

The Energy Charter Treaty: A Brief Introduction to Its Scope and Initial Arbitral Awards

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The Energy Charter Treaty

- Signed December 17, 1994
- Entered into force April 16, 1998
- In force in 48 States
 - 5 states have signed but not ratified (Australia, Belarus, Iceland, Norway, and the Russian Federation)
 - 6 states have signed the 1991 Charter but not the ECT
- ECT Signatories have a combined GDP of over \$26 trillion



Documents

1991 European Energy Charter

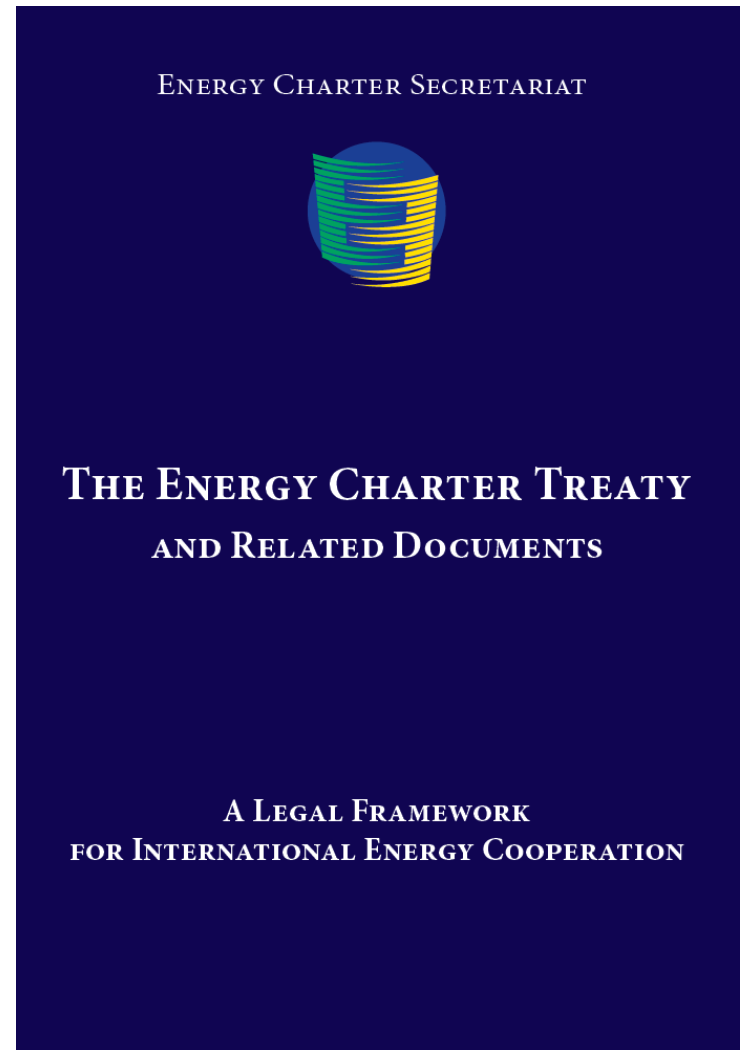
1994 Energy Charter Treaty

22 Understandings

11 Declarations

14 Annexes

1994 Protocol on Energy
Efficiency and Related
Environmental Aspects



ECT Evolving Areas

- 1998 Trade Amendment

 - Would incorporate WTO rules that did not exist when ECT was signed

 - Was expressly anticipated when ECT was signed

 - Has been ratified by 33 states; will enter into force after ratification by 35

- Transit Protocol

 - Would supplement Article 7 provisions relating to energy transit

 - Negotiations began in 1999 and continue intermittently

Treatment Obligations

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Article 10(1): Treatment of Investments

ARTICLE 10 PROMOTION, PROTECTION AND TREATMENT OF INVESTMENTS¹⁹

(1) 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. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations.

²⁰ Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.²¹

- “Fair and equitable treatment”
- “Most constant protection and security”
- No “impair[ment] by unreasonable or discriminatory measures”
- No “treatment less favourable than that required by international law” (Minimum Standard Treatment)
- Each State “shall observe any obligations it has entered into with an Investor” (umbrella clause)

Art. 10(1) Fair & Equitable Treatment (FET)

- The “fair and equitable treatment” standard in Art. 10(1) arises in relation to conditions for Investors “to make Investments”
- Is FET synonymous with “Minimum Standard Treatment”?
 - E.g.*, NAFTA parties have stated that FET under NAFTA requires no more than the “minimum standard treatment” which traditionally under international law is violated only by “egregious” or “shocking” treatment of aliens or alien property
- Application of FET in ECT awards
 - Plama Merits*: Bulgaria’s modification of environmental law not a violation of FET; applied two-pronged standard
 - Petrobart*: Government letters to bankruptcy court and reorganization of debtor state-owned company violated FET, but standard not elaborated

Art. 10(1) Constant Protection & Security

- Does “protection and security” require more than *physical* security (i.e. regular police protection)?

