

The Energy Charter Treaty

Settlement of Disputes
between an Investor and a Member State

Energy Charter Secretariat, Brussels

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Introduction

- Overview of the ECT investor-state dispute settlement mechanisms
 - Amicable settlement and the “cooling off” period
 - Choice of dispute settlement mechanisms
 - International arbitration
- Overview of the ECT cases to date
 - Published decisions
 - Pending cases
- Tactics for States faced with ECT claims

I. Overview of the ECT Investor-State Dispute Settlement Mechanisms

Core role in ECT for dispute settlement

- Investor-State dispute settlement procedures:
 - ***strengthen the rule of law*** in relation to energy investments
 - ***minimise risks*** associated with energy-related investments
 - help to build a ***favourable investment climate***
 - can contribute to economic growth and ***liberalising investment*** in the energy sector
 - are essential to ***confidence-building***

Favourable investment climate

■ *European Energy Charter 1991:*

TITLE I OBJECTIVES

Within the framework of State sovereignty and sovereign rights over energy resources and in a spirit of political and economic co-operation, they undertake to promote the development of an efficient energy market throughout Europe, and a better functioning global market, in both cases based on the principle of non-discrimination and on market-oriented price formation, taking due account of environmental concerns. They are determined to create a climate favourable to the operation of enterprises and to the flow of investments and technologies by implementing market principles in the field of energy.

Catalyse economic growth

■ *Energy Charter Treaty 1994, Preamble:*

Desiring also to establish the structural framework required to implement the principles enunciated in the European Energy Charter;

Wishing to implement the basic concept of the European Energy Charter initiative which is to catalyse economic growth by means of measures to liberalize investment and trade in energy;

Confidence-building

■ *The Energy Charter Treaty Secretariat:*

The existence of the Treaty's dispute settlement procedures is of considerable value in confidence-building terms. The fact that such procedures are available, and that the Treaty's Contracting Parties have taken on the unconditional obligation to accept their application where necessary, provides reassurance for investors that, in the case of a dispute, they will be entitled to have recourse to the above mechanisms in defence of their interests.

ECT Investment Disputes

PART V DISPUTE SETTLEMENT ⁴⁰

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.

Elements of an ECT investment dispute

■ Article 26 ECT:

- disputes between a **Contracting Party** and an **Investor**
- relating to an **Investment** of the investor
- in the **Area** of the Contracting Party
- concerning breach of an obligation of the Contracting Party **under Part III** of the ECT (but **not other obligations** in the ECT or, for instance, an investment contract or licence)

Settlement of ECT investment disputes

- Amicable settlement, if possible
- If no settlement within **3 months** from the date either party requested negotiations (a relatively brief “**cooling-off**” period), Investor may opt for other dispute settlement procedures, but...
- **Article 10(7) ECT:**
 - Can investors evade the “cooling-off” period and commence arbitration by relying on the **MFN treatment** obligation?
 - *Maffezini v. Argentine Republic* (Spain-Argentina BIT)
 - *Plama v. Republic of Bulgaria* (ECT & Cyprus-Bulgaria BIT)

Choice of dispute settlement mechanisms

- Article 26(2) provides **Investors** with the **option** to submit disputes:
 - (a) to the **courts** or administrative tribunals of the Contracting Party to the dispute;
 - (b) in accordance with any applicable, **previously agreed** dispute settlement procedure; or
 - (c) **international arbitration** in accordance with the Article 26

Arbitration of ECT investment disputes

- Article 26(4) provides the Investor with three options for ***arbitration***:
 - **ICSID** (the International Centre for the Settlement of Investment Disputes) (if the Contracting Party to the dispute and the Investor's Home State are Contracting States to the 1965 ICSID Convention)
 - **UNCITRAL** (i.e. *ad hoc* arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law) before a sole arbitrator or three member tribunal
 - the Arbitration Institute of the **Stockholm Chamber of Commerce**

Choice of fora for ECT arbitration

- Institutional arbitration -v- *ad hoc* arbitration
- Publicity -v- confidentiality
- Speed of process (screening role of ICSID Secretariat)
- Additional jurisdictional hurdles
- Review of awards
- Enforcement of awards
- Political and cultural considerations

ICSID arbitration

- Institution within the World Bank Group
- Frequent jurisdictional objections
- Awards final and binding subject to annulment procedures
- No appeal or review in courts (cf. UNCITRAL: *Occidental v. Ecuador*)
- Recognition and enforcement of awards in 143 Contracting States
- Contracting States recognise and enforce the pecuniary obligations of Awards as if a final judgment of their own courts
- No derogation from rules of sovereign immunity *from execution*
- Publication of Awards, growing body of case law (but not precedent)

Consent to international arbitration

- ECT states give unconditional consent to international arbitration
- Article 26(3) ECT provides ***two exceptions***:

- the “**fork in the road**”:

- (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).

