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Issue : (provisional)
October 2006

This article will be published in a future issue of OGEL (2006). Check website for final publication date for correct reference.

This article may not be the final version and should be considered as a draft article.

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OGEL Cover v1.2

Oil, Gas & Energy Law Intelligence

The Energy Charter Treaty Affords Investor Protections and Right to Arbitration by E. Sussman

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Reprinted with permission from the American Bar Association, Environment Energy and Resources Section, Energy Committees Newsletter, August 2006

The Energy Charter Treaty Affords Investor Protections and Right to Arbitration
By Edna Sussman, Hoguet Newman & Regal LLP, ESussman@hnrlaw.com

The Energy Charter Treaty (the “ECT”) had its genesis in the ending of the Cold War which offered an opportunity for mutually beneficial cooperation between Russia and its many neighbors who needed major investments in their energy rich resources and the states of western Europe who had a strategic interest in diversifying their sources of energy. As stated in Article 2, the ECT “establishes a legal framework in order to promote long term cooperation in the energy field”; by so doing it increases confidence by investors and the financial community and promotes investment and trade flow among members. www.encharter.org

The ECT was signed in 1994 and entered into force in 1998. It has been signed or acceded to by 51 states, mainly countries in Europe and the former U.S.S.R., as well as the EU, Japan and Australia (“Contracting Parties”). The ECT has many states with observer status including the U.S., China, Saudi Arabia, Iran, Venezuela, Tunisia, United Arab Emirates, and many other Persian Gulf states as well as international organizations such as the World Bank and the Association of Southeast Asian Nations.

The ECT provisions include (a) investment protections intended to create a “level playing field” and reduce to a minimum the non-commercial risks associated with energy sector investments; (b) trade provisions consistent with WTO rules and practice; (c) obligations to facilitate transit of energy on a non-discriminatory basis consistent with the principle of free transit; (d) energy efficiency and environmental provisions which require states to formulate a clear policy for improving energy efficiency and reducing the energy cycle’s negative impacts on the environment; and (e) dispute resolution mechanisms for investment related disputes between an investor and a Contracting Party or between one state and another as to the application or interpretation of the ECT.

This article will focus on the investment protection and dispute resolution provisions of the ECT. With the increasing globalization of the world’s economy, the interdependence of the energy sector, and the long term and highly capital intensive nature of energy projects, multilateral rules for international cooperation are needed. The ECT was negotiated to meet that need. As the arbitral tribunal stated in *Plama Consortium Limited vs. Republic of Bulgaria*, the ECT is the “first multi-lateral treaty to provide as a general rule the settlement of investor-state disputes by international arbitration” and provides “a covered investor an almost unprecedented remedy for its claims against a host state.” <http://www.worldbank.org/icsid/cases/awards.htm#awardARB0324>

Investment Protections

The ECT provides for a variety of protections for foreign investments, including:

General protections- Contracting Parties must accord “fair and equitable treatment,” “constant protection and security” and “shall on no way impair by unreasonable or discriminatory measures the management, maintenance, use enjoyment or disposal of an investment;” in no case shall “treatment be less favorable than that required by international law;”

Discrimination- Contracting Parties must accord investors treatment no less favorable than that accorded to its own investors or to investors of any other state;

Expropriation- Investments shall not be expropriated, nationalized or subjected to measures which have an effect equivalent to expropriation or nationalization unless certain limited exceptions are met and then only if a prompt, adequate and effective compensation payment equivalent to fair market value is made;

Fund Transfers- Contracting Parties guarantee freedom to transfer funds in and out of the country without delay and in a freely convertible currency;

Interplay with Other Treaties- If two or more Contracting Parties enter into a prior or subsequent international agreement, the provision more favorable to the Investor shall govern where there are disparities.