If it also requires assurance of *legal* or *economic* security, is it meaningfully different than FET?

- Is a State obligated to protect against unlawful acts by third parties in its area?

A right to recover against the State for failure to protect against third party acts would be unusual – e.g., police usually not liable for failing to respond to “911” calls

- Is the standard for physical security universal or allowed to vary for States with less stable conditions or less ability to control conditions?
- Has not served as the specific basis of any ECT award

Plama Merits (in general discussion): it is “an obligation to create a framework that grants security” but “the standard is not absolute and does not imply strict liability of the host State”

Art. 10(1) Umbrella Clause

- Each State “shall observe any obligations it has entered into with an Investor”

Subject to an opt-out provision in Article 26(3)(c)

- Can any breach of contract by a State incur treaty liability? Combined with Art. 22 obligations (if arbitrable under Art. 26), can any breach of contract by a State-controlled enterprise incur liability for the State?

- Tribunals have tended to hold back from such broad reach

In ECT context, *AMTO* tribunal stated that under general principles the State could only be liable where the enterprise exercised state functions (*puissance publique*)

AMTO: “It does not constitute an obligation of the state to assume liability for any failing of a state-owned legal entity to discharge a commercial debt in a given instance”

Art. 10(1) No Unreasonable or Discriminatory Measures

- “No Contracting Party shall in any way impair by unreasonable or discriminatory measures [the] management, maintenance, use, enjoyment, or disposal” of Investments.
- Prohibition against “unreasonable measures” overlaps with requirements of FET and Constant Protection & Security
- Prohibition on “discriminatory measures” overlaps with requirements of National/MFN Treatment.

Arts. 10(2)-(3), (7): National or MFN Treatment

ARTICLE 10 PROMOTION, PROTECTION AND TREATMENT OF INVESTMENTS ¹⁹

- (1) 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. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations.
²⁰ Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party. ²¹
- (2) Each Contracting Party shall endeavour to accord to Investors of other Contracting Parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (3).
- (3) For the purposes of this Article, “Treatment” means treatment accorded by a Contracting Party which is no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is the most favourable.
- (7) Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any other Contracting Party or any third state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable. ²³

- Arts. 10(2)-(3): Each State “shall ***endeavor*** to accord . . . as regards the ***Making of Investments*** . . . [treatment] no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is most favorable.”

I.e., the better of National Treatment or MFN Treatment

Aspirational – “***endeavor*** to accord”

- Art. 10(7): Each State “***shall accord to Investments*** . . . treatment no less favourable . . .”
as regards Investments once made

National or MFN Treatment

- Claimant must show State's preferential treatment of another investor/investment **and** that the other investor/investment is in "like circumstances"

E.g., in *Methanex* (NAFTA), a *methanol* producer could not point to preferential treatment of *ethanol* industry

Some argue for a "disproportionate disadvantage" approach

- ECT tribunals appear to be following the "like circumstances" approach

Nykomb: a showing of differential treatment shifted the burden to Respondent "to prove that no discrimination has taken or is taking place"

Nykomb: Highlighted importance of comparing "like with like" investments in evaluating alleged discriminatory treatment

Art. 10(12) Effective Means for Assertion of Claims

- “Each Contracting Party shall ensure that its domestic law provides effective means for assertion of claims and the enforcement of rights with respect to Investments”
- *AMTO* ECT tribunal analogized Art. 10(12) claim to a “denial of justice,” a type of claim the tribunal felt was “afflicted by imprecision” at international law

AMTO: Claimant’s “frustrating” experience in bankruptcy court did not amount to a denial of justice

Art. 13: Expropriation

ARTICLE 13 EXPROPRIATION

(1) Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as “Expropriation”) except where such Expropriation is:

- (a) for a purpose which is in the public interest;
- (b) not discriminatory;
- (c) carried out under due process of law; and
- (d) accompanied by the payment of prompt, adequate and effective compensation.

Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the “Valuation Date”).