6. ANNEX ID

LIST OF CONTRACTING PARTIES NOT ALLOWING AN INVESTOR TO RESUBMIT THE SAME DISPUTE TO INTERNATIONAL ARBITRATION AT A LATER STAGE UNDER ARTICLE 26 (IN ACCORDANCE WITH ARTICLE 26(3)(B)(I))

- | | |
|-------------------------|--|
| 1. Australia * | 13. Japan |
| 2. Azerbaijan | 14. Kazakhstan |
| 3. Bulgaria | 15. Mongolia |
| Canada ⁵⁹ | 16. Norway * |
| 4. Croatia | 17. Poland |
| 5. Cyprus | 18. Portugal |
| 6. The Czech Republic | 19. Romania |
| 7. European Communities | 20. The Russian Federation * |
| 8. Finland | 21. Slovenia |
| 9. Greece | 22. Spain |
| 10. Hungary | 23. Sweden |
| 11. Ireland | 24. Turkey |
| 12. Italy | United States of America ⁵⁹ |

* Denotes State for which ratification of the Energy Charter Treaty is still pending as of September 2004.

⁵⁹ Editor's note: Canada and the United States of America have not signed the Energy Charter Treaty.

Consent to international arbitration

- **Article 26(3) ECT** second exception to States' consent:

- the “**umbrella clause**”:

- (c) A Contracting Party listed in Annex IA does not give such unconditional consent with respect to a dispute arising under the last sentence of Article 10(1).

7. ANNEX IA

LIST OF CONTRACTING PARTIES NOT ALLOWING AN INVESTOR OR CONTRACTING PARTY TO SUBMIT A DISPUTE CONCERNING THE LAST SENTENCE OF ARTICLE 10(1) TO INTERNATIONAL ARBITRATION (IN ACCORDANCE WITH ARTICLES 26(3)(C) AND 27(2))

1. Australia *
- Canada ⁶⁰
2. Hungary
3. Norway *

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⁶⁰ Editor's note: Canada has not signed the Energy Charter Treaty.

The ‘umbrella clause’

- The Umbrella Clause (Article 10(1) last sentence)
 - “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”
- *SGS v. Pakistan* (does not elevate contract claims to treaty claims)
- *SGS v. Philippines* (does so elevate contract claims)
- *CMS v. Argentina* (does so elevate contract claims)
- *Eureko v. Poland* (does so elevate contract claims)
- Contractual exclusive jurisdiction clauses may render claims inadmissible

Applicable law in ECT investment arbitration

■ Article 26(6):

- (6) A tribunal established under paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law.

Finality, Remedies and Enforcement

■ Finality

- ECT arbitral Awards are final (**Article 26(8)**)

■ Remedies

- awards may include interest and provide that the host state pay “monetary damages in lieu of any other remedy granted”

■ Enforcement

- the New York Convention 1958 (**Article 26(5)(b)**)
- the ICSID Convention 1965

II. Overview of ECT cases to date

ECT arbitration decisions to date

■ Final Awards:

- *Nykomb Synergetics Technology Holding AB v. The Republic of Latvia*
- *Petrobart Ltd v. The Kyrgyz Republic*

■ Jurisdictional Decisions:

- *Plama Consortium Ltd v. The Republic of Bulgaria*

Other ECT claims

■ Settled:

- *AES Summit Generation Ltd v. Republic of Hungary*

■ Pending:

