Nusantara: Journal of Law and Islamic Law
Published by Yayasan Cerdas Pedia Indonesia
Volume 1 Issue 3, 2026 ISSN (Online) ***3110-8415***
Journal Homepage: **https://jurnal.smartpedia.co.id/index.php/nusantara**

Proportionality Test in International Investment Agreements: Balancing Regulatory Sovereignty and Investor Protection

Uji Proporsionalitas dalam Perjanjian Investasi Internasional: Menyeimbangkan Kedaulatan Regulasi dan Perlindungan Investor

Syifa Rizky Almasari
Faculty of Law, University of Indonesia, Indonesia

Article Info

Corresponding Author:
Syifa Rizky Almasari
✉syifa.rizky@ui.ac.id

History:
Submitted: 08-05-2026
Revised: 26-05-2026
Accepted: 29-05-2026

Keyword:
International Investment Agreements; Proportionality Test; Regulatory Sovereignty.

Kata Kunci:
Perjanjian Investasi Internasional; Uji Proporsionalitas; Kedaulatan Regulasi.

https://doi.org/10.65101/nusantara.v1i3.385

Abstract

This study analyzes the jurisdictional clash between investor protection and host state regulatory sovereignty within modern international investment agreements. While new generation treaties incorporate explicit right to regulate provisions, arbitral tribunals frequently undermine these reforms through orthodox interpretations, creating a systemic arbitral backlash. Employing a normative legal methodology with statutory, conceptual, and case approaches, this research investigates the urgency of integrating the proportionality test into investor state dispute settlement. The systemic integration principle from the Vienna Convention on the Law of Treaties legitimizes this methodological transplantation. Results indicate that adopting proportionality as a mandatory standard of review effectively limits arbitral overreach, converting the conditional defenses of the state into inherent police powers. Contextualized within the new Model Bilateral Investment Treaty of Indonesia, this structural adaptation proves empirically vital. Ultimately, aligning national textual reforms with supranational proportionality analysis provides an equitable framework, successfully harmonizing absolute investment protections with public welfare mandates.

Abstrak

Penelitian ini menganalisis benturan yurisdiksional antara perlindungan investor dan kedaulatan regulasi negara penerima dalam kerangka perjanjian investasi internasional modern. Walaupun perjanjian generasi baru memasukkan ketentuan hak mengatur yang eksplisit, tribunal arbitrase sering kali merusak reformasi tersebut melalui penafsiran ortodoks, sehingga menciptakan anomali putusan arbitrase yang sistemik. Dengan menggunakan metodologi hukum normatif melalui pendekatan peraturan, konseptual, dan kasus, riset ini menginvestigasi urgensi pengintegrasian uji proporsionalitas ke dalam penyelesaian sengketa penanaman modal. Prinsip integrasi sistemik dari Konvensi Wina tentang Hukum Perjanjian secara dogmatis melegitimasi transplantasi metodologis ini. Hasilnya menunjukkan bahwa pengadopsian instrumen proporsionalitas sebagai standar tinjauan yang mengikat secara efektif membatasi dominasi arbitrase, mengubah pembelaan bersyarat milik negara menjadi kewenangan inheren kekuasaan publik. Dikontekstualisasikan pada Perjanjian Investasi Bilateral Model baru milik Indonesia, adaptasi struktural ini terbukti vital secara empiris. Pada akhirnya, penyelarasan reformasi tekstual nasional dengan analisis proporsionalitas supranasional memberikan kerangka yang adil, guna mengharmonisasikan perlindungan investasi absolut dengan mandat kesejahteraan publik.

A. INTRODUCTION

1. Background

The international investment law system in the third decade of the twenty-first century stands at a crucial paradigmatic and structural crossroads, wherein the traditional equilibrium between the imperative of foreign capital protection and host-state sovereignty is undergoing a process of fundamental recalibration. For over five decades, the architecture of International Investment Agreements (IIAs)—manifested in thousands of Bilateral Investment Treaties (BITs) and multilateral instruments—has been dominated by asymmetric, first-generation treaty designs. These neoclassical agreements were engineered with an exclusive objective: shielding foreign investors from the risks of political intervention and regulatory dynamics within developing states.[1,2]

The textual formulations employed within these early-generation instruments are highly abstract and open-ended, thereby effectively delegating expansive interpretative discretion to Investor-State Dispute Settlement (ISDS) arbitral tribunals.[3] The logical consequence of this asymmetrically protective legal architecture is the emergence of the 'regulatory chill' phenomenon—a state of regulatory paralysis wherein the looming risk of substantial financial compensation liabilities within ISDS forums compels sovereign states to defer, rescind, or dilute domestic regulatory standards vital to the public interest, particularly within critical sectors such as public health, environmental preservation, and the renewable energy transition.[4]

This situation engenders a profound clash of norms between a state's international obligations under the investment regime *vis-à-vis* its fundamental constitutional responsibility to regulate for the public welfare. Within the context of Indonesian positive law, this obligation to safeguard the public interest is not merely a matter of executive discretion; rather, it constitutes an imperative constitutional mandate rooted in Article 33 of the 1945 Constitution of the Republic of Indonesia (UUD NRI 1945) and

[1] Anne van Aaken, "Investment Law in the Twenty-First Century: Things Will Have to Change in Order to Remain the Same," *Journal of International Economic Law* 26, no. 1 (March 9, 2023): 166–76, https://doi.org/10.1093/jiel/jgac054.
[2] Oliver Hailes, "Environmental Clauses in Investment Arbitration: Deep Roots, Green Shoots and Dead Wood," *ICSID Review* 40, no. 2 (January 13, 2026): 399–440, https://doi.org/10.1093/icsidreview/siaf003.
[3] M. Sornarajah, *The International Law on Foreign Investment*, 5th ed. (Cambridge: Cambridge University Press, 2021), Page, 411-17. https://doi.org/10.1017/9781316459959.
[4] Kyla Tienhaara, "Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement," *Transnational Environmental Law* 7, no. 2 (July 22, 2018): 229–50, https://doi.org/10.1017/S2047102517000309.

