according to the view of the author, in Kazakhstani court practice on environmental disputes, it is rare to engage in a balancing exercise between environmental public policy and economic/social consequences of the environmental measure. This decision of the Supreme Court raises questions and creates a negative precedent in consideration of environmental disputes in major O&G projects in Kazakhstan.

Thus, let us assume, for the sake of argument now, that the Supreme Court, hypothetically, had overturned the rulings of the lower courts, enabling the investor to bring a claim for denial of justice under the proposed FET wording.

First, the facts of the case suggest that it could possibly be a breach of due process in administrative proceedings. The lack of clear procedures in Kazakh legislation on methodological approaches and instrumental methods for determining the impact of pollutants on the atmospheric air from wastewater discharge sources brought uncertainty to the evaluation of the amount of excess chemicals in wastewater. The local environmental agency relied on its own methods and methodology of calculation. The local environmental agency was aware that the modernization of water treatment facilities would take at least two years. Despite this awareness, the local environmental agency imposed a severe measure to halt the discharge of wastewater that would lead to the shutdown of the field. The agency did not set precise deadlines for the modernization of water treatment facilities. The investor acknowledged that the existing water treatment facility could not achieve cleansing of wastewater to the standard required by the local environmental agency but the investor ensured that the investor would deal with this within two years. On the other hand, the local agency provided the investor with the right to be heard and was transparent in its dealings. In this case, by allowing production to continue, the local environmental agency would fail to properly follow its own procedure and uphold its own standards.

The proposed FET wording, it is recalled that, excludes due process from the FET delict of denial of justice. However, the fair procedure or due process delicts would be compensated through the arbitrariness or unreasonableness delicts under the proposed FET. The facts of the case give rise to a breach of arbitrariness or unreasonableness. In matters concerning arbitrary or unreasonable measures, it is important to incorporate objective measurement of the negative impact of irregularity. In this case, the negative

impact of irregularity is manifest since it led to the shutdown of the field and brought material loss for the investors billions of dollars.

Second, the investor might possibly claim discrimination since the local environmental agency did not provide proper substantiation for their decision. The investor could easily provide comparable examples of wastewater treatment from nearby major O&G fields.

Third, if the national court relied on the facts of the government agency and did not take into account all the facts of the case, the investor can raise procedural or substantive breaches of denial of justice in adjudicatory proceedings.

Fourth, it appears that there is a low likelihood of claiming indirect expropriation because the oil production would have solely been temporarily suspended and there would have been no transfer of property rights. The investor possibly might claim only the FET breaches.

The proposed right to regulate wording allows Kazakhstan to implement public policy measures aimed at the protection of the environment. Moreover, a bona fide exercise of the measure should not result in a breach of the proposed FET. Therefore, in examination of the facts, firstly, a tribunal should place a burden of proof on the investor to justify that the exercise of the measure was not in bona fide manner, secondly, arbitrary or unreasonable or discriminatory, including denial of justice.

In arbitration practice, most environment-related disputes have been initiated under the expropriation clause rather than the FET. Under FET, investors have mostly challenged the stability obligation or argued that their legitimate expectations have been frustrated by the host states' specific measures aimed at protecting the environment. In two recently initiated arbitration claims against the ECT Contracting Parties *Ascent Resources v. Slovenia and Rockhopper v. Italy*, both investors, for example, have claimed the breach of Article 13 of the ECT on expropriation and Article 10 of the ECT FET on obligations [114; 417; 418; 419].

The claimant in the first case, Ascent Resources – a UK-based company,<sup>85</sup> has recently submitted a request for arbitration against the Republic of Slovenia for measures taken to prevent development of the Petišovci oil and gas field in northeastern Slovenia [419, paras 2.3, 2.4, 2.5, 2.6, 2.7]. The claimant has challenged the ban adopted by Slovenia's different State bodies which prohibits holders of mining rights from carrying out exploration and exploitation of hydrocarbons with the use of any hydraulic stimulation (fracking) [417, para 1.2.1]. The claimant as part of petroleum operations in 2011 had drilled two new wells and afterwards performed hydraulic stimulation [419, para 3.6]. The threshold stipulated in Slovenian law for environmental impact assessment (EIA) did not apply to this case [419, para 3.6]. Further, in 2017 the claimant performed additional