Such fair market value shall at the request of the Investor be expressed in a Freely Convertible Currency on the basis of the market rate of exchange existing for that currency on the Valuation Date. Compensation shall also include interest at a commercial rate established on a market basis from the date of Expropriation until the date of payment.

- (2) The Investor affected shall have a right to prompt review, under the law of the Contracting Party making the Expropriation, by a judicial or other competent and independent authority of that Contracting Party, of its case, of the valuation of its Investment, and of the payment of compensation, in accordance with the principles set out in paragraph (1).
- (3) For the avoidance of doubt, Expropriation shall include situations where a Contracting Party expropriates the assets of a company or enterprise in its Area in which an Investor of any other Contracting Party has an Investment, including through the ownership of shares.

■ “Investments . . . shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation”

■ Except:

In the public interest

Non-discriminatory

Carried out with due process

Prompt, adequate and effective compensation

■ Specific terms with respect to the valuation of adequate compensation

Indirect Expropriation

- “. . . measures having ***effect equivalent*** to nationalization or expropriation”
- Can regulatory measures amount to indirect expropriation?
 - Metalclad*: Indirect expropriation includes even “incidental interference with the use of property which has the effect of depriving the owner . . . of the use or reasonably-to-be-expected economic benefit”
 - Methanex*: “A non-discriminatory regulation for the public purpose . . . is not deemed expropriatory . . . unless specific commitments had been given”
 - U.S. constitutional 5th Amd. “Takings Clause” analysis
- *Plama*: Change in environmental regulations that left investment with large environmental liability did not amount to indirect expropriation
- *Nykomb* and *Petrobart* found Art. 10 treatment violations but rejected alleged Art. 13 expropriation

Pre-Investment Obligations (Arts. 10(2), (4))

- Article 1(8) defines the “Making of Investments” as “establishing new Investments, acquiring all or part of existing investments or moving into different fields of Investment activity”
- Pre-investment generally not mandatory
 - E.g., Art. 10(2): States “shall **endeavor** to accord”
- Parties anticipated that pre-investment obligations would be addressed in a **supplemental treaty**

Article 10(4): “A supplemental treaty shall . . . oblige each party thereto to accord to Investors . . . as regards the Making of Investments . . . the Treatment described in” Article 10(3).

ECT Introduction: “The adoption of a Supplementary Treaty that would extend this obligation to ensure non-discriminatory treatment also in the pre-investment phase (the so-called ‘Making of Investments’ stage) remains under discussion among the Energy Charter’s member states.”

Consent to arbitration (and its limits)

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Investor-State Arbitration (Art. 26)

ARTICLE 26

SETTLEMENT OF DISPUTES BETWEEN AN INVESTOR AND A CONTRACTING PARTY ⁴¹

- (1) Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably.
- (2) If such disputes can not be settled according to the provisions of paragraph (1) within a period of three months from the date on which either party to the dispute requested amicable settlement, the Investor party to the dispute may choose to submit it for resolution:
 - (a) to the courts or administrative tribunals of the Contracting Party party to the dispute; ⁴²
 - (b) in accordance with any applicable, previously agreed dispute settlement procedure; or
 - (c) in accordance with the following paragraphs of this Article.
- (3) (a) Subject only to subparagraphs (b) and (c), each Contracting Party hereby gives its unconditional consent to the submission of a dispute to international arbitration or conciliation in accordance with the provisions of this Article.
 - (b)(i) The Contracting Parties listed in Annex ID do not give such unconditional consent where the Investor has previously submitted the dispute under subparagraph (2)(a) or (b).
 - (ii) For the sake of transparency, each Contracting Party that is listed in Annex ID shall provide a written statement of its policies, practices and conditions in this regard to the Secretariat no later than the date of

- Article 26 governs investor-State arbitration
- Submission of disputes to arbitration (in Art. 26(2)) only applies to “**such disputes**” as laid out in Art. 26(1), namely:

“Disputes between ***a Contracting Party*** and ***an Investor*** of another Contracting Party ***relating to an Investment*** of the latter in the Area of the former, which concern an alleged ***breach of an obligation . . . under Part III . . .***”

Limits: Art. 26(1) “a Contracting Party”

- Article 1(2): “Contracting Party” “means a state or Regional Economic Integration Organization which has consented to be bound by this Treaty and for which the Treaty is in force.”
- The only “Regional Economic Integration Organization” signatory to the ECT is the EU

Limits: “an Investor”

ARTICLE 1 DEFINITIONS

- (7) “Investor” means:
- (a) with respect to a Contracting Party:
- (i) a natural person having the citizenship or nationality of or who is permanently residing in that Contracting Party in accordance with its applicable law;
 - (ii) a company or other organization organized in accordance with the law applicable in that Contracting Party;⁶
- (b) with respect to a “third state”, a natural person, company or other organization which fulfils, mutatis mutandis, the conditions specified in subparagraph (a) for a Contracting Party.