operationalized via Law No. 25 of 2007 concerning Investment. The existence of this domestic legal framework demonstrates that the host state's exercise of its police powers possesses a binding juridical foundation, which frequently collides normatively with the expansionist interpretation of the Fair and Equitable Treatment (FET) clause within BITs. This collision, in turn, catalyzes a comprehensive academic discourse and poses systemic legitimacy challenges to the ISDS architecture before the global community.[5]

As a jurisprudential and political response to these legitimacy challenges, the international community and treaty drafters are undertaking institutional restructurings to formulate new-generation IIAs, which are architecturally designed to reclaim and safeguard host-state policy space. This doctrinal transformation is manifested through a series of textual innovations, such as the inclusion of general exception clauses, the explicit reaffirmation of the right to regulate, the narrowing of the material scope of FET standards, and the integration of environmentally and socially conscious corporate governance obligations for investor entities.[6] Nonetheless, the operational efficacy of these progressive texts when confronted with the realities of adjudication within arbitral tribunals has polarized academic discourse, particularly regarding the extent to which textual overhauls can effectively countervail the expansionist trajectory of investor property rights protection doctrines.

To fortify the analytical depth and scholarly credibility of this manuscript, a mapping of recent literature from leading primary journals (2021–2026) reveals a clear dichotomy within the discourse evaluating the efficacy of new-generation IIAs. The first camp, anchoring its position in a normative-textual approach, posits a wave of theoretical optimism. Tarcisio Gazzini (2025), for instance, posits that the international investment law pendulum has swung back toward the host state, wherein the right to regulate is now recognized as an explicit attribute of state sovereignty that strictly circumscribes the doctrines of indirect expropriation and FET standards.[7]

---

[5] Stephan Schill and Christian Tams, eds., *International Investment Protection and Constitutional Law* (Edward Elgar Publishing, 2022), Page, 1-15. https://doi.org/10.4337/9781839100420.

[6] Shotaro Hamamoto, "Aikaterini Titi, The Right to Regulate in International Investment Law," in *Permutations of Responsibility in International Law* (Brill | Nijhoff, 2016), 835–38, https://doi.org/10.1007/978-3-319-29215-1_40.

[7] Tarcisio Gazzini, "The Right to Regulate in International Investment Law," in *Routledge Handbook on International Economic Law* (London: Routledge, 2025), 383–401, https://doi.org/10.4324/9781003399711-28.

In alignment with this perspective, Catharine Titi (2022) identifies that the new formulations within IIAs establish clear linguistic guardrails for tribunals when interpreting investors' legitimate expectations *vis-à-vis* the state's regulatory autonomy.[8] From a sectoral research perspective, scholars such as Szostak (2025) and Kuzhatov (2022) highlight the centrality of reforming multilateral instruments, most notably the Energy Charter Treaty (ECT), wherein redefining the right to regulate and narrowing the scope of FET are deemed absolute prerequisites to prevent the investment regime from operating as an impediment to green energy transition policies.[9,10]

Conversely, the empirical camp counters this normative optimism by exposing the systemic inconsistencies within adjudicatory practices. Wolfgang Alschner (2022), utilizing large-scale computational analysis of recent arbitral awards, uncovers a jurisprudential anomaly he terms an "arbitral backlash." Alschner demonstrates that state-driven textual reforms are systematically frustrated by arbitral tribunals that continue to import orthodox protection standards through the exploitation of Most-Favored-Nation (MFN) clauses, the invocation of customary international law, and a rigid reliance on conservative precedents.[11]

This inter-literary dialogue vividly illuminates a substantial research gap: current scholarly discourse is bifurcated between analyses that solely dissect macro-level textual innovations on one hand, and empirical observations that highlight ISDS anomalies on the other. A methodological blind spot persists between these two positions, namely the absence of a precise judicial construct regarding the "standard of review" that arbitrators must operate to preempt arbitral backlash and guarantee that new treaty texts are interpreted through the lens of public law rationality. As an epistemological bridge to fill this lacuna, this study proposes the application of the proportionality test. The proportionality test constitutes a prevalent and well-established analytical methodology within the realm of comparative public law (as evidenced in European jurisprudence);

[8] Catharine Titi, "The Right to Regulate in International Investment Law (Revisited)," *Courses of the Summer School on Public International Law* 18 (March 14, 2022), https://doi.org/10.65556/MYOE1036.
[9] Aleksander Szostak, "Towards Right to Regulate for Climate Actions: A Closer Look at the Modernized Energy Charter Treaty," *The Journal of World Investment & Trade*, August 22, 2025, 1–29, https://doi.org/10.1163/22119000-12340382.
[10] Bagdat G. Kuzhatov, "The Energy Charter Treaty Reform: Why and How to Reach a Consensus on Fair and Equitable Treatment?," *Energy Policy* 163 (April 2022): 112769, https://doi.org/10.1016/j.enpol.2021.112769.
[11] Wolfgang Alschner, *Investment Arbitration and State-Driven Reform* (Oxford University Press, 2022), https://doi.org/10.1093/oso/9780197644386.001.0001.

this study intends to transplant said instrument into the ISDS adjudicatory system to provide a structured framework for resolving conflicts of norms.