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<sup>85</sup> Ascent UK and Malta-based companies in a joint venture with Geoenergo-a Slovenian company hold a license in relation to the Petišovci oil and gas field granted by the Government of Slovenia. Ascent Malta holds a 75% participating interest in the joint venture, while Geoenergo holds the remaining 25%. The joint venture was first established under a Joint Venture Agreement dated 23 March 2001 and is currently governed by the Restated Joint Operating Agreement between Ascent Malta and Geoenergo dated 30 October 2013. Overall, they have invested sums in excess of €50 million in Slovenia.

hydraulic stimulation. Out of an abundance of caution, and at the request of Geoenergo<sup>86</sup>, the Slovenian Environmental Agency (ARSO) conducted an EIA. ARSO's cautious decision prevented the use of further hydraulic stimulation and was appealed through local courts [419, para 3.7, 4.5]. The Administrative Court held that the ARSO's decision did not contradict Slovenian law [419, para 4.5]. On 6 April 2022, Slovenia's Parliament voted to adopt amendments to Slovenia's Mining Law which prohibit holders of mining rights from carrying out the exploration and exploitation of hydrocarbons with the use of any hydraulic stimulation [417, para 1.2.1]. The ban entered into force on 5 May 2022 [417, para 1.2.1].

Ascent Resources claimed that ARSO's decision caused losses [419, para 4.6], and Slovenia's measures constitute a breach of FET and unreasonable and discriminatory standards under Article 10 (1) of the ECT and Article 2 of the UK-Slovenia BIT [419, para 5.1].

Aside from this Slovenian case, fracking is a general environmental concern [420, p. 394]. During a fracturing operation, breaks in the rock can extend upwards into drinking water aquifers and perhaps to the subsurface [420, p. 394]. There is political and scientific discussion around other indirect negative effects of fracturing operations on waste disposal, air, water and land pollution and public health [420, p. 390-400].

The second case is related to the moratorium on granting oil exploration permits in environmentally sensitive areas in Italy. In February 2019 the Italian Parliament passed Law 11/2019. This law imposes a moratorium on exploration permits and new applications for production concessions for a period of eighteen months [114]. During this period Italy's Government would identify suitable areas for O&G production taking into account environmental issues [114]. In light of the law, in September 2021 the Italian Ministry of the Ecological Transition approved the Plan for the Sustainable Energy Transition of Sustainable Areas (PiTESAI) that liberalized gas exploration activities in the territory of Italy [114]. PiTESAI limited exploration to gas only excluding oil [114]. Accordingly, all exploration permits that are not compatible with PiTESAI will be revoked [114]. Any direct and consequential claims of investors arising from revoked licenses would be handled from the increased administrative fees on hydrocarbon activities [114].

In early 2017, the UK-based energy company Rockhopper commenced an arbitration claim against Italy under the ECT in relation to the Ombrina Mare project [418]. The Rockhopper claimed a breach of FET under Article 10 (1) of the ECT [418, para 96]. The claim arose out of the decision of the Ministry of Economic Development not to award the Rockhopper a production concession on the Ombrina Mare project located within 12 miles of the coast of Italy [418]. On 24 August 2022 the Tribunal rendered a decision on this case which is publicly not available [117]. The Tribunal found unlawful expropriation and awarded the sum EUR 190 million [421].

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<sup>86</sup> Geoenergo holds the remaining 25% in the joint venture.

The Ascent Resources and Rockhopper cases set out a good example of the type of situations where FET claims are brought under ECT, even though it is early to assess the facts of the claims when the decisions are not yet available.

The aim of the proposed FET standard is to enhance certainty and clarity in such cases when the FET is applied. The proposed FET excludes the stability obligation and the frustration of legitimate expectations and sets a high threshold for other delicts. In the case of Slovenia, for example, if the investor hypothetically had brought its claim pursuant to the proposed FET provision in this dissertation, the investor could not claim the frustration of legitimate expectations and the breach of stability obligation. However, the claimant would have had a better chance of asserting breach of arbitrary or unreasonable conduct, discriminatory elements, and due process under the proposed FET scope<sup>87</sup>. If the investors' business suffers after the total ban of the operations due to environmental considerations, probably it would be qualified as expropriation rather than an FET breach. In case the investor will be able to continue the operation, the bona fide imposed regulatory measures shall not be compensated. Therefore, the proposed FET left sufficient room for the bona fide legitimate regulatory measures of the investor.

