



OCCASIONAL PAPER SERIES

**THE ENERGY CHARTER
TREATY AND ADR
IN THE CONTEXT OF
INVESTOR/STATE
AND OTHER DISPUTES**

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ENERGY CHARTER SECRETARIAT
KNOWLEDGE CENTRE
2016

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INTRODUCTION

The furore over the use of ISDS (Investor/State Dispute Settlement) in the US/EU TTIP negotiations has illustrated the increasing distrust by some Governments and NGOs of the use of arbitration in resolving Investor/State disputes. Jean-Claude Juncker, the President of the European Commission, has likened arbitral tribunals to “secret courts”. This criticism has also spilled over into domestic arbitration. The New York Times published two critical articles¹ this year accusing arbitration of “stacking the deck of justice” and calling it a “privatization of the justice system”. The articles went on to level the following complaints against the arbitral process: lack of transparency; private judges; no appeal, no accountability; and opting out of the legal system. This unprecedented attack, whether founded in fact or not, has damaged the public perception of arbitration, not helped by recent high profile corruption allegations involving arbitral tribunals notably in France and Bulgaria.²

Interestingly, in the past century business has turned away from the State Court System, which was seen as cumbersome, process-oriented and lacking critical subject matter expertise and appeared to find an alternative in Arbitration, where likeminded business people could determine disputes cheaply, quickly and effectively. The main commercial arbitration institutions (ICC, CIArb, LCIA and AAA) all found their genesis during this period. They are now entering their second century with a lot less confidence and with many of the same criticisms once levelled at State Courts.

This uncertain situation has increasingly left the door open to mediation, not necessarily as an alternative, but as an adjunct to arbitration or the Courts. There is a newfound interest shown by governments, corporations and institutions in using mediation to resolve disputes earlier in the cycle. Clearly, this has been a growing trend in civil disputes for some time, but is now finding its way into the arena of bilateral investment treaties (BITS) and Investor/State disputes themselves.

There has been interest in bringing mediation into these forms of disputes for some time. A clear indication of the change in attitude by governments, multi-nationals and institutions came in the form of the IBA Rules for Investor-State Mediation adopted by the IBA Council on the 4th of October 2012. This was a clear attempt by a variety of stakeholders to set out a framework by which mediation could be utilised in Investor/State disputes, thereby avoiding the need for arbitration. All the major

¹ New York Times, “Arbitration Everywhere, Stacking the Deck of Justice”, 31 October 2015; “A Privatisation of the Justice System”, 1 November 2015.

² <http://www.out-law.com/en/articles/2015/december/bernard-tapie-ordered-to-repay-403-million-to-french-government/>

institutions historically involved in such disputes, including the ICSID, ICC and SCC, were involved in the initiative.

Continuing on from there, mediation was included in the Canada-US Investment Treaty (CETA)³ concluded at the end of 2014, formally recognizing the ability to utilise mediation in trade disputes. This same option is being considered in the TTIP negotiations. In addition, the EU Commission has stated that it will explore the use of mediation to resolve intra-EU investment disputes, where the feeling is that existing BITS with their arbitration provisions are no longer legitimate. To help with enforcement of mediated settlements, the United Nations Commission on International Trade Law (UNCITRAL) is reviewing the possibility of a multilateral treaty permitting direct enforcement of mediated settlement agreements, similar to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).

One of the Authors⁴, having acted in an international role as in-house counsel to major multi-national investors for over 25 years, has had first-hand knowledge of the change in attitude to dispute resolution in a cross-border context. When in the past arbitration in a neutral forum was the accepted dispute resolution mechanism adopted by many States in their contracts with international parties, this is no longer taken for granted. International business is being forced to look at more pragmatic ways of managing its disputes with States, and States are reciprocating. Mediation is now a serious consideration, but many perceived obstacles to using mediation for a State player remain.

The Author has also seen the evolution of mediation use in business disputes. It is now established practice in most multi-national companies to have a disputes management process in place. This often begins with building mediation into the disputes clause in contracts, mediation training for in-house counsels and key business positions, as well as ensuring that mediation is attempted for all disputes that do become litigious. He has witnessed first hand the successful conclusion of highly complex IP disputes and multi-billion dollar litigation through the use of mediation. Mediation saved his company not only due to litigation costs, but also by limiting lost opportunity costs and the damage to relationships that litigation inevitably brings. Mediation in Investor/State disputes brings these same benefits.

³ http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf

⁴ Wolf von Kumberg served as European Legal Director and Assistant General Counsel to Northrop Grumman Corporation until February 2015.

A good example of how the use of mediation in Investor/State disputes is being employed and challenges overcome is the work being carried out by the Energy Charter Secretariat under the Energy Charter Treaty.

The Energy Charter Treaty

The Energy Charter Treaty (ECT) was signed in 1994 and came into force in 1998. To date, it has been joined by 52 states, the EU and Euratom. The World Bank and the WTO have observer status to the Energy Charter Conference and most OPEC members are also observers. The object of the ECT, which is a legally-binding multilateral instrument, is to strengthen the law on energy issues by creating a level playing field of rules to be observed by all participants, so as to reduce and mitigate risks associated with energy-related investment, transit and trade.