Based on the conceptual and operational lacunae mapped above, this research asserts its scholarly *novelty* and added value. Unlike preceding studies that focus on treaties in isolation (e.g., Titi and Gazzini) or merely expose empirical anomalies without offering procedural remedies (e.g., Alschner), this study underscores the urgency of institutionally integrating the doctrine of *police powers* through the proportionality test as a binding diagnostic instrument within ISDS procedural law. This theoretical novelty is formulated by situating the proportionality test not as a discretionary interpretative option, but as a supranational public law doctrine designed to moderate the doctrine of (legitimate expectations).[12] Furthermore, this research offers comparative novelty by contextualizing said doctrine within Indonesia's institutional adaptation practices. Indonesia is selected for its representative position as a *capital-importing state* that has undertaken a radical restructuring of its network of Bilateral Investment Treaties (BITs). Consequently, the 2021 Indonesian Model BIT serves as a highly valid empirical laboratory for testing its efficacy as an antithesis to the orthodox investment law regime.[13]

As a synthesis of the aforementioned framework, this article posits its central *thesis statement*: sovereign regulatory space within new-generation IIA architectures can only be comprehensively actualized—and shielded from the risk of *arbitral backlash*—if the international investment dispute settlement system definitively adopts the proportionality test as a *balancing framework*. This framework institutionalizes the doctrine of "margin of appreciation" regarding the host state's institutional competence, thereby addressing the limitations of purely textual reforms. Ultimately, this methodological integration formulates a proportional review framework that shifts the legal posture of the host state's fundamental rights from a mere "exception" to "inherent powers"—immune from financial compensation claims, provided that the exercise of such public authority is grounded in legitimate, non-discriminatory, and precisely proportional rationality.

[12] Eric De Brabandere and Paula Baldini Miranda da Cruz, "The Role of Proportionality in International Investment Law and Arbitration: A System-Specific Perspective," *Nordic Journal of International Law* 89, no. 3–4 (November 12, 2020): 471–91, https://doi.org/10.1163/15718107-89030012.
[13] David Price, "Indonesia's Bold Strategy on Bilateral Investment Treaties: Seeking an Equitable Climate for Investment?," *Asian Journal of International Law* 7, no. 1 (January 11, 2017): 124–51, https://doi.org/10.1017/S2044251315000247.

2. Pormulation of the Problem

Based on the conceptual and methodological lacunae identified above, this research is designed to address the following three legal inquiries:

a. To what extent does the phenomenon of *arbitral backlash* within international investment jurisprudence systematically distort the efficacy of public interest protection norms (*right to regulate*) that have been redefined through the architectural textual transition of new-generation International Investment Agreements (IIAs)?
b. How can the *proportionality test* be methodologically constructed as a binding judicial *standard of review* to effectively balance the standards of investor protection with the exercise of the *police powers* doctrine?
c. How can the construction of such a proportional *standard of review* be contextualized within the investment regime restructuring of a *capital-importing state*, specifically through the regulatory parameters of the 2021 Indonesian Model BIT?

3. Research Methods

This normative legal research is designed to address the dissonance between the text of international investment treaties and the interpretive practices of arbitral tribunals. To ensure analytical precision, this study integrates three distinct legal approaches: (1) a *statute/treaty approach* to dissect the textual anatomy of new-generation IIAs; (2) a *conceptual approach* to analyze the doctrinal discourse between a state's *police powers* and investors' *legitimate expectations*; and (3) a *case approach* to scrutinize the *ratio decidendi* of arbitral awards that exemplify the *arbitral backlash* phenomenon and early applications of the proportionality test.[14]

Primary legal materials are classified into two distinct spectra. The domestic spectrum is anchored in the 1945 Constitution of the Republic of Indonesia and Law No. 25 of 2007 concerning Investment, which serve as the constitutional basis for regulatory sovereignty. The international spectrum encompasses mega-regional instruments (CPTPP, RCEP, and the draft ECT) as well as bilateral instruments (the 2021 Indonesian Model BIT and the 2021 Indonesia-Singapore BIT). Arbitral awards of precedential value

[14] Xu Qian, "Revisiting Proportionality in Investment Arbitration: Theory, Methodology, and Interpretation," *Chinese Journal of International Law* 21, no. 3 (December 15, 2022): 547–87, https://doi.org/10.1093/chinesejil/jmac020.

(*Methanex v. United States*, *Tecmed v. Mexico*, and *Philip Morris v. Uruguay*) are specifically selected through a *purposive sampling* method, as these represent *landmark decisions* that adjudicated the *clash of norms* between investor protection and the *police powers* doctrine within the environmental and public health sectors. Secondary legal materials are restricted to high-reputation, contemporary scholarship (Scopus-indexed, 2021–2026), collated through a systematic literature review.

The collected legal materials are analyzed prescriptively through teleological interpretation and the Principle of Systemic Integration. Teleological interpretation is employed to discern the *object and purpose* of textual innovations within IIAs. Furthermore, the Principle of Systemic Integration, pursuant to Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT), is operationalized to provide the methodological legitimacy required to harmonize public law doctrines—specifically proportionality—into the ISDS architecture. The logic flow is subsequently tested through deductive syllogism: commencing from a major premise regarding the existence of *police powers* in international law, transitioning through a minor premise regarding the orthodox interpretative practices of arbitral tribunals, to formulate a prescriptive conclusion regarding the urgency of integrating the proportionality test.[15]

B. DISCUSSION

1. The Architectural Transition of IIAs and Jurisprudential Distortion via Arbitral Backlash

The international investment law architecture, as a sub-discipline of international economic law, is constructed upon the post-World War II politico-economic rationality, in which capital-exporting developed states sought to secure the transnational flow of capital into capital-importing developing jurisdictions. First-generation Bilateral Investment Treaties (BITs) were engineered with the philosophical premise that foreign capital constituted an entity requiring an absolute legal shield, protected from political dynamics, societal shifts, and regulatory imperatives within the host jurisdictions of operation.[16,17]

[15] Campbell McLachlan KC, *The Principle of Systemic Integration in International Law* (Oxford University Press, 2024), Page, 31. https://doi.org/10.1093/law/9780192893741.001.0001.
[16] Kate Miles, *The Origins of International Investment Law* (Cambridge University Press, 2013), Page, 32. https://doi.org/10.1017/CBO9781139600279.
[17] Sornarajah, *The International Law on Foreign Investment*. Page, 15-17.