■ Article 1(7) defines “Investor”

- (i) a natural person having the citizenship or nationality of or who is permanently residing in that Contracting Party in accordance with its applicable law; or
- (ii) a company or other organization organized in accordance with the law applicable in that Contracting Party

Limits: “an Investment”

ARTICLE 1 DEFINITIONS

- (6) “Investment” means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:⁵
- (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;
 - (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;
 - (c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;
 - (d) Intellectual Property;
 - (e) Returns;
 - (f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

A change in the form in which assets are invested does not affect their character as investments and the term “Investment” includes all investments, whether existing at or made after the later of the date of entry into force of this Treaty for the Contracting Party of the Investor making the investment and that for the Contracting Party in the Area of which the investment is made (hereinafter referred to as the “Effective Date”) provided that the Treaty shall only apply to matters affecting such investments after the Effective Date.

“Investment” refers to any investment associated with an Economic Activity in the Energy Sector and to investments or classes of investments designated by a Contracting Party in its Area as “Charter efficiency projects” and so notified to the Secretariat.

- Article 1(6) defines “Investment”
- The definition is broad
- Must be “owned or controlled” by an Investor

Subject to “Understanding 3”
regarding “control”

Limits: “an Investment”

- ECT tribunals have interpreted broadly thus far

E.g., Petrobart tribunal found that a gas condensate supply agreement that “did not involve any transfer of money or property as capital in a business in the [host State]” nonetheless qualified as an investment under the broad ECT definition

But ECT claims brought at ICSID (as opposed to SCC or UNCITRAL *ad hoc*) are subject to the ICSID concept of investment

- An ECT Investment must be “**associated** with an Economic Activity in the Energy Sector”

Article 1(5) defines “Economic Activity in the Energy Sector” as “economic activity concerning the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or sale of Energy Materials and Products”

AMTO found that the provision of services to nuclear power plants, such as wiring, alarms systems, and more basic services such as painting, was sufficiently associated with an Economic Activity in the Energy Sector

Limitations. Art. 26(1) an alleged breach of an obligation . . . under Part III”

- By its terms, Article 26 does not permit submission to arbitration of disputes alleging breaches of **non-Part III** obligations, such as
 - Transit (Part II)
 - Competition policy (Part II)
 - Transparency (Part IV)
 - Treatment by state enterprises (Part IV)
 - Treatment by sub-national authorities (Part IV)
- ECT tribunals have not always strictly applied this limit
 - For example, in *Nykomb* and *AMTO* the tribunals did not object to claimants’ invocation of Article 22 obligations
 - Nykomb*: “the provisions of Article 22 referred to do not give rise to any separate claim, but are rather invoked as provisions which clarify the scope and contents of other treaty provisions”

Amicable Settlement

- Article 26(1) states that disputes “shall, if possible, be settled amicably”
- Article 26(2) only allows for arbitration “if such [a] dispute **can not** be settled” amicably within three months – implies a mandatory character?
- Amicable settlement must be attempted in good faith
 - AMTO: Parties at least “discuss the dispute, with a view to exchanging views over its causes, the interests involved, clarifying factual uncertainties and possible misunderstandings, and identifying possible solutions within the framework of the promotion of long term cooperation in the energy field based on complementarities and mutual benefits.”
- AMTO held that the State could not rely on inadequacy of attempted settlement as an argument in arbitration but rather should have raised the issue earlier in the process, when claimant could have cured it

Ratione Temporis and Provisional Application

- The ECT requires ratification for entry into force. (Art. 44) But it also provides for provisional application pending entry into force, subject to a domestic-law inconsistency clause, and subject to the ability of a state upon signature to except itself from provisional application without regard to domestic law. (Art. 45)
- The *Kardassopoulos* tribunal stated the two clauses are not the same: “there is no necessary link between paragraphs (1) and (2)” of Article 45 and “a State whose situation is characterised by such inconsistency is entitled to rely on the proviso to paragraph (1) without the need to make, in addition, a declaration under paragraph (2).” (¶ 228)

Ratione Temporis and Provisional Application

- Article 1(6) states that the ECT “***shall only apply*** to matters affecting such investments after the Effective Date,” i.e. the “entry into force for” both investor and host States
 - “Entry into force” in Art. 1(6) could be read as requiring ***ratification*** by both States
 - This interpretation rejected by *Kardassopoulos*, which held that the language “entry into force” in Article 1(6) “embraces provisional application”
- Questions of jurisdiction *ratione temporis* thus may also arise depending on whether the critical date of the investment, treatment, or dispute arose before or after entry into force (or signature).

