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Contents

Dispute Settlement Under the Energy Charter Treaty

By Richard Happ*

A. Introduction

The Energy Charter Treaty[1] (ECT) is a multilateral treaty with 46 Contracting Parties which entered into force on 16 April 1998 and which, *inter alia*, protects investments in the energy sector. More importantly, it allows investors to directly start arbitral proceedings against a Contracting Party to the ECT if that state has violated any of its obligations on investment protection.

The purpose of this paper is twofold: First, to examine the investment regime of the ECT and, second, to analyze the investment dispute resolution mechanism under Article 26 of the ECT. In doing so, a number of recent arbitral awards rendered under the North American Free Trade Agreement[2] (NAFTA) and under other bilateral investment agreements will be considered. It is to be noted that a number of these disputes were based on whether a particular regulatory measure by the host state amounted to a violation of its treaty commitments. Consequently, the question will be asked in this article whether and to what extent disputes based on regulatory measures are covered by the provisions of the ECT.

The general legal framework of disputes between states and foreign investors is sketched out in Section B of this article. Section C outlines the general structure and content of the Energy Charter Treaty. Section D examines the standard of protection enjoyed under the ECT and Section E the procedural aspects of treaty-based direct state-investor arbitration.

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[1] Energy Charter Treaty, Annex 1 to the Final Act of the European Energy Charter Treaty Conference, 17 December 1994, reprinted in: ILM, vol. 34, 1995, 381 *et seq.*

[2] North American Free Trade Agreement between the Government of Canada, the Government of the United Mexican States, and the Government of the United States of America, 17 December 1992, available at: http://www.sice.oas.org/trade/nafta/naftatce.asp.

B. The Legal Framework of Investment Disputes

Disputes between states and foreign investors are resolved within a tight framework of substantive rules regulating the protection of the investor and his investment (I) and procedural rules regulating the settlement of the dispute itself (II).

I. Investment Disputes as International Disputes

Disputes between states and foreign investors have a long history in public international law. Their roots lie in disputes between states and foreigners whose property was confiscated by the state or damaged during military actions or revolts. For example, in 1796, the then U.S. Secretary of State *Adams* stated that no principle of international law was more solid than the protection of foreign property.[3] At the beginning of the last century, it was generally accepted that the property of foreigners was protected by international law.[4] In addition, European and American states demanded a certain international minimum standard of treatment of their nationals; a standard which was thought to apply irrespective of how the foreign state treated its own nationals.[5] However, this concept was vigorously opposed by the Latin American states which advocated the national treatment standard under the flag of the *Calvo Doctrine.*[6]

[3] "There is no principle of the law of nations more firmly established than that which entitles the property of strangers within the jurisdiction of another country in friendship with their own to the protection of its sovereign by all efforts in his power. This common rule of intercourse between all civilized nations has, between the United States and Spain, the further and solemn sanction of an express stipulation by treaty," cited in: *Rudolf Dolzer,* New Foundations of the Law of Expropriation of Alien Property, American Journal of International Law (AJIL), vol. 75, 1981, 553, 558.

[4] *Knut Ipsen* (ed.), Völkerrecht, 4th ed., 1999, 658; *Reinhard Patzina,* Rechtlicher Schutz ausländischer Privatinvestoren gegen Enteignungsrisiken in Entwicklungsländern, 1981, 44.

[5] "There is a standard of justice, very simple, very fundamental, and of such general acceptance by all civilized countries as to form a part of the international law of the world. The condition upon which any country is entitled to measure the justice due from it to an alien by the justice which it accords to its own citizens is that its system of law and administration shall conform to this general standard. If any country's system of law and administration does not conform to this standard, although the people of the country may be compelled to live under it, no other country can be compelled to accept it as furnishing a satisfactory measure of treatment to its citizens." *Elihu Root,* 1910, cited in: *Louis Henkin/Richard Pugh/Oscar Schachter/Hans Smit,* International Law, 1993, 680.

[6] The Latin American scholar *Carlos Calvo* developed the *Calvo Doctrine.* It was applied both as a substantive and as a procedural rule. In its application as a substantive rule, it proclaimed equality of treatment between foreigners and nationals, who were thus not entitled to an international standard of treatment. As a procedural rule, it required the foreigner to waive his right of diplomatic protection and to seek recourse with the national courts only, and according to the host state laws. Whether it ever achieved the status of customary international law is doubtful. In any case, the so-called *Calvo Clauses* under which foreign investors were forced to waive their right to diplomatic protection were ineffective under international law. *Cf.* generally *David Shea,* The Calvo Clause, 1955.