This premise is reflected in the linguistic anatomy of these agreements, which are highly abstract and unidimensional, imposing obligations solely upon the host state while simultaneously granting exclusive rights to investor entities. These foundational instruments are markedly restrictive, frequently lacking—or entirely devoid of—exception clauses or *carve-outs* that accommodate public interest-oriented policy maneuvers.[18] Key protection standards, such as Fair and Equitable Treatment (FET) and protection against indirect expropriation, were drafted without precise limiting parameters. This resulted in the creation of over-inclusive *catch-all provisions*, which are inherently vulnerable to exploitation by multinational corporations through ISDS arbitral mechanisms to challenge constitutionally valid domestic regulations.[19]

The escalation of multi-billion dollar ISDS claims targeting state policies—ranging from minimum wage regulations and bans on toxic chemicals to energy transitions and tobacco control—has catalyzed a fundamental reform, culminating in the emergence of new-generation IIAs. This paradigmatic transition is driven by a shift in the ontological purpose of these agreements: from a paradigm oriented toward absolute investment protection toward an investment regime integrated with sustainable development. The innovative features of these new-generation IIAs are manifested in textual engineering that seeks to restore state regulatory sovereignty in a measured and proportional manner.[20]

Architecturally and doctrinally, this reform includes a reformulation of the preamble to accord equal normative weight to the protection of capital flows and the safeguarding of the public interest. Furthermore, jurisdictional delimitation mechanisms have been introduced through the narrowing of investment definitions and the restriction of Most-Favored-Nation (MFN) clauses, designed to preempt doctrinal exploitation tactics such as *treaty shopping*.[21]

These reforms also incorporate general exception clauses, adapted from Article XX of the GATT/WTO, alongside doctrinal codifications affirming that *bona fide* regulatory actions taken in the public interest are, *a priori*, not categorized as expropriation requiring

[18] Alschner, *Investment Arbitration and State-Driven Reform*. Page, 20-22.
[19] Ursula Kriebaum, Christoph Schreuer, and Rudolf Dolzer, *Principles of International Investment Law* (Oxford University Press, 2022), Page, 130-133. https://doi.org/10.1093/law/9780192857804.001.0001.
[20] United Nations Conference on Trade and Development, "The Reform of International Investment Agreements – State of Play," *United Nations Conference on Trade and Development*, 2023, https://unctad.org/system/files/official-document/diaepcbinf2023d5_en.pdf.
[21] United Nations Conference on Trade and Development, "Investment Policy Framework for Sustainable Development," 2015, https://unctad.org/system/files/official-document/diaepcb2015d5_en.pdf.

compensation.[22,23] To provide a structured analytical mapping, Table 1 demonstrates an anatomical comparison between classic and new-generation IIAs, which directly implicates the expansion of host-state autonomy.

Table 1. Anatomical Comparison of International Investment Agreement (IIA) Architectures

Architectural Dimension	Classic IIA Paradigm (Pre-2000)	New-Generation IIA Paradigm (Post-2015)
Regulatory Sovereignty	Implicitly subordinated to investment protection standards.	Explicitly codified via *right to regulate* clauses in preambles and substantive provisions.
Anatomy of FET Standards	Abstract, autonomous, and expansively reliant on *legitimate expectations* doctrines.	Narrowly defined; strictly bounded by the Minimum Standard of Treatment (MST) under customary international law.
Indirect Expropriation Criteria	Focused exclusively on economic loss (*sole-effect doctrine*).	Public-interest oriented (*purpose-based doctrine/police powers*); bona fide regulations are excluded from expropriation definitions.
Investor Obligations	Non-existent; characterized by a *one-way street* protection mechanism.	Incorporates reciprocal obligations regarding host-state law compliance, ESG governance, and anti-corruption standards.

The synthesis derived from Table 1 confirms that treaty drafters have proactively sought to establish textual mechanisms designed to constrain adjudicatory outcomes. Notwithstanding the comprehensiveness of these architectural reforms, the underlying conceptual *clash of norms* persists as a formidable challenge in adjudicatory practice—particularly at the frictional intersection between investor property rights and sovereign regulatory authority. Contemporary investment disputes essentially converge upon the conflict between the principle of *pacta sunt servanda*, which legitimizes the protection of an investment's economic value, and the maxim *salus populi suprema lex esto*, an essential element of state sovereignty.

The elevation of this normative conflict is most visibly manifested in the jurisprudential dialectic surrounding FET standards and its primary derivative, *legitimate expectations*. FET was ostensibly designed as a minimum standard to shield capital

[22] World Trade Organization, "WTO Rules and Environmental Policies: GATT Exceptions," World Trade Organization, 2026, https://www.wto.org/english/tratop_e/envir_e/envt_rules_exceptions_e.htm.
[23] Céline Lévesque, "The Inclusion of GATT Article XX Exceptions in IIAs: A Potentially Risky Policy," in *Prospects in International Investment Law and Policy* (Cambridge University Press, 2013), 363–70, https://doi.org/10.1017/CBO9781139565479.029.

providers from *manifestly arbitrary* state conduct or *denial of justice*. However, historical jurisprudential precedents have frequently projected that FET guarantees mandate a static legal landscape (the *stabilization requirement*), implying that any shift in domestic policy constitutes a breach of *legitimate expectations*. This logical construction affords investors a position of privilege over the inevitable socio-legal evolution of the state. Such *regulatory chill* represents a substantial threat to states such as Indonesia, where regulatory intervention in strategic sectors is a direct derivation of the constitutional mandate under Article 33 of the 1945 Constitution, which necessitates state control for the collective prosperity of the people.