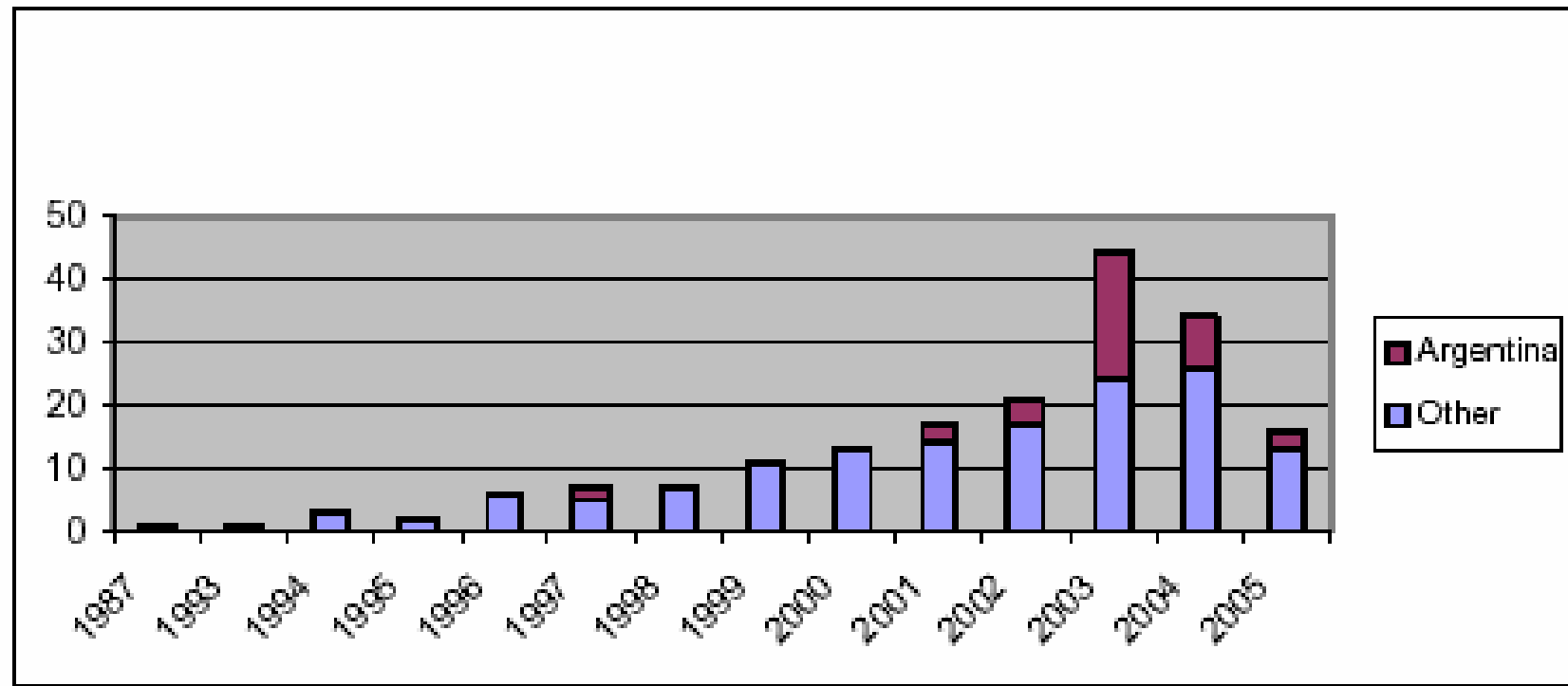
- *Alstom Power Italia SpA and Alstom SpA v. The Republic of Mongolia*
- *Hulley Enterprises Ltd v. The Russian Federation*
- *Yukos Universal Ltd v. The Russian Federation*
- *Veteran Petroleum Trust v. The Russian Federation*

Non ECT investment treaty arbitrations

- 183 known investment treaty arbitration claims (June, 2005)
 - BIT (161+) (37 against Argentina)
 - NAFTA (21)
 - ASEAN (1)
- Estimates of half as many again (or more) non-ICSID arbitrations
- 56 Governments known to have been named as respondents
 - 36 in “developing world”
 - 12 in “developed countries”
 - 8 in south-east Europe and the CIS

BIT arbitrations

Figure 10. Known investment treaty arbitrations, June 2005



Source: UNCTAD.