In the early 20th century, the character of investment disputes changed; this was due to the vast increase in foreign direct investment and the concurrent rise of nationalism and communism. These new political ideologies led to expropriations on a massive scale in the communist and socialist countries. These measures put a considerable strain on the accepted rule of compensation in case of expropriation. Faced with claims for full compensation by thousands of claimants, the nationalizing states considered such demands as an infringement of their sovereignty and often refused to pay compensation. The clash between the different perceptions of international law was reflected in the dispute between Mexico and the United States in 1938 relating to compensation for the expropriation of agrarian property owned by U.S. citizens. When the United States demanded full compensation, the Mexican Minister of Foreign Affairs refused to do so; relying on the *Calvo Doctrine,* he argued that no rule of international law obliged Mexico to pay compensation for nationalizations.[7] In his response, the then U.S. foreign secretary *Cordell Hull* summarized the American position as follows:

> The Government of the United States merely adverts to a self-evident fact when it notes that the applicable and recognized authorities on international law support its declaration that, under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose, without provision for prompt, adequate and effective payment therefore.[8]

This standard of compensation, the *Hull Formula,* reflected not only the American positions but also the position of European states before World War II.[9] The U.S.-Mexican dispute was a harbinger of most of the investment disputes that arose after World War II, when an increasing number of former colonies and newly independent states challenged the *Hull Formula* and the international minimum standard. Confronted with long-term concessions held by foreign investors, a wave of nationalizations and expropriations under the concept of "Permanent Sovereignty over Natural Resources" followed. Politically, the conflict was fought within the UN General Assembly and focused mainly on the standard of compensation to be paid by a state for nationalizing foreign-owned property. The 1974 Charter of Eco-

[7] "My Government maintains, on the contrary, that there is in international law no rule universally accepted in theory nor carried out in practice which makes obligatory the payment of immediate compensation nor even for deferred compensation, for expropriations of a general and impersonal character like those which Mexico has carried out for the redistribution of the land," cited in: *Henkin/Pugh/Schachter/Smit* (note 5), 681.

[8] *Id.*

[9] *Dolzer* (note 3), 558; *Patrick Norton,* A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation, AJIL, vol. 85, 1991, 474, 475.

nomic Rights and Duties of States passed by General Assembly Resolution 3281 spoke of 'appropriate' compensation.[10] Even thought the resolution was hortatory,[11] the sheer number of states voting in its favor undermined the perception that the *Hull Formula* reflected customary international law.[12]

Today, the importance of customary international law for the protection of foreign investments has diminished due to the proliferation of bilateral investment treaties[13] (BITs) concluded since the 1950s. The uncertain legal and political situation during the phase of decolonization had given the incentive for capital-exporting countries to create special treaties for the protection of investments. The first bilateral investment treaty was concluded in 1959 between the Federal Republic of Germany and Pakistan and was soon to be followed by other countries. As BITs were meant to secure investments, they were initially concluded between the capital-exporting states of the northern hemisphere and the developing states of the southern hemisphere. It is only since the beginning of the 1990s that developing states and 'economies in transition' began to conclude BITs among themselves.[14] Although the web of bilateral investment treaties contains surprisingly similar provisions,[15] no multilateral investment treaty has yet been concluded. Until the early

[10] Charter of Economic Rights and Duties of States, GA Res. 3281 (XXIX) of 17 December 1974. On the legal concepts behind it, see *Ian Brownlie*, Legal Status of Natural Resources in International Law, Recueil des Cours (RdC), vol. 162/I, 1979, 245–318.

[11] The resolution does not have the status of customary international law, *Dolzer* (note 3), 553, 564; *Ulrich Häde*, Der völkerrechtliche Schutz von Direktinvestitionen im Ausland, Archiv des Völkerrechts, vol. 35, 1997, 181, 198. However, the *opinio iuris* necessary for customary international law "may, though with all due caution, be deduced from, *inter alia*, the attitude of the Parties and the attitude of States towards certain General Assembly Resolutions," ICJ, *Case Concerning Military and Paramilitary Activities in and against Nicaragua* (Nicaragua *v.* United States), Merits, Judgment of 27 June 1986, ICJ Reports 1986, 4, 89–90.