As a jurisprudential antithesis to such expansive interpretations, contemporary investment law has begun to revitalize the *police powers* doctrine, transposing it from the realm of public law into the international investment regime. *Police powers* represent the residual authority and inherent right of a sovereign entity to execute regulations within its territorial jurisdiction to maintain public order, communal health, and environmental sustainability.[24] The momentum of this doctrine's penetration is exemplified in the tribunal's award in *Methanex Corporation v. United States* (2005), in which the claim for compensation was dismissed. The tribunal established the *ratio decidendi* that a state's ban on gasoline additives, driven by scientific findings intended to protect water reserves, constituted a non-discriminatory regulatory exercise for a (legitimate public purpose).[25]

In the domain of indirect expropriation, the collision between investor economic protection and *police powers* yields a complex judicial classification dilemma between the *effect-based doctrine* and the *purpose-based doctrine*. Resolving this dichotomy requires a mechanism of continuous calibration. The absence of a standardized methodological foundation for arbitrators to balance these two doctrinal entities has generated ambivalent jurisprudence, wherein tribunals repeatedly fail to articulate a consistent (*standard of review*).

A prevailing theoretical assumption posits that the precise drafting of new-generation IIAs will automatically bind ISDS tribunals to the host state's intent. However, the empirical computational research conducted by Wolfgang Alschner (2022) offers an

[24] Indah Dwi Qurbani and Ilham Dwi Rafiqi, "Ecological Justice and Energy Transition Policy in Indonesia," *Jurnal Pembangunan Dan Alam Lestari* 16, no. 2 (October 24, 2025): 89–94, https://doi.org/10.21776/ub.jpal.2025.016.02.03.
[25] "Methanex Corporation v United States of America, UNCITRAL (Final Award on Jurisdiction and Merits) Part IV, Chapter D, Para 7." (2025), https://www.italaw.com/sites/default/files/case-documents/ita0529.pdf.

empirical rebuttal that disrupts this normative assumption. Through a computational analysis of ISDS awards post-textual reform, Alschner identifies a jurisprudential anomaly termed *arbitral backlash*. This phenomenon represents a tangible manifestation of jurisprudential resistance, wherein arbitral panels erode the essence of reforms advocated by states, culminating in the issuance of conventional-style awards stemming from modern treaty instruments—a paradox of (new treaties, old outcomes).[26]

The operational mechanism behind this failure in textual interpretation often functions through the abusive exploitation of Most-Favored-Nation (MFN) clauses. Even when new-generation IIAs have fortified FET interpretations or inserted public law exceptions, corporate investors utilize MFN clauses to "import" broader substantive protection clauses from first-generation BITs that still bind the host state via third-party treaties. This manipulative practice of *treaty shopping* is facilitated by conservative-leaning tribunals that expand *ratione materiae* jurisdiction beyond intended limits, thereby nullifying the restrictions conscientiously engineered by the host state within new-generation IIAs. This risk of interpretative distortion via *arbitral backlash* provides empirical justification for Indonesia's policy of mass termination regarding first-generation Bilateral Investment Treaties (BITs), serving as a preventive measure against disputes that infringe upon domestic policy space.

Furthermore, tribunals frequently rely upon the regime of customary international law, processed through an orthodox paradigm of interpretation. Instead of employing a teleological interpretation that mandates sensitivity toward the *right to regulate*, arbitral panels often remain trapped within pro-investor precedents of the past. In evaluating the validity of health or environmental emergency clauses, tribunals frequently impose excessively stringent scientific standards of proof, which ultimately reduce the function of such exception clauses to mere formalities. Consequently, the regulatory sovereignty guaranteed within the treaty text remains dangerously susceptible to dilution upon entering the jurisdiction of ISDS scrutiny.

The elaboration of these jurisprudential anomalies confirms that reforming the architectural text of treaties—without a corresponding fundamental modification of the adjudicatory paradigm—inevitably leads to repetitive institutional inefficiency. Absent a prescriptive diagnostic instrument, even the most progressive treaty texts remain

[26] Alschner, *Investment Arbitration and State-Driven Reform*. Page, 202-204.

susceptible to reinterpretation through the prism of orthodox capital protection. Based on this rationalization, the international investment law regime must adopt a binding *standard of review*, primarily through the mandatory operationalization of the *proportionality test*. The adoption of such a standard of review finds its methodological justification through the Principle of Systemic Integration, as mandated by Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT), which facilitates the harmonization of global public law norms into the adjudicatory framework of investment dispute settlement.