*Measures to achieve climate-change goals and energy security.* Chapter 1 has elucidated two case studies on the EU and Kazakhstan regulatory frameworks and the character of the regulatory measures. From these two case studies, it is observed that the main regulatory measures aimed at the promotion of clean energy such as regulatory incentives, the close of coal plants, carbon taxes, and so forth. These measures are globally related to the prevention of climate change, rather than specific environmental issues discussed above. Further, the current ISDS system creates a conflict in international law between standards of protection in IIAs and treaties that aim to reduce GHG for example, Paris Agreement by burdening states with multi-million awards or liability to compensate affected foreign investors when they attempt to make progress towards environmentally friendly targets such as NetZero. This conflict between the right to regulate and stability/legitimate expectations obligations is particularly clear in the two Spanish cases and other awards discussed earlier. The dissertation proposed to resolve this conflict inter alia through the exclusion of stability obligation/protection of legitimate expectations from the FET delicts and the incorporation of stricter right to regulate provision. It is therefore crucial how these measures will be fallen within the scope of the proposed FET and the right to regulate.

In relation to the measures aimed at the shut-down of coal plants, the proposed FET wording and the right to regulate safeguard the right to regulate of the ECT Contracting Parties.

The main idea of the proposed wordings was to put forward the right to regulate as the centerpiece of the ECT and in such situations FET protection would only be possible when the right to regulate has been improperly exercised. The proposed FET excludes the

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<sup>87</sup> The Claimant claimed that ARSO had to issue a decision within two months in accordance with the Slovenian law but ARSO issued a draft decision over a year [419, para 4.1].

stability obligation and the frustration of legitimate expectations and sets a high threshold for other delicts. In the case of arbitration claim<sup>88</sup> against the Netherlands discussed in Chapter 1 due to the Coal Ban Act, for example, if the investor hypothetically had brought its claim pursuant to the proposed FET provision in this dissertation, the investor could not claim the frustration of legitimate expectations and the breach of stability obligation [422, paras 29, 456, 461, 462 (a)]. However, the arbitrariness or unreasonable, discrimination delicts of the new proposed FET could be raised. In finding a breach of the FET delicts, a tribunal may apply proportionality analysis to compare alternative or less intrusive measures than a total ban. As discussed at the beginning of the dissertation pleading for a breach of FET shows an attractive alternative to the expropriation clause. The new proposed FET carves out the headings of the claim on the protection of a stable legal framework and the frustration of legitimate expectations. Therefore, hypothetically the claimant rather has to attempt to justify the expropriation. In the fact of the case, the claimant mainly raised the expropriation clause and the FET was raised as the supplementary heading of the claim. However, there is still an open question in arbitral practice regarding paying compensation for regulatory expropriation for legitimate policy objectives. This topic is beyond the subject of this dissertation but is widely discussed in several decisions of tribunals and academic writings [423].

The EU ECT Contracting Parties are applying different support schemes which could be subject to the proposed FET scope in case the Contracting Parties conduct in an arbitrary or unreasonable and discriminatory manner. Contracting Parties have defined support schemes broadly. For example, the 2018 EU Directive defines the support scheme as:

*“any instrument, scheme, or mechanism applied by a Member State, or a group of Member States, that promotes the use of energy from renewable sources by reducing the cost of that energy, increasing the price at which it can be sold, or increasing, by means of a renewable energy obligation or otherwise, the volume of such energy purchased, including but not restricted to, investment aid, tax exemptions or reductions, tax refunds, renewable energy obligation support schemes including those using green certificates, and direct price support schemes including feed-in tariffs and sliding or fixed premium payments”* [96, art. 2 (5)].

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<sup>88</sup> The claimant-Uniper Group raised the FET under Article 10 (1) in three ways: an unreasonable and disproportionate measure; frustration of legitimate expectations; legal regime was fundamentally and radically changed. According to the Claimants, the Coal Ban Act requires shutdown without payment of any financial compensation by no later than 1 January 2030 but envisages in-kind compensation within ten-year transition period. In the context of the FET, the Claimants do not dispute the legitimate policy goal of the Netherlands to reduce carbon emissions. Rather the Claimants put forward the question for the Tribunal whether the Coal Ban Act was the least intrusive measure available to the Netherlands in order to achieve that goal and whether the Netherlands took its measures with “*due regard for the consequences imposed on*” the Claimants. In this regard, the Claimants raised the reasonableness and proportionality elements of the FET. The Claimants argue that the Netherlands had available to it alternative and less intrusive measures that would have in fact been more efficient for meeting its policy goal of reducing emissions, but instead chose the politically expedient option of banning the use of coal entirely for the production of electricity [422, paras 29, 456, 461, 462 (a)].