Denial of Benefits (Article 17(1))

ARTICLE 17

NON-APPLICATION OF PART III IN CERTAIN CIRCUMSTANCES

Each Contracting Party reserves the right to deny the advantages of this Part to:

- (1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized; or
- (2) an Investment, if the denying Contracting Party establishes that such Investment is an Investment of an Investor of a third state with or as to which the denying Contracting Party:
 - (a) does not maintain a diplomatic relationship; or
 - (b) adopts or maintains measures that:
 - (i) prohibit transactions with Investors of that state; or
 - (ii) would be violated or circumvented if the benefits of this Part were accorded to Investors of that state or to their Investments.

- “Each Contracting Party reserves the right to deny the advantages of this Part” . . .

If citizens or nationals of a third state own **or** control such entity **and** If that entity has no substantial business activities in the Area of the Contracting Party in which it is organized

AMTO: “Substantial business” does not require any particular quantum of activity; the requirement is one “of substance rather than form”

Denial of Benefits (Article 17(1))

- *Plama* tribunal held that denial of advantages operates at the merits stage – *i.e.*, even if it does apply, it does not affect a tribunal's jurisdiction

Is it appropriate to burden a State with defending itself on the merits if claimant cannot raise Part III claims (since Art. 26 provides arbitration only for alleged breaches of Part III obligations)?

- *Plama* tribunal held that State must declare its intention to deny advantages to an investor in advance of the investor actually making the investment

Not clear this is what parties intended

Interpretation raises questions about what notice will be accepted as a practical matter, taking account that State will not necessarily be a party to or have knowledge about any particular investment before it is made.

Taxes and Taxation Measures

ARTICLE 21 TAXATION

- (1) Except as otherwise provided in this Article, nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties. In the event of any inconsistency between this Article and any other provision of the Treaty, this Article shall prevail to the extent of the inconsistency.
 - (2) Article 7(3) shall apply to Taxation Measures other than those on income or on capital, except that such provision shall not apply to:
 - (a) an advantage accorded by a Contracting Party pursuant to the tax provisions of any convention, agreement or arrangement described in subparagraph (7)(a)(ii); or
 - (b) any Taxation Measure aimed at ensuring the effective collection of taxes, except where the measure of a Contracting Party arbitrarily discriminates against Energy Materials and Products originating in, or destined for the Area of another Contracting Party or arbitrarily restricts benefits accorded under Article 7(3).
- * * *
- (7) For the purposes of this Article:
 - (a) The term “Taxation Measure” includes:
 - (i) any provision relating to taxes of the domestic law of the Contracting Party or of a political subdivision thereof or a local authority therein; and
 - (ii) any provision relating to taxes of any convention for the avoidance of double taxation or of any other international agreement or arrangement by which the Contracting Party is bound.

- **“nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures”**
- Article 21 uses two separate terms: “Taxation Measures” and “taxes” – e.g.:
 - 21(3): “Article 10(2) and (7) shall apply to **Taxation Measures**”
 - 21(5): “Article 13 shall apply to **taxes**”
- Article 21(7) indicates that “Taxation Measures” are broader than “taxes”: Taxation Measures **“includes . . .** Any provision relating to taxes of the domestic law of the Contracting Party.”

Art. 21 Taxation Carve-outs and Claw-backs

- Under Art. 21(3), National Treatment/MFN under Art. 10(2) and 10(7) “shall apply to Taxation Measures,” **except**
 - This does not apply to Taxation Measures “on income or on capital”, and
 - This does not apply to “any Taxation Measure aimed at ensuring the effective collection of taxes,” **except**
 - measures that **arbitrarily** discriminate or restrict benefits
- “Taxation Measures” carved out in Art. 21(1) thus appear necessarily to include measures taken for the enforcement and collection of taxes
- Article 21 has received little attention in the ECT arbitral decisions to date
 - For example, the *Plama* merits tribunal viewed Article 21 as barring a claim based on tax administration and enforcement activities but proceeded to reject the claim on its merits; the *AMTO* tribunal also rejected a tax-related claim on its merits without addressing Article 21

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