2. The Proportionality Test as a Methodology for Review and Conflict Resolution

To mitigate the anomalies of *arbitral backlash* and resolve the conceptual collision between the FET doctrine and *police powers*, this article posits that the investment dispute settlement system requires the structural incorporation of the *proportionality test*. The concept of proportionality possesses deep-rooted jurisprudential foundations within comparative constitutional and administrative law traditions and has demonstrated robust application as a diagnostic instrument within the European Court of Human Rights (ECtHR) and the WTO's Dispute Settlement Body in calibrating the rationality of state intervention. The transplantation of the proportionality test from the realm of comparative public law into the ISDS architecture finds its methodological justification in the Principle of Systemic Integration, as mandated by Article 31(3)(c) of the VCLT. This principle provides the legal legitimacy for investment tribunals to interpret investment protection clauses in harmony with, and in consideration of, relevant international public law norms and standards of review.[27]

When contextualized within the investment law ecosystem, the application of the proportionality test demands a jurisdictional paradigm shift: from operating as a purely commercial adjudication forum to functioning as an institution that evaluates the rationality of the host state's public actions.[28] The empirical foundation for applying this concept is evidenced in the landmark award in *Philip Morris v. Uruguay*. In adjudicating the challenge against tobacco plain-packaging regulations, the tribunal employed the proportionality test to verify that the host state's regulation was justified as an exercise

[27] De Brabandere and da Cruz, "The Role of Proportionality in International Investment Law and Arbitration: A System-Specific Perspective."
[28] Benedict Kingsbury and Stephan W. Schill, "Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest—the Concept of Proportionality," in *International Investment Law and Comparative Public Law* (Oxford University Press, 2010), 75–104, https://doi.org/10.1093/acprof:oso/9780199589104.003.0003.

of *police powers* for the sake of public health, weighing whether the chosen instruments were commensurate with the scale of the national nicotine addiction threat.[29] To systematize this analytical framework into an operational standard of adjudication, this study formulates a synthesized three-step analytical framework, as illustrated in Table 2:

Table 2. Construction of Proportionality Test Analysis in the Police Powers Doctrine

Proportionality Phase	Jurisprudential Review Criteria	Operational Analysis under *Police Powers*
Phase 1: Validation of Public Purpose (*Bona Fide*)	Investigating whether the regulatory intervention is grounded in *bona fide* intent to achieve public health, environmental, or public order objectives.	*The host state carries the burden of proof to present a scientific basis or objective urgency underpinning the regulatory enactment.*
Phase 2: Methodological Suitability	Evaluating the rational nexus and causal link between the regulatory policy instrument and the proclaimed public law objective.	The measure must be non-discriminatory, not specifically targeting foreign investors, and free from elements of disguised economic protectionism.
Phase 3: Substantive Balancing (*Proportionality Stricto Sensu*)	Comparative weighing of the severity of investment value depreciation against the significance of the essential public interest protected.	Integration of the *margin of appreciation* doctrine; the tribunal shall not intervene unless the policy is proven to be *manifestly without reasonable foundation*.

The operation of Phase 3 (*Proportionality Stricto Sensu*) serves as a critical *balancing mechanism* in mitigating normative tension within ISDS. Orthodox tribunals frequently overstep their mandate by evaluating the substance of domestic regulations *de novo*. The proportionality test constrains this jurisdictional expansion by mandating the internalization of the doctrine of institutional deference (*margin of appreciation*).[30] This doctrine is grounded in the epistemological argument that the domestic branches of government in the host state possess democratic legitimacy, sectoral technical expertise,

[29] International Institute for Sustainable Development, "Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7," International Institute for Sustainable Development, 2018, https://www.iisd.org/itn/2018/10/18/philip-morris-v-uruguay/.
[30] Niccolò Zugliani, "A Role for Precedent in the Determination of the Standard of Review Applicable by Investment Arbitral Tribunals? A Case Study of Ect-Based Energy Disputes Against Spain," *The Italian Review of International and Comparative Law*, December 19, 2022, 1–20, https://doi.org/10.1163/27725650-02020008.

and superior empirical insight compared to *ad-hoc* arbitral panels—which often lack democratic accountability—particularly in assessing the threshold of ecological crises or public safety threats.[31]

The diagnostic application of the proportionality test underscores the methodological relevance of this study: adopting this judicial standard of review will realize the potential of new-generation IIAs, transforming them into legal protection instruments that are immune to orthodox interpretations of FET clauses. As a theoretical precedent, the revocation of mining permits to fulfill climate change mitigation commitments under the Paris Agreement would no longer be narrowly classified as unlawful expropriation; rather, it would be analyzed as a proportional consequence of host-state adaptation, necessitating investor compliance with regulations of global interest.[32] Dogmatically, the proportionality framework repositions state regulatory autonomy from a mere *conditional defense* to an *inherent power*. Public policies that pass these three analytical stages are *a priori* precluded from being classified as breaches of FET or indirect expropriation, thereby exempting the host state from the obligation to provide compensation for investment losses.

3. Contextualization: The Adaptation of Indonesian Law in the Global Arena

The re-conceptualization of regulatory sovereignty requires empirical elaboration on state practice, particularly those pioneered by the Global South. As an empirical exploration of this study's significance for international legislative governance, analyzing Indonesia's precedents and state-crafting practices presents a highly representative laboratory of observation. Indonesia has positioned itself as a primary actor in global institutional reform, sharply restructuring its investment commitments and moving beyond the subordinations of the past.

Observing the historical trajectory leading up to 2015, the Indonesian government endured structural disruption as a direct implication of the first-generation IIA design, marked by a series of substantial claims by investors, such as in the *Churchill Mining* case. Responding to this anomaly, Indonesia initiated mitigation measures by declaring the

[31] Caroline Henckels, "General and Security Exceptions and the Question of Compensation in International Investment Law," *Journal of International Economic Law* 28, no. 1 (April 8, 2025): 63–77, https://doi.org/10.1093/jiel/jgaf005.
[32] United Nations Framework Convention on Climate Change, "The Paris Agreement," United Nations Framework Convention on Climate Change, 2026, https://unfccc.int/process-and-meetings/the-paris-agreement.

termination of over 60 legacy Bilateral Investment Treaties (BITs).[33] This mass termination was not merely a reactive political maneuver, but a manifestation of vertical synchronization to restore the international investment architecture to its adherence to the mandate of Article 33 of the 1945 Constitution. This mandate requires that state control over essential production branches and natural resources be oriented fundamentally toward collective prosperity, rather than mere commercial investor rationality. This phase of treaty termination was followed by institutional reconstruction via the issuance of the 2021 Indonesian Model BIT and subsequent bilateral renegotiations, such as the 2021 Indonesia-Singapore BIT.[34,35] Comparatively, while strategic partners such as Singapore pursue a path of normative adaptability, Indonesia applies a paradigm of institutional adaptability to restore regulatory autonomy in alignment with constitutional mandates.