Qualifying the scheme as a tax measure seems particularly attractive for the ECT Contracting Parties, because it may help putting the measure within the ECT Article 21 which contains a carve-out for tax matters [2, p.269]. This approach, however, does not automatically preclude investors from bringing claims relating to such measures. Arbitral jurisprudence shows that arbitral tribunals do not dismiss a case simply because the defendant State argues that the contested measure was a tax. *9REN v. Spain* case best illustrated this discussion [100, paras 190-195]. Even for support schemes non-related tax, if the investor hypothetically had brought its claim pursuant to the proposed FET provision in this dissertation, the investor could not claim the frustration of legitimate expectations and the breach of stability obligation.

Consider hypothetically a case in the Kazakhstani example. The foreign investor operating a wind farm generating electricity concluded the contract with a state agency for a sale of electricity based on a fixed tariff in national currency tenge as a result of the auction in line with Law “On supporting the use of renewable energy sources” dated 4 July 2009. The determination of the fixed tariff is linked to the international obligations of Kazakhstan to promote clean energy. The current legislation provides for the possibility of the adjustment of the fixed tariff once a year subject to the changes in the exchange rate of the national currency to USD and the inflation rate. The adjustment is based on a complex formula depending on the sources of renewable energy. Due to the high inflation rate and considerable fluctuation of the national currency, the state agency refused to adjust the fixed tariff substantiating that the fixed tariff is reasonable in comparison with the other electricity producers from renewable energy sources. The investor argued that he will incur significant losses during the next year if the state agency does not make an adjustment. The state agency further denied considering the proposals of the investor on the adjustment formula. It led to the claim of the investor in the national court against the state agency. The national court held a decision in favor of the state agency taking into account the reasonableness of the fixed tariff in comparison with other renewable energy plants. Under the new proposed FET, despite the investor having no right to claim stability obligation, and the frustration of the legitimate expectations, the investor may claim unreasonableness and discrimination substantiating that the investor was treated discriminatorily and arbitrarily in comparison with other investors in the same sector.

Let us change the above case a bit and assume that the state agency would refuse to adjust the fixed tariffs on the ground that further increase would be burdensome on the state budget and consumers. In other words, the state agency advances a public purpose as the main argument. The national court would then render a decision in favor of the state considering the public purpose of the measure. In this scenario, under the purposed right to regulate wording, a tribunal should give preference to the public purpose of the measure. The tribunal should consider the new FET wording if the investor challenges the legitimate and bona fide character of the measure. The rationale of the proposed wording of the right to regulate exception is that the measure should have a permissive nature than

a defence. If the investor shows that there is a denial of justice, or unreasonableness of the measure, then the tribunal may consider a breach of the FET delicts.

In practice, there are other examples related to energy security such as the obligation of O&G companies to deliver a certain amount of extracted O&G products to the domestic market at a fixed lower price or the reduction of oil production under the OPEC+ obligations, etc. In another case, an investor was required to deliver 100% of extracted O&G products to the domestic market during an exploration phase, and 30% during a production phase. The investor disagreed with this obligation defined by a state agency and argued that a state agency unreasonably and discriminately applied requirements because the legislation provides for differential mechanisms depending on the production and transport expenses of each O&G field. Therefore, the investor argued that the obligation is burdensome in comparison with other companies delivering 20% or 30% of products to the domestic market. Given a material loss in profit due to the applied measures, the investor claimed this measure in a national court. The national court decided in favour of the state agency due to energy security public purpose. If this case hypothetically was considered in international arbitration, under the proposed right to regulate exception to FET, first, a tribunal should consider the bona fides of the measure in light of energy security. If the investor does prove that the measure is not related to energy security public purpose, then a tribunal should move to the analysis of the FET breach. The proposed right to regulate exception would leave sufficient room for the bona fide exercise of these measures.