The ECT is the only multilateral, legally-binding instrument in the energy sector dealing with investment protection, energy trade and transit and dispute resolution (both state-state and investor-state)⁵. The ECT also provides for a conciliation process as a precursor to arbitration of such disputes (both transit and investment disputes). This was further developed in 2014, with the emergence of the voluntary Early Warning Mechanism in order to prevent and overcome emergency situations in the energy sector related to the Transit and supply of electricity, natural gas, oil and oil products through cross-border grids and pipelines.

The Energy Charter Treaty and Arbitration

It is reported that there have been 88 Investment arbitration cases under the ECT up to the end of 2015; 50% of these are ongoing at the moment while at least 9 cases were settled amicably by the parties through mediation/negotiation. The cases have included the Yukos case, where, in mid-2014, three arbitral tribunals held that the Russian Federation had breached its international obligations under the ECT by destroying Yukos Oil Company and appropriating its assets. The tribunals ordered the Russian Federation to pay the majority shareholders of Yukos Oil Company some accumulated amount of US\$ 50 billion in damages, the largest ever award of damages in an arbitration. The case however, raised questions related to the arbitral proceedings, witnesses, experts and how the award itself was written. Enforcement is

⁵ Including disputes against the European Union, which is a contracting Party to the ECT.

fraught with difficulty and the Award may never be fully effective. This is certainly not the objective the Treaty seeks to achieve.

The Energy Charter Treaty and Mediation/Conciliation

Dispute resolution by means other than arbitration or litigation is a key part of the ECT. For example, there are specialised conciliation guidelines for settling energy transit disputes.

In particular, the Treaty expressly contemplates settlement being attempted prior to the initiation of arbitration or conciliation. Pursuant to Article 26 of the Treaty, the following procedure is contemplated:

"(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 cannot 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;

(b) in accordance with any applicable, previously agreed dispute settlement procedure; or

(c) in accordance with the following paragraphs of this Article.

(3) 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."

Pursuant to the Treaty, should the dispute not be amicably settled within a period of three months, the door is left open not only to arbitration but also to conciliation. Interestingly, no provision is made in the Treaty as to what conciliation entails nor what the process to be followed is. It is this uncertainty which the Energy Charter Secretariat is now seeking to address.

The Energy Charter Secretariat and its Role

The role of the Energy Charter Secretariat is to provide the Energy Charter Conference with assistance in the performance of its duties and to carry out the functions allocated to it under the Energy Charter Treaty. There is a Secretary General and a range of permanent staff and secondees from Member States and elsewhere that supports that individual.

The headquarters of the Secretariat is in Brussels, Belgium. The Secretariat recently organised the Seventh Executive Training Programme for Young Energy Leaders - Legal Session, which focussed on Settling Investment Disputes through Mediation: How to Reach an Agreement. This programme, on which one of the Authors, Michael Cover, was part of the faculty, looked at mediation in this area, against the background of other forms of private dispute resolution. It also followed a model mediation from start to finish, with the delegates role playing as the parties to disputes and their lawyers and the faculty acting as mediators.

Obstacles to Mediating Investor/State Disputes

There are many reasons cited why mediation will not work in Investor/State disputes. These range broadly from the argument that States are different than normal commercial parties and therefore not capable of mediating, through to the argument that, by the time disputes reach arbitration under BITs, negotiation has already run its course and the relationship is so tarnished that mediation is useless. These arguments do not take into account the fact that many States have incorporated mediation procedures in their own domestic dispute resolution practises. The British Government, for example, has a stated policy to attempt mediation in all disputes with its disputants.⁶ It is therefore clearly possible for States to engage in the mediation process and that fact alone is not an obstacle.

The argument that, by the time disputes come to arbitration under BITs, it is too late to mediate, is also not compelling. It shows a lack of understanding for mediation, which by its nature is an interest-based process, as opposed to negotiation, which is a rights-based process. Simply because negotiation between parties fails, does not imply that mediation facilitated through a trained neutral exploring options with all potential interested parties present, will not lead to settlement. It is also fair to say that mediation, when employed much earlier in the dispute cycle, has a chance of

5 <https://www.gov.uk/government/speeches/mediation-and-government>

preserving relationships and permitting investments to continue, perhaps in a more acceptable and altered form.

It is true that States are subject to procedural and political constraints that private individuals do not face. Developing States, in particular, often operate through large bureaucracies, where accountability and transparency may be lacking. In this context, it can take a long time to have decisions made and to have the appropriate official involved. The motivation for States to make decisions is also often related to public policy and political considerations and pressures, not only commercial concerns. This leads to differing objectives for the State and the investor.