The manifestation of this architectural adaptation is clinically formulated within the text of the 2021 Indonesian Model BIT. First, the Indonesian legal regime imposes multi-layered limits on ISDS jurisdictional consent and restrictively narrows the scope of MFN clauses to preempt the importation of inconsistent arbitral precedents. Furthermore, the legal definition of a qualified investment is tightened with stringent legality prerequisites. The restrictive definition of investment and the "in accordance with host-state law" requirement in the 2021 Model BIT are direct international extensions of Articles 15 and 16 of Law No. 25 of 2007 on Investment. Through this construction, the investor's obligation to comply with environmental governance and respect local cultural traditions—*Corporate Social Responsibility*—is elevated from a mere domestic administrative obligation to an absolute *jurisdictional requirement* for treaty protection.

As a maneuver to fortify *police powers*, the Indonesian Model BIT successfully incorporates the customary international law principle of *rebus sic stantibus* into the contemporary investment regime. By formulating an innovative clause titled "Change of Circumstances," Indonesia provides a jurisdictional basis for the state to demand a review

[33] Putu George Matthew Simbolon and Oktavani Yenny, "The Chilling Effect of International Investment Law and Indonesia's Preventive Steps to Overcome It," *Jurnal Kajian Pembaruan Hukum* 5, no. 1 (June 20, 2025): 91–122, https://doi.org/10.19184/jkph.v5i1.53690.
[34] Mariani Agnestasia Soeitoe et al., "Adaptabilitas Arbitrase Internasional Dalam Sengketa Investasi: Studi Indonesia Dan Singapura," *Journal Juridisch* 4, no. 1 (March 3, 2026): 93–109, https://doi.org/10.26623/jj.v4i1.13406.
[35] United Nations Conference on Trade and Development, "International Investment Agreements Navigator: Indonesia," United Nations Conference on Trade and Development, 2026, https://investmentpolicy.unctad.org/international-investment-agreements/countries/97/indonesia.

of treaty obligations when fundamental shifts—such as unforeseen global health crises or climate emergencies—occur, without the host state being classified as a default treaty violator. This epistemological injection invalidates pro-investor stabilization doctrines. It reaffirms the international legal postulate that a state is a dynamic sovereign entity that must inevitably adapt to the sociological demands of public interest protection.

Comparatively, the restructuring via the 2021 Indonesian Model BIT represents the first half of the reform struggle: legislative-textual improvement. However, the subsequent crucial phase rests upon the level of adjudication. The jurisdictional limitations, investment legality requirements, and force majeure clauses crafted by Indonesia will only be effective if arbitral tribunals shift their standards of review toward the proportionality test framework. The synergy between the assertiveness of national-level text reform and the tribunal's compliance with the proportionality test at the supranational level is the absolute instrument for realizing an equilibrium between investment protection and the mandate of *salus populi suprema lex esto*.

C. CONCLUSION

The re-conceptualization of regulatory sovereignty within the contemporary international investment law architecture is hindered by the phenomenon of *arbitral backlash*, wherein arbitral tribunals frequently distort new-generation treaty innovations through orthodox interpretations favoring investor protection. As a solution to this jurisprudential impasse, the investment dispute settlement system must definitively adopt the *proportionality test* as a binding judicial *standard of review* to balance investor protection standards with the state's *inherent powers* (*police powers*). In a comparative review, the investment regime restructuring executed by Indonesia through the 2021 Model BIT has successfully established a precise legislative-textual foundation to protect domestic policy space and constitutional mandates. Nevertheless, the effectiveness of this national treaty architecture overhaul can only be fully realized when harmonized with the supranational tribunal's adherence to the *proportionality test* at the adjudicatory stage.

REFERENCES

Aaken, Anne van. "Investment Law in the Twenty-First Century: Things Will Have to Change in Order to Remain the Same." *Journal of International Economic Law* 26, no. 1 (March 9, 2023): 166–76. https://doi.org/10.1093/jiel/jgac054.

Alschner, Wolfgang. *Investment Arbitration and State-Driven Reform*. Oxford University Press, 2022. https://doi.org/10.1093/oso/9780197644386.001.0001.

Brabandere, Eric De, and Paula Baldini Miranda da Cruz. "The Role of Proportionality in International Investment Law and Arbitration: A System-Specific Perspective." *Nordic Journal of International Law* 89, no. 3–4 (November 12, 2020): 471–91. https://doi.org/10.1163/15718107-89030012.

Gazzini, Tarcisio. "The Right to Regulate in International Investment Law." In *Routledge Handbook on International Economic Law*, 383–401. London: Routledge, 2025. https://doi.org/10.4324/9781003399711-28.

Hailes, Oliver. "Environmental Clauses in Investment Arbitration: Deep Roots, Green Shoots and Dead Wood." *ICSID Review* 40, no. 2 (January 13, 2026): 399–440. https://doi.org/10.1093/icsidreview/siaf003.

Hamamoto, Shotaro. "Aikaterini Titi, The Right to Regulate in International Investment Law." In *Permutations of Responsibility in International Law*, 835–38. Brill | Nijhoff, 2016. https://doi.org/10.1007/978-3-319-29215-1_40.

Henckels, Caroline. "General and Security Exceptions and the Question of Compensation in International Investment Law." *Journal of International Economic Law* 28, no. 1 (April 8, 2025): 63–77. https://doi.org/10.1093/jiel/jgaf005.