*Measures to protect public health and measures related to economic sanctions.* Apart from the public health problems arising in energy operations as discussed in Chapter 1, states have faced unprecedented problems in addressing the COVID-19 pandemic. To respond to the COVID-19 pandemic states, including the Contracting Parties imposed and continue to impose restrictions on social and economic activities, including lockdowns, restrictions on travel, and public gatherings. Since the energy sector is an essential part of the Contracting Parties' infrastructure, the pandemic had an impact on energy consumption, investments, operations, and industry in its entirety [424]. The pandemic highlighted the significance of the right to regulate in the context of implementing measures to protect public health. In this context, IIA provisions could come into play in relation to the measures of the states implemented to address COVID-19 [425]. For instance, in the case of FET, certain elements of the FET might be invoked for imposing export restrictions, and difficulties may arise when assessing the reasonableness of the measure under a FET [425]. Generally, the statistics of ISDS demonstrate that the FET is often invoked standard in health-related cases [426, p.6].

As of the date of writing, the political situation in the Eurasian continent is destabilized. Russia and Ukraine are at war, and Western economies have imposed a series of sanctions on Russia and Belarus. These sanctions are unprecedentedly broad in range and cover almost all sectors of the Russian economy [427; 428]. They cover export and import restrictions for certain products including energy products such as crude oil, petroleum

products, coal, metals, etc. [428]. In response to sanctions, Russia adopted retaliatory measures directed against companies from “unfriendly countries” – countries (US, UK, EU member states) that imposed sanctions against Russia [429]. In the context of this confrontation between Russia and Western countries, there are two possible scenarios of arbitration claims under the proposed modernized FET provision of ECT.

The first possible scenario envisages an “unfriendly country” foreign investor claim against measures taken by the Russian state relating to the free transfer of funds and transfer of foreign currency [430]. For example, there are ongoing proceedings in a national court of Russia between ExxonMobil and the Ministry of Finance/General Prosecutor office in relation to the execution of the Russian President’s resolution on the prohibition of selling ExxonMobil’s shares in the Sakhalin-1 project [431]. ExxonMobil announced that it would terminate operations in Sakhalin-1 and sell its share. However, the above state agencies prohibited executing it and seized assets of ExxonMobil. ExxonMobil claimed that the ban infringes on its rights and prevents it from exiting the project. In light of Article 45.3 b of the ECT “Sunset clause” the ECT investment protection provisions are binding for Russia from 30 July 2009 for twenty years till 2029 for investments made during provisional application [432].

In the second possible scenario, Russian foreign investors (including those who are on the sanction list) could initiate arbitration claims against other ECT Contracting Parties, for example, against EU member states for frozen assets, including their shares in energy companies. US and Canada passed laws intended to seize the frozen assets of Russian nationals [433;434]. The legality of such measures and their subject to investment claims remain to be comprehensively examined.

In light of the new proposed FET wording, in both scenarios perhaps investors are likely to argue that those economic sanctions/ retaliatory measures constitute a denial of justice, arbitrary conduct, and discrimination delicts. Issues related to sanctions are not new in arbitration and have been a topic of discussion before in a number of studies in relation to situations in Iran, Libya, and Iraq [435]. There has been a question regarding the arbitrability of the measures arising from sanctions under IIAs. Generally, there is an understanding that arbitral tribunals can review the measures related to international sanctions in line with the object and purpose of IIAs [436]. The issue of sanctions is mostly a subject of international commercial arbitration. For example, *the Fincantieri v. Ministry of Defense of Iraq* and *La Compagnie Nationale Air France v. Libyan Arab Airlines* cases concerned breaches of contractual obligations due to sanctions [437]. Moreover, there are cases where measures related to sanctions are subject to State-to-State negotiations, such as the Iranian and South Korean negotiations over frozen funds in South Korean banks and removing the ban on oil import [438].

### **Findings and concluding remarks on Chapter 3**

In light of the research question, this Chapter provided a number of proposals to resolve the theoretical and practical issues found and discussed in Chapters 1 and 2. The

Chapter has completely reconsidered the current FET norms under Article 10 (1) of the ECT.