[12] *Dolzer* (note 3), 553, 565; *Ipsen* (note 4), 1999, 562.

[13] On the topic of bilateral investment treaties generally, see *Rudolf Dolzer/Margrete Stevens*, Bilateral Investment Treaties, 1995; UNCTAD, Bilateral Investment Treaties in the Mid-1990s, 1998; *Frederick Alexander Mann*, British Treaties for the Promotion and Protection of Investments, in: *id.* (ed.), Further Studies in International Law, 1990, 234–251; *Georgio Sacerdoti*, Bilateral Treaties and Multilateral Instruments on Foreign Investment Protection, RdC, vol. 269, 1997, 251–460.

[14] *Cf.* UNCTAD (note 13), 137. A list of bilateral investment treaties can be found on the website of the International Center for the Settlement of Investment Disputes (ICSID), available at: http://www.worldbank.org/icsid/.

[15] *Cf. Dolzer/Stevens* (note 13) and UNCTAD (note 13) which give a survey of the different provisions. However, it is extremely doubtful whether customary international law can be deduced from the web of those treaties. In principle, it is possible that a web of similar bilateral treaties creates customary international law, *cf. Marc Villiger*, Customary International Law and Treaties, 1997, 189. However, treaties are often concluded for political reasons, and their very existence can be interpreted as evidence of lacking customary international law, as otherwise the states would not have seen the need to conclude a treaty. The fact that developing states often concluded BITs in the expectation of future investments weakens the value of the BITs as evidence for *opinio iuris*, *cf. Dolzer* (note 3), 553, 567.

1990s, only negotiations for multilateral treaties without substantive investment protection provisions were successful, such as the 1965 ICSID Convention or the MIGA Convention in 1985.[16] Negotiations for a true Multilateral Agreement on Investment started in 1995 but failed in 1998.[17] Although NAFTA and the ECT are multilateral agreements in force, they are not as such 'pure' investment agreements; they also regulate other economic activities, most notably trade in goods.[18]

II. Dispute Settlement

Under the traditional conception of international law, a foreign investor aggrieved by the conduct of a host state in which he happened to invest could only seek recourse with the local courts of that state. Once these local remedies had been unsatisfactorily exhausted, the only remaining option was for the investor to apply to his home state for diplomatic protection. His home state could pick up his claim[19] and pursue it via negotiation, arbitration, or even force.[20] Any dispute based on the alleged breach of

[16] Early attempts at multilateral conventions on the protection of foreign investments were the Abs-Shawcross Draft Convention on Investments Abroad and the OECD Draft Convention on the Protection of Foreign Property, reprinted in: ILM, vol. 7, 1968, 117–143.

[17] OECD, The Multilateral Agreement on Investment, Draft Consolidated Text, 22 April 1998, available at: http://www1.oecd.org/daf/mai/htm/2.html. The negotiations are described by *Alexander Böhmer*, The struggle for a multilateral agreement on investment – an assessment of the negotiation process in the OECD, German Yearbook of International Law, vol. 41, 1998, 267–298.

[18] An excellent overview of the various multilateral agreements containing provisions on the protection of foreign investment can be found in: WTO, Bilateral, Regional, Plurilateral and Multilateral Agreements, WTO Doc. WT/WGTI/W/22, 1998.

[19] This right of the state to diplomatic protection of its nationals has been summarized by the PCIJ as follows: "It is an elementary principle of international law that a state is entitled to protect its subjects, when injured by acts committed by another state, from which they have been unable to obtain redress though the ordinary channels. By taking up the case of one of its nationals and by resorting to diplomatic action or international judicial proceedings, a state is in reality asserting its own rights – its right to ensure, in the person of its subjects, respect for the rules of international law," PCIJ, *The Mavrommatis Palestine Concessions* (Greece *v.* United Kingdom), Merits, Judgment of 26 March 1925, Series A, No. 2, 4, 12. With the prohibition of the use of force in Art. 2 para. 4 United Nations Charter, diplomatic protection lost its effectiveness.

[20] The British government was adamant in protecting its citizens. In 1821 during the war between Spain and its former colonies, Spanish privateers had seized a British merchantman. When the Spanish government offered no compensation, in 1823 a squadron was ordered to Puerto Rico to confront the governor and recover the vessel. When, in 1874, a local Colonel in Honduras looted property of a British railway construction company, the British battleship *Niobe*

international law protecting foreign investors was considered a dispute between the state and the foreign investor's home state only. Thus, if a state expropriated property of foreigners without compensation only the investor's home state could claim a violation of international law. Such disputes between states and foreign investors sparked famous cases such as the *Mavrommatis Concessions Case*[21] (1924) and the *Oscar Chinn Case*[22] (1934), the *Nottebohm Case*[23] (1955), the *Barcelona Traction Case*[24] (1972), and the *ELSI Case*[25] (1989).