Dispute Resolution Provisions

In international disputes, resort to arbitration over domestic courts has generally been viewed as preferable because of concerns about neutrality, competence, process, efficiency and respect for rule of law in local courts. Equally important is the question of enforceability of any decision rendered. The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”) is the most successful international treaty to date with over 130 countries as signatories. Pursuant to the New York Convention, the signatory countries have committed to enforcing arbitration awards; the grounds for refusing to enforce arbitration awards are extremely limited. There is no parallel international treaty that has been broadly adopted for recognition of foreign court decisions. While the new Hague Convention on Choice of Court Agreements may change that, it is years away from widespread adoption and it is not yet clear how widely it will be accepted. Thus the ECT’s provisions governing dispute resolution are of great importance to the protection of investors in the energy sector.

The ECT enables an investor to make claims against a Contracting Party in case of a breach of an obligation relating to investment protection. It mandates conciliation as a first step but if that fails the investor can choose the forum for dispute resolution: either a domestic court or international arbitration. The ECT creates “arbitration without privity,” i.e. the host country need not be a party to the investment contract to be subject to the claim. Under the ECT the Contracting Party gives its “unconditional consent to the

submission of the dispute to international arbitration.” This commitment is viewed as an “offer” which can be “accepted” by the investor.

Arbitration under the ECT is to be submitted to the International Centre for Settlement of Investment Disputes (“ICSID”) if one or both parties are party to the ICSID Convention, to a sole or ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (“UNCITRAL”), or to an arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce.

Decisions Under the ECT

As the ECT is a relatively new treaty there have been few cases decided to date, but claims under the treaty are emerging. Two publicly reported decisions on the merits are of interest: *Petrobart* won a claim against the *Kyrgyz Republic* for the state’s decision to transfer assets out of KGM, a state owned company, to which Petrobart had delivered gas to the detriment of Petrobart as KGM’s judgment creditor. <http://www.iisd.org/investment/itn/documents.asp> *Nykomb Synergetics* won a claim against the *Republic of Latvia* for changing a government policy and amending legislation which had the effect of altering an incentive system for environmental investment and depriving the claimant of double tariffs in connection with the construction of a cogeneration power plant. <http://ita.law.uvic.ca/documents/Nykomb-Finalaward.doc> In both of these decisions the tribunals addressed the applicability of the ECT and found in favor of the claimant.

An interesting case is now pending brought in connection with the Yukos Oil Company dispute in which the Group Menatep shareholders are seeking \$30 billion against Russia claiming that Russia’s actions in connection with the forced auction of Yukos amounted to virtual expropriation. This arbitration, now in its early stages, will likely require the tribunal to address the question of whether Russia, which signed but has not ratified the ECT, is governed by its provisions. The ECT in Article 45 commits each signatory to apply the ECT “provisionally” pending its entry into force “to the extent such provisional application is not inconsistent with its constitution, laws and regulations.” This provision will undoubtedly be argued to bind Russia to the ECT’s provisions. Article 25 of the Vienna Convention on the Law of Treaties expressly provides for provisional application if the treaty so provides. The ECT specifically authorizes states to deliver a declaration that they are not able to accept provisional application; several states did deliver such a declaration but Russia did not do so. See Matteo Winkler, *Arbitration Without Privity and Russian Oil: The Yukos Case before the Houston Court*, 27 U. Pa. J. Int’l Econ. L. 115 (2006).

Another recently filed case is that of *Libananco vs. Republic of Turkey* in which a Cypriot company seeks \$10 billion for an alleged unlawful seizure and expropriation of two of the largest hydroelectric facilities in Turkey. The case will raise interesting issues concerning ICSID jurisdiction including an examination of Libananco’s *bona fides* as a Cypriot company to establish standing, the nature of Libananco’s investment and whether

a prior court proceeding in Turkey defeats Libananco's claim that Turkey consented to arbitration under the ECT. For a discussion of this case, *see* http://www.erenlaw.com/cc_libananco-turkey_icsid_0506.htm Another set of cases under the ECT were filed recently against Azerbaijan by Azpetrol and Barmek, *see* http://www.iisd.org/pdf/2006/itn_aug10_2006.pdf

The growing body of decisions interpreting the ECT will create greater certainty as to the meaning, scope and application of its provisions. For an excellent discussion of many issues under the ECT see Thomas Walde, *Investment Arbitration under the Energy Charter Treaty: An Overview of Key Issues*, , *Transnational Dispute Management*, Volume I, Issue 2, 2004, <http://www.transnational-dispute-management.com/samples/freearticles/tv1-2-article224b.htm>