AES v. Hungary

- First claim brought under the ECT
- Claims also brought under the UK-Hungary BIT
- Dispute concerned allegation that Hungary reneged on privatisation agreement with investment of a multinational energy company
- Claimant opted for ICSID arbitration
- Claims in region of US\$300 million settled favourably
- Proceedings discontinued 3 January 2002
- No further information in the public domain

Nykomb v. Latvia

- Swedish claimant invested via 100% shareholding in Latvian company Windau
- Windau had contracted with Latvian state company Latvenergo to construct cogeneration plant
- Latvenergo to purchase surplus electricity at a price, for first 8 years, calculated based on a multiplier per 1995 Entrepreneurial Law
- Entrepreneurial Law repealed by 1998 Energy Law, but double tariff obligation set out in contract
- Windau contended multiplier was 2, Latvenergo said it was 0.75
- Local competitors continued to receive double tariff

Nykomb v. Latvia

■ ECT claims alleged:

- failure to ensure fair and equitable treatment
- failure to provide treatment not less favourable than that required by international law
- impairment of investment by unreasonably or discriminatory measures
- measures equivalent to expropriation, without compensation

Nykomb v. Latvia

■ Issues:

- Was Latvia responsible for conduct of Latvenergo?
(Article 22(1) ECT)
- Scope and effect of the umbrella clause? **(Article 10(1))**
- Adequate explanation for different treatment of local competitors?
- Expropriation by failure to pay debts due under contract?
(Article 13)
- Quantification of damages

- Award (16 December 2003) of approximately US\$3 million

Plama v. Bulgaria

- Plama purchased shares in Nova Plama, which in turn owned an oil refinery in Bulgaria
- 2002 Environmental Protection Act absolved Bulgaria of responsibility for environmental damage caused by public companies pre-privatisation
- Nova Plama liable under the Act

Plama v. Bulgaria

- **Claims** (approx US\$300 million):
 - under the ECT
 - under the Bulgaria-Cyprus BIT
- **Issues:**
 - Whether new Environmental Protection Act amounted to “regulatory expropriation”?
- **Decision on Jurisdiction** (8 February 2005):
 - Plama allegedly merely a Cypriot “mailbox company”
 - Article 17(1) of the ECT creates only a “right to deny” protection
- Recent ***request for provisional measures*** denied; case pending

The “right to deny” advantages of Part III

■ Article 17(1) ECT:

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

Mailbox companies and Article 17(1)

- A **mailbox company** is no more than a brass plate and a certification of incorporation, that
 - is owned or controlled by nationals of a third State; **and**
 - carries on no substantial business activities in the territory of the Contracting Party where it is incorporated
- Findings in *Plama* on Article 17(1):
 - not a bar to jurisdiction
 - no more than a ***right to deny*** that must be invoked and once invoked only applies ***prospectively***

Petrobart v. the Kyrgyz Republic

- Gibraltarian investor
- Contract for shipments of gas condensate to state-owned company
- Failure to pay for shipments under contract
- Kyrgyz courts issue judgment in Petrobart's favour
- Vice Prime Minister intervenes so that court stays auction of assets
- Assets of state-owned company subsequently sold to third party and company declared bankrupt
- Claimant commenced:
 - first, UNCITRAL arbitration under Foreign Investment Law
 - second, Stockholm arbitration under ECT

Petrobart v. Kyrgyz Republic

■ Issues:

- Whether rights under gas delivery contract an investment?
- Whether claimant was an investor?
- Whether finding of lack of jurisdiction in UNCITRAL arbitration under Foreign Investment Law *res judicata*?
- Whether Gibraltar company able to bring claim although ECT applies only provisionally to Gibraltar? (**Article 45(1) ECT**)

- Award (29 March 2005) of approximately US\$1 million

Alstom v. Mongolia

- Mongolia acceded to the ECT in 1999
- Alstom invested in thermal energy station
- Dispute arose in respect of boiler rehabilitation of the power plant
- Claims brought under the ECT and a BIT
- Sums in dispute modest, but not in the public domain
- December 2003: Alstom submitted dispute to ICSID arbitration
- Current status: pending

Yukos Shareholders v. Russia

- Three cases against the Russian Federation (claim of US\$33 billion)
 - Hulley Enterprises Ltd (Cyprus)
 - Yukos Universal Ltd (Isle of Man)
 - Veteran Petroleum Trust (Cyprus)
- Menatep (parent company) is Gibraltarian, ultimate owners Russian
- Loss of value of shares in Yukos
- Consolidation of claims and Tribunal recently constituted

Yukos Shareholders v. Russia

■ (Potential) Issues:

- Provisional application of the ECT (**Article 45(1)**)
- ECT protection for mailbox companies (**Article 17(1)**)
- Whether taxation measures expropriatory (**Articles 13, 21(5)**)
- Application of yet untested procedures in Article 21(5) for determinations by Competent Tax Authorities

Provisional application of ECT

- Highly controversial
- Article 25 Vienna Convention on the Law of Treaties 1969
- Passing remarks in *Plama* and *Petrobart*
- Questions of Russian constitutional law?