Clearly, these characteristics give mediation in the investor/State context a different dimension to disputes purely in a commercial context. This does not, however, imply that mediation cannot be utilised to help in settling such disputes. It may involve a different skill set for the mediator, include additional interested parties in the mediation process and require that the appropriately-authorized State official is at the mediation. The latter point in particular is important, as mediation requires each party to have a decision maker present who has been part of the dynamics of the process and understands the basis upon which the settlement could be reached. This is the particular nut that has to be cracked in disputes with States. Someone in authority has to be willing to make a decision and enter into an agreement. This is, however, no different than any other settlement negotiated with a Government and, from personal experience, such settlements do successfully occur in most State disputes, with very few ultimately being litigated or arbitrated.

It may be that, in establishing the mediation, procedurally a State will have to verify that the appropriately empowered State official is attending the mediation. The mediation process will have to be more transparent than normal commercial mediations, given the public policy concerns at stake, and the mediation settlement will likely have to be formally ratified by the Government to ensure protection of the State official negotiating it. All of these factors are, however, already present in most judicial processes in which a State is involved and can be formalised for mediation as well.

At present, investment treaty regimes lack the infrastructure for the incorporation of mediation in investor-state disputes. The ECT Secretariat has launched an effort to introduce mediation guidelines to fill the procedural void currently existing in the conciliation provision of the Treaty, together with assistance from the authors to this paper, the International Mediation Institution (IMI), CEDR and the Treaty's supporting

Institutions, including ICSID, PCA, ICC and SCC. This may well serve as a template for other investment treaties and international institutions administering them to emulate.

States have an important role to play in this, encouraging the use of mediation, as the UK Government has done, and to ensure that they put in place the internal mechanisms to permit State officials to negotiate effectively leading to binding settlements.

Institutions also have a role to play, in particular ensuring that panels of appropriately-trained and acceptable mediators are available for these disputes. IMI is currently working on standards for Investor/State mediators. Once these are published in 2016, there will exist a standard which training organisations can use in their training programmes. Investor/State disputes also lend themselves to co-mediation where the parties can choose two mediators from differing backgrounds to help garner trust and respect in the individuals, ingredients essential to permitting a settlement to be reached.

ECT Mediation Guidelines

Under Article 26.1 of the ECT, investors and Contracting Parties are free to choose any mediation or conciliation rules, such as those of:

- IBA – International Bar Association
- ICC - International Chamber of Commerce
- ICSID - International Centre for Settlement of Investment Disputes
- PCA – Permanent Court of Arbitration
- SCC - Stockholm Chamber of Commerce
- UNCITRAL – United Nations Commission on International Trade Law

Under Article 26.3 of the ECT, it is for the investor to choose the applicable set of rules and administering institution, since the Contracting Parties have already given their unconditional consent pursuant to the Treaty. This means that, if an investor chooses to proceed by way of conciliation under the Treaty, the State is obligated to do so pursuant to the rules chosen by the investor.

The current project on which the Energy Charter Secretariat has embarked relates to the formulation of Guidelines which provide a procedural framework under which the mediation process is explained. Furthermore, they set out the steps by which

mediation can be utilised in practical terms, attempting to address some of the issues identified as obstacles to investor/State mediation. The interesting development behind the Guidelines is that it is an initiative formulated by the Secretariat at the behest of member States. It is the member States themselves that have seen mediation as being a beneficial step in dispute resolution under the Treaty. The States have asked the Secretariat to find an effective way to incorporate mediation into the Treaty process and that is what the Guidelines have been written to do.

The Guidelines themselves will be augmented with mediation training for State officials and institutional administrators. They will also be promoted broadly within the Secretariat and its organs, ensuring that all Treaty members are aware of the potential benefit mediation brings to resolving disputes with investors. The Secretariat itself will provide advisory services related to mediation and can help with the administration of such mediation. States will be encouraged to implement internal processes encouraging mediation and ensuring that public officials are both empowered to mediate settlements and protected from retaliation in regards to such settlements.

The mediation Guidelines will also be more broadly discussed and promoted to Law Firms and Users, so that investors also see the benefit of using mediation when disputes falling under the Treaty arise.

The Future

This is still an ongoing project and no doubt additional issues and solutions to them will be formulated before it is completed, but the effort in itself is encouraging. The next step may well be to move forward into the area of dispute avoidance and this may be achieved by building in a mediator, as in project life mediation or the use of dispute boards.

There are possibilities in the future for an Energy Charter Ombudsman and an administrative role for the Energy Charter Secretariat in disseminating information about the mediation process and selection of mediators. These are all part of the drive to have ever more effective dispute resolution processes, and even dispute avoidance processes, in place. The fact that such a high profile investment Treaty has seriously taken on the effort to utilise mediation in an investor/State context, will in time facilitate its use in a much broader context.

Conclusion

The Members of the Energy Charter Treaty and the Energy Charter Secretariat have been extremely active and indeed proactive in promoting the use of mediation and conciliation in investor/State and energy transit disputes. This should, over a period of time, result in fewer disputes and more cost-effective resolution of those differences and claims which do turn into disputes. It may well also serve as a boon to arbitration, as the inclusion of mediation in the investor/State dispute arena may deflect some of the criticism that has been levelled against it. The greater the options for investors and States to resolve their differences before arbitration, the more beneficial it will be for all stakeholders involved.

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