International Institute for Sustainable Development. "Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7." International Institute for Sustainable Development, 2018. https://www.iisd.org/itn/2018/10/18/philip-morris-v-uruguay/.

Kingsbury, Benedict, and Stephan W. Schill. "Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest—the Concept of Proportionality." In *International Investment Law and Comparative Public Law*, 75–104. Oxford University Press, 2010. https://doi.org/10.1093/acprof:oso/9780199589104.003.0003.

Kriebaum, Ursula, Christoph Schreuer, and Rudolf Dolzer. *Principles of International Investment Law*. Oxford University Press, 2022. https://doi.org/10.1093/law/9780192857804.001.0001.

Kuzhatov, Bagdat G. "The Energy Charter Treaty Reform: Why and How to Reach a Consensus on Fair and Equitable Treatment?" *Energy Policy* 163 (April 2022): 112769. https://doi.org/10.1016/j.enpol.2021.112769.

Lévesque, Céline. "The Inclusion of GATT Article XX Exceptions in IIAs: A Potentially Risky Policy." In *Prospects in International Investment Law and Policy*, 363–70. Cambridge University Press, 2013. https://doi.org/10.1017/CBO9781139565479.029.

Mariani Agnestasia Soeitoe, Zaenal Arifin, Wijayono Hadi Sukrisno, Putri Haliza, and Ni Nyoman Tri Partini. "Adaptabilitas Arbitrase Internasional Dalam Sengketa Investasi: Studi Indonesia Dan Singapura." *Journal Juridisch* 4, no. 1 (March 3, 2026): 93–109. https://doi.org/10.26623/jj.v4i1.13406.

McLachlan KC, Campbell. *The Principle of Systemic Integration in International Law*. Oxford University Press, 2024. https://doi.org/10.1093/law/9780192893741.001.0001.

Methanex Corporation v United States of America, UNCITRAL (Final Award on Jurisdiction

and Merits) Part IV, Chapter D, para 7. (2025). https://www.italaw.com/sites/default/files/case-documents/ita0529.pdf.

Miles, Kate. *The Origins of International Investment Law*. Cambridge University Press, 2013. https://doi.org/10.1017/CBO9781139600279.

Price, David. "Indonesia's Bold Strategy on Bilateral Investment Treaties: Seeking an Equitable Climate for Investment?" *Asian Journal of International Law* 7, no. 1 (January 11, 2017): 124–51. https://doi.org/10.1017/S2044251315000247.

Qian, Xu. "Revisiting Proportionality in Investment Arbitration: Theory, Methodology, and Interpretation." *Chinese Journal of International Law* 21, no. 3 (December 15, 2022): 547–87. https://doi.org/10.1093/chinesejil/jmac020.

Qurbani, Indah Dwi, and Ilham Dwi Rafiqi. "Ecological Justice and Energy Transition Policy in Indonesia." *Jurnal Pembangunan Dan Alam Lestari* 16, no. 2 (October 24, 2025): 89–94. https://doi.org/10.21776/ub.jpal.2025.016.02.03.

Schill, Stephan, and Christian Tams, eds. *International Investment Protection and Constitutional Law*. Edward Elgar Publishing, 2022. https://doi.org/10.4337/9781839100420.

Simbolon, Putu George Matthew, and Oktavani Yenny. "The Chilling Effect of International Investment Law and Indonesia's Preventive Steps to Overcome It." *Jurnal Kajian Pembaruan Hukum* 5, no. 1 (June 20, 2025): 91–122. https://doi.org/10.19184/jkph.v5i1.53690.

Sornarajah, M. *The International Law on Foreign Investment*. 5th ed. Cambridge: Cambridge University Press, 2021. https://doi.org/10.1017/9781316459959.

Szostak, Aleksander. "Towards Right to Regulate for Climate Actions: A Closer Look at the Modernized Energy Charter Treaty." *The Journal of World Investment & Trade*, August 22, 2025, 1–29. https://doi.org/10.1163/22119000-12340382.

Tienhaara, Kyla. "Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement." *Transnational Environmental Law* 7, no. 2 (July 22, 2018): 229–50. https://doi.org/10.1017/S2047102517000309.

Titi, Catharine. "The Right to Regulate in International Investment Law (Revisited)." *Courses of the Summer School on Public International Law* 18 (March 14, 2022). https://doi.org/10.65556/MYOE1036.

United Nations Conference on Trade and Development. "International Investment Agreements Navigator: Indonesia." United Nations Conference on Trade and Development, 2026. https://investmentpolicy.unctad.org/international-investment-agreements/countries/97/indonesia.

———. "Investment Policy Framework for Sustainable Development," 2015. https://unctad.org/system/files/official-document/diaepcb2015d5_en.pdf.

———. "The Reform of International Investment Agreements – State of Play." *United Nations Conference on Trade and Development*, 2023. https://unctad.org/system/files/official-document/diaepcbinf2023d5_en.pdf.

United Nations Framework Convention on Climate Change. "The Paris Agreement." United

Nations Framework Convention on Climate Change, 2026. https://unfccc.int/process-and-meetings/the-paris-agreement.

World Trade Organization. "WTO Rules and Environmental Policies: GATT Exceptions." World Trade Organization, 2026. https://www.wto.org/english/tratop_e/envir_e/envt_rules_exceptions_e.htm.

Zugliani, Niccolò. "A Role for Precedent in the Determination of the Standard of Review Applicable by Investment Arbitral Tribunals? A Case Study of Ect-Based Energy Disputes Against Spain." *The Italian Review of International and Comparative Law*, December 19, 2022, 1–20. https://doi.org/10.1163/27725650-02020008.