ARTICLE 45 PROVISIONAL APPLICATION

- (1) Each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its constitution, laws or regulations.

Taxation measures

- **Article 10(2) and 10(7)** apply to taxes
- **Article 13** (expropriation) applies to **taxes**
- Issue whether a tax is an ***expropriation*** or whether a tax is ***discriminatory*** shall be referred to **Competent Tax Authority**
- International Arbitral Tribunals ***may take account*** of conclusions arrived at by Competent Tax Authority

III. Tactics for States faced with ECT claims

Negotiate waiver of rights to arbitrate ECT claims

- A controversial issue, not yet fully tested in investment treaty arbitration
- Is a waiver of the right to submit ECT claims to international arbitration likely to be valid?
 - A classic view of international law might suggest “**no**”
 - A modern view of the nature of investment treaty rights might suggest “**yes**”
- So, consider seeking an express waiver of rights to submit ECT claims to international arbitration when negotiating terms of entry of new investments

Ensure the claimant is entitled to claim

- Challenge the Claimant to establish that it qualifies as an Investor of a Contracting Party
- e.g., *Soufraki v. United Arab Emirates*
 - proof of nationality of a Contracting Party to Italy / UAE BIT?
- for dual of multiple nationals, consider the Claimant's “**effective nationality**”
- e.g., *Tokios Tokelès v. Ukraine*
 - Chairman's dissent: claims in substance those of nationals of respondent State not appropriate for ICSID arbitration, at least
- e.g., *Petrobart v. The Kyrgyz Republic*
 - qualifying investment under the ICSID Convention?

Exclude protection to “mailbox companies”

- Article 17(1):
 - a “right to deny” the advantages of Part III to “mailbox companies”
 - ***must be exercised***
 - only applies ***prospectively*** (if *Plama* is to be followed)
- Consider ***exercising your rights*** under Article 17(1)
 - on a blanket coverage basis; or
 - in relation to specific, identified investments before they are made

The importance of advocacy

- Traditionally the domain of investors
- States tend to be less savvy
- Remember that the Tribunal will be reviewing even the early correspondence – so engage in correspondence with one eye on how the Tribunal will assess the State's conduct
- This includes:
 - actively (appearing?) to manage disputes as they arise
 - positively engaging in negotiations during the cooling-off period
 - taking specialist advice - **early**

Fora for claims

- Attract jurisdiction of local courts (Annex ID States)
- Commence local proceedings seeking declaration of no ECT breach
- Consider possible strategic advantages of influencing the potential claimant's choice of forum
 - possible ICSID Convention defences
 - timing issues (ICSID much slower)
 - scope to challenge Award (greater for non-ICSID cases)
- Downsides
 - cost (is ICSID cheaper?)
 - publicity and enforcement?

Consolidation of claims

- Avoid *CME v. Czech Republic / Lauder v. Czech Republic* scenario
- Multiple proceedings multiplies risk of losing
- Seek to consolidate:
 - ECT / BIT claims
 - ECT / Foreign Investment Law claims
 - ECT / investment contract claims
- Consider *de facto* consolidation, same arbitrators etc...
- Consolidation of multiple investor claims

Appointment of arbitrators

- Appoint an arbitrator who:
 - will be able to **communicate** with other Tribunal members
 - can influence selection of Chairperson
 - has necessary **gravitas** to convince other Tribunal members
 - has expertise in **both** local law and public international law
- Compare:
 - *CME v. Czech Republic* (appointment of local professor)
 - *Hulley et al. v. Russia* (appointment of former President of ICJ)
- Avoid the “knee-jerk” reaction to appoint an obviously sympathetic arbitrator

Speaker's Profiles



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