Firstly, the new proposed wording unlinks FET from MST. Secondly, it provides a closed list of grounds that can qualify as a breach of FET. The closed-list delicts should truly reflect the meaning of FET terms such as a denial of justice, arbitrariness or unreasonableness, discrimination, and abusive treatment. The stability obligation and protection of legitimate expectations shall be out of the scope of the FET, or if needed, they should be agreed on individual contractual negotiations between the host state and the investor or in national legislation. The reasons for the exclusion were widely discussed in Chapter 2.

Thirdly, in this Chapter, the dissertation proposes the right to regulate norms in the modernized ECT framework in both preambles and the main text. This is unprecedented in the ECT text since the current ECT text lacks the regulatory space for the regulation of public policy goals. The preamble wording is proposed for interpretation purposes, while the main text wording is for the purposes of having sufficient room for the manoeuvre in relation to specific and defined governmental public policy goals. The proposed right to regulate provisions for specified areas of public policy shall not play the role of the defence clause, i.e., the FET delicts should be invoked when the regulatory measures were improperly exercised and were not bona fide.

Further, the Chapter provided an illustrative application (modeling) of public policy measures under the new proposed FET and the right-to-regulate clause to test the effectiveness of the proposed norms. By hypothetically testing various public policy measures, the dissertation proposes to apply the right to regulate clause as a permission clause, i.e., the centrepiece clause of the new ECT, not a defence clause. In this manner, FET delicts may be only invoked by investors when the host state improperly exercises regulatory measures. The results of the testing demonstrated the effectiveness of the proposed formulation in balancing the rights of States and investors.

## CONCLUSION

This conducted doctoral research on the balance issue of FET under Article 10 (1) of the ECT allowed us to once again understand the complexity and the issues of application of several doctrinal concepts of IIL in the energy sector. In this way, the dissertation disclosed a number of theoretical and practical gaps in IIL and proposed feasible approaches to fill in them. Summarizing the conclusions made at the end of each Chapter the dissertation gives the following main conclusions:

1. The FET under the current ECT has become a natural incubator for international arbitration disputes for the last eight years and will continue to be if ECT Contracting Parties do not take decisive action in the wider framework of ECT modernization reforms. The energy sector has an evolving nature that is subject to the development of technologies and consumer demand. Nobody could have predicted that the FET under the ECT incorporated in 1994 to protect fossil fuel investment would generate a significant number of disputes against the ECT Contracting Parties and cause a legal risk for governments that took legitimate regulatory measures aimed at the protection of the environment and mitigation of climate change after twenty years. The evolving nature of the energy sector, economic, political and societal changes raise new challenges and priorities in IIL. In turn, IIL lawyers search for the right solution to adequately respond. In this evolutionary scenario, and with ever-changing regulatory measures, the author believes that one possible response is an adaptation of the treaty text to ensure the relevance of and enhance adherence to the treaty. It is impossible to predict how the energy sector will evolve and what kind of disputes will be generated over the next twenty years. Therefore, the dissertation proposes to resolve the conflict through the adaptation and reconsideration of applicable provisions of the ECT in light of emerging regulatory rights of ECT Contracting Parties for sustainable development and public purposes.

2. Gaps in IIL in relation to the FET origin are a huge issue that needs to be solved through the identification of historical facts and clarification of the treaty text. The author believes that historical US treaty practice and foreign policy played an important role in the formulation of FET wording in IIAs. The origin of this obscure FET wording can be traced back through historical treaties, for example, commercial and mixed claims treaty practice and the US FCNs. Nevertheless, these treaties do not provide a response to the ordinary meaning and normative content of FET but allow us to understand the purposes of the States in the inclusion of similar wordings in those treaties;

3. The incorporation of FET in IIAs is associated with the reduction of uncertainty around MST and was intended to supplement MST. However, as practice demonstrates, vague FET wording without specification served only to increase this uncertainty. An unacceptable degree of vagueness in the concept of FET has led to an expansion of the application of FET to various measures taken by host states;

4. The normative content of FET is largely formulated by tribunals. Different interpretations by tribunals under various IIAs created a jurisprudence of FET. Tribunals

have avoided touching on the doctrinal concepts of the FET and rather focused on the fact-specific nature of the FET. They have not engaged in a textual analysis of the FET clause in IIAs but simply referred to how this requirement has been generally understood under arbitral practice, even if it is not required to do so. Precedents have played an essential role in the formation of FET. The expansion of the content of the law beyond the intention of IIA parties raises the legitimacy of this exercise in international law;