From the point of view of an investor, the concept of diplomatic protection has serious weaknesses and drawbacks as a mechanism for obtaining redress for grievances. Besides requiring the nationality of the investor and the exhaustion of local remedies, the investor has neither a right to diplomatic protection[26] nor a claim to the compensation paid.[27] These uncertainties do not make the political risk in the host state calculable for the foreign investor and make diplomatic protection unsuited to the settlement of investment disputes.[28] To avoid the necessity of seeking recourse with the local courts in the host state, investors from early on began to include arbitration clauses in their agreements with foreign states. Accordingly, the rising number of disputes in the oil sector after the Second World War led to several cases between foreign oil companies and Arabian states, *e.g.*, the cases *Aramco*[29] and

bombarded the Colonel's fortress until he capitulated and handed over his loot. *Cf. Lawrence James*, Rise and Fall of the British Empire, 1997, 173–177, calling it the "informal empire."

[21] PCIJ, *The Mavrommatis Palestine Concessions* (note 19).

[22] PCIJ, *The Oscar Chinn Case* (Belgium *v.* United Kingdom), Judgment of 12 December 1934, Series A/B, No. 63, 4 *et seq.*

[23] ICJ, *Nottebohm Case* (Liechtenstein *v.* Guatemala), Second Phase, Judgment of 6 April 1955, ICJ Reports 1955, 4 *et seq.*

[24] ICJ, *Barcelona Traction, Light and Power Company, Limited* (Belgium *v.* Spain), Second Phase, Judgment of 5 February 1970, ICJ Reports 1970, 4 *et seq.*

[25] ICJ, *The Case concerning Elettronica Sicula S.p.a. (ELSI)* (United States *v.* Italy), Judgment of 20 July 1989, ICJ Reports 1989, 4 *et seq.*

[26] "The State must be considered the sole judge to decide whether its protection will be granted, to what extent it will be granted and when it will cease. [...] It retains in this respect a discretionary power the exercise of which may be determined by considerations of a political or other nature, unrelated to the case." ICJ, *Barcelona Traction, Light and Power Company, Limited* (note 24), 44.

[27] *Wilhelm Geck*, Diplomatic Protection, in: *Rudolf Bernhardt* (ed.), Encyclopedia of Public International Law, vol. I, 1992, 1045, 1058; *Peter Muchlinski*, Multinational Enterprises and the Law, 1995, 535.

[28] *Muchlinski* (note 27), 536; *David Caron*, The Nature of the Iran-United States Claims Tribunal and the Evolving Structure of International Dispute Resolution, AJIL, vol. 84, 1990, 104, 153.

[29] *Saudi Arabia v. Arabian American Oil Company*, reprinted in: International Law Reports (ILR), vol. 27, 1963, 47 *et seq.*

the famous Libyan arbitrations *Liamco*, *BP* and *TopCo.*[30] Despite the large number of disputes settled by arbitration tribunals, however, the mechanism of international commercial arbitration had not been designed to settle such disputes. The lack of a special international legal framework sparked legal controversies, *e.g.*, with respect to the applicable law,[31] the enforcement of awards despite the sovereign immunity of states,[32] and the question whether the state was a party to the agreement at all.[33]

The development of the necessary legal framework for settling investment disputes by state-investor arbitration started in 1965 with the creation of the International Centre for the Settlement of Investment Disputes (ICSID).[34] By excluding

[30] *Libyan American Oil Corporation v. Government of the Libyan Arab Republic*, reprinted in: ILR, vol. 62, 1982, 140 *et seq.*; *British Petroleum Exploration Company (Libya) v. Government of the Libyan Arab Republic*, reprinted in: ILR, vol. 53, 1979, 279 *et seq.*; *Texaco Overseas Petroleum Company and California Asiatic Oil Company v. the Government of the Libyan Arab Republic*, reprinted in: ILR, vol. 53, 1979, 389 *et seq.* These cases have been excellently described and analyzed by *Christopher Greenwood*, State Contracts in International Law – The Libyan Oil Arbitrations, British Yearbook of International Law (BYIL), vol. 53, 1982, 27–81.