United States and the ECT

The United States was heavily involved in the early stages of the development of the Energy Charter, but it is not a party to the ECT. Ria Kemper, Secretary General of the Energy Charter Secretariat delivered a speech in 2001 stating that she had been informed that the United States had not signed the treaty because (a) the protections of investments in the ECT are not as strong as those contained in U.S. bilateral agreements; (b) there is a potential conflict between the ECT's unconditional provisions on most favored nation treatment and the Jackson-Vanik Amendment to the 1970 U.S. Trade Act; and (c) there would be difficulty in ensuring that the ECT's provisions are implemented on a sub-federal level. Others have suggested that the U.S. did not become a party to the treaty because no resolution was reached on how to legally bind the parties at the pre-investment stage which relates to such issues as access conditions as opposed to the post-investment risks ultimately covered by the ECT. For a review of the ECT negotiation process, see Bamberger, Lineham and Walde, *The Energy Charter Treaty in 2000*, from *Energy Law in Europe*, ed. Roggenkamp 2000, <http://iis-db.stanford.edu/evnts/3917/Charter.pdf>

As the United States is not a party to the ECT, many practitioners recommend that in structuring deals for multi-national U.S. companies, consideration be given to selecting an entity domiciled in a state that is party to the ECT as the contracting party in order to benefit from its protections. Indeed, as there are many countries that are parties to the ECT with whom the U.S. has not entered into a bilateral investment treaty, it would seem advisable in structuring deals to conduct a review of which countries will be involved in the project and what investment treaties are in effect that may be applicable with respect to those countries; many energy projects span several countries, last for decades and require enormous capital investments making investor protection particularly significant.

Moreover, additional signatories to the ECT may be in the wings; the Energy Charter accession team and the government of China are working together towards China's accession; Pakistan recently became an ECT observer; efforts are underway to

persuade Russia to move from being a signatory to full ratification of the ECT. Other countries are in serious discussions on accession to the treaty. While the ECT does not expressly provide how it should be applied temporally, parties will undoubtedly argue that the investor protections of the ECT govern with respect to contracts entered into before accession to the ECT by a Contracting Party. While whether such a construction will prevail has yet to be decided, in *Nykomb Syngernetics Technology Holding vs. the Republic of Latvia, supra*, the tribunal determined that Latvia was subject to the ECT for action with respect to a contract entered into before the ECT came into force but subsequent to Latvia's signature and ratification of the treaty.

If seeking coverage under the ECT, the selection of the corporate domicile of the contracting entity should include a review of Section 17 of the ECT which provides that a Contracting Party reserves the right to deny the benefits of the ECT to a legal entity if citizens or nationals of a third state own or control that entity and that entity has no substantial business activities in the area of the Contracting Party. An extensive discussion of Section 17 of the ECT is found in the case of *Plama Consortium Limited vs. Republic of Bulgaria, supra*.

Conclusion

The number of investor-state arbitrations based on international investment agreements is growing; of the 219 known investor- state arbitrations to date, two-thirds commenced since the beginning of 2002. Several of these commenced under the ECT and more will likely follow.

The ECT is a young treaty and the Energy Charter Secretariat is working on raising awareness of the ECT, developing areas of consensus among member states and observers on key issues such as energy security, transit issues and energy efficiency, and attracting additional Contracting Parties. Today the world's attention is centered on energy issues due to concerns about energy independence and reliability, energy security and climate change. The ECT can play an important role in shaping decisions on how energy is managed and energy resources developed around the world.

Edna Sussman is chair of the Renewable Energy Resources Committee of the Environment Energy and Resources Section of the American Bar Association and the chair of the Energy Committee of the Association of the Bar of the City of New York. She is an experienced arbitrator and mediator serving on arbitration panels of the American Arbitration Association, the International Centre for Dispute Resolution, the International Institute for Conflict Prevention and Resolution, the Emissions Trading Panel of the Permanent Court of Arbitration in the Hague, the National Association of Securities Dealers, the New York Stock Exchange and on the mediation panels of the state and federal courts in New York.