5. The vagueness of FET wording was a hurdle in the interpretation of the FET according to Article 31 and Article 32 of the VLCT. The “ordinary meaning” interpretation condition in Article 31 of the VLCT does not help to interpret the FET. *Travaux préparatoires* of IIAs are also silent on the FET meaning, therefore, tribunals could not rely on Article 32 of the VCLT. Therefore, the normative content of FET is largely formulated based on the interpretation in light of the “object and purpose” of the treaty under Article 31 of the VCLT and arbitration practice case by case. This has led to a lack of coherence with regard to clause and unmanaged expansion of the scope;

6. The FET wording under Article 10 (1) of the ECT and generally ECT provisions were formulated taking into account political and economic circumstances at the time of the conclusion of EEC and ECT in the 1990s. The dissertation found that expansive interpretation of the vague FET norms under Article 10 (1) of the ECT by tribunals which creates a strict obligation for ECT Contracting Parties to provide a stable regulatory framework and protect legitimate expectations in the national legislation for investors. It paved the way for tribunals to promote a strong notion of stability within ECT FET. But this strong notion of the stability obligation under FET norms Article 10 (1) of the ECT is theoretically and practically not sustainable. The creation of a “stable and predictable legal framework” was a result of the political and economic policies of the time when the ECT was concluded. This declaratory wording of Article 10 (1) of the ECT was interpreted by tribunals as an “obligation” to provide a stable and predictable legal framework obligation” and was improperly included in “catchall” FET norms;

7. Analyzed awards well demonstrated that tribunals are not able to deal with a conflict between investment protection and the right to regulate for public policy purposes in light of FET. The objection of States to rendered awards raises a fundamental question in IIL regarding the liability of States for bona fide public purpose measures. The current IIL norms do not provide a response to this objection. Different mechanisms of the right to regulate in the ECT and CIL do not effectively work to safeguard the public policy objectives of the Contracting Parties. As a result, the broad application of FET norms burden ECT Contracting Parties with multi-million awards on the way to progress climate-change obligations and protecting other public policy goals, therefore, the treatment of the right to regulate of ECT Contracting Parties for public purposes is unsatisfactory in the current ECT.

8. The new wording of FET shall be without a link to MST and would contain the delicts that truly reflect the meaning of the phrase “fair and equitable” such as a fair procedure or due process, arbitrariness or unreasonableness, discrimination, and abusive

treatment. Closed-list delicts increase the certainty and predictability for the ECT Contracting Parties and investors as to what behaviour would qualify as a FET breach and which one would not. The FET delicts shall require a high threshold of the breach in order to filter normal regulatory measures exercised in a bona fide manner;

9. It is important to give preference to the emerging right to regulate provisions. The dissertation provides an illustrative application (modeling) of public policy measures under the new proposed FET and the right-to-regulate clause. By hypothetically testing various public policy measures, the dissertation proposes to apply the right to regulate clause as a permission clause, i.e., the centerpiece clause of the new ECT, not a defense clause. In this manner, FET delicts may be only invoked by investors when the host state improperly exercises regulatory measures. The results of the testing demonstrated the effectiveness of the proposed formulation in balancing the rights of States and investors.

The author asserts that the objective of the dissertation has been achieved within the allotted timeframe and the recommended length of the dissertation.

In the framework of this research, the author analyzed a large number of tribunal decisions under and beyond the ECT, a wide range of IIAs including FCNs, BITs, and FTAs, and writings of leading academics in IIL and young scholars. This research dissertation could be useful guidance material for academics and scholars as a theoretical basis for further research; practicing lawyers wanting to better understand the scope of the FET; government bodies wanting to understand the relationship between regulatory measures and how they fit with FET; ECT Contracting Parties in the framework of modernization reforms; States to take into account of if they wish to incorporate the FET standard in future international investment agreements; investors to take into account relevant regulatory measures and the scope of the FET for due diligence purposes.

The dissertation concludes that given the economic, political, and societal importance of the energy sector, the resolution of disputes between the host state and investors will remain a centerpiece of the unique and multilateral ECT framework.

Based on the above, the dissertation posits that the FET topic in IIL is complex and inexhaustive, and certainly further requires research from different angles. Without claiming to cover this topic completely and with impeccable conclusions, the author believes that the present proposals and conclusions would make a perceptible contribution to the development and evolution of IIL.

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