[31] The issue of the applicable law may be the most controversial issue in state-investor arbitration. To avoid subjecting the contract with the state to the national law of the host state, investors have sought to 'freeze' the law of the host state by including stabilization clauses in their contracts, or to internationalize the contracts by choosing public international law or general principles of law as applicable law. The literature on both issues is immense. On stabilization clauses, see generally, *Hanno Merkt*, Investitionsschutz durch Stabilisierungsklauseln, 1994, and *Thomas Wälde/George Ndi*, Stabilizing International Investment Commitments: International Law vs. Contract Interpretation, Texas Journal of International Law, vol. 31, 1996, 216–267. On the internationalization of contracts, *Frederick Alexander Mann*, The Theoretical Approach towards the Law governing Contracts between States and Aliens, in: *Id.* (Note 13), 264–269; *Stephen Toope*, Mixed International Arbitration, 1990; *Esa Paasivirta*, Participation of States in International Contracts, 1990; *Uwe Kischel*, State Contracts, 1992; *Muthucumaraswami Sornarajah*, The Settlement of Foreign Investment Disputes, 2000, 223–278.

[32] On state immunity generally, see, *e.g.*, *Christoph Schreuer*, State Immunity – Some recent Developments, 1988; with special regard to investment arbitrations *Hazel Fox*, Sovereign Immunity and Arbitration, in: *Julian Lew* (ed.), Contemporary Problems in International Arbitration, 1987, 323–331; *Albert Jan van den Berg*, The New York Arbitration Convention and State Immunity, in: *Karl-Heinz Böckstiegel* (ed.), Acts of State and Arbitration, 1997, 41–60.

[33] In cases where the investor has concluded a contract with a state enterprise, and where the state interferes with the performance of the contract, the question arises whether the state is party to the contract. On this issue, see generally *Karl-Heinz Böckstiegel*, Der Staat als Vertragspartner ausländischer Vertragsunternehmen, 1971; the contributions of *A.M. Hermann*, *Pierre Lalive* and *Philippe Cahier* in: *Julian D.M. Lew* (ed.), Contemporary Problems in International Arbitration, 1987; *Emmanuel Gaillard/John Savage* (eds.), Fourchard Gaillard Goldman On International Commercial Arbitration, 1999, paras. 508–510.

[34] Convention on the Settlement of Investment Disputes between States and Nationals of other States, 18 March 1965, reprinted in: ILM, vol. 4, 1965, 524 *et seq.* On the ICSID gener-

recourse to diplomatic protection, on the one hand, and regulating questions of applicable law and enforcement of awards on the other, the ICSID was tailor-made for settling investment disputes in a neutral atmosphere. Its only major weakness, the necessity of an arbitration agreement between state and investor, was rectified by the states giving their consent in national laws on foreign investment and investment treaties.[35] Today, most of the 1900 bilateral investment treaties and the multilateral investment treaties such as NAFTA and the ECT deviate from the traditional approach by allowing an investor to directly sue a foreign state before an international arbitral tribunal for the violation of these treaties. The ICSID has faced a considerable increase of its caseload during the last ten years: While only 38 proceedings took place between 1965 and 1997, nearly 10 new cases are now submitted each year, most of which are based on bilateral investment treaties. With 136 member states and 156 states having signed the convention,[36] the ICSID is thus of considerable importance in the field of international investment law.

This development of the procedural position of an investor is especially apparent in the energy industry. Fifty years after the British government espoused the claim of its national company *Anglo-Iranian Oil Co.* for compensation after its assets were nationalized by Iran, the British corporation *AES Summit Generation Ltd.* filed a claim against Hungary with the ICSID in Washington, claiming the violation of public international law. AES Summit Generation Ltd. based its claim on Article 26 of the Energy Charter Treaty.[37]

C. The Energy Charter Treaty

I. Overview

After three years of intense negotiations, the Energy Charter Treaty was opened for signature in Lisbon on 17 December 1994 and since then has been signed by 51 and ratified by 46 states of Western and Eastern Europe and Asia and by the European Communities. The ECT has an extremely complex structure, consisting of

ally, see, *Aaron Broches,* The Convention on the Settlement of Disputes between States and Nationals of other States, RdC, vol. 136/III, 1972, 337–410; *Moshe Hirsch,* The Arbitration Mechanism of the International Centre for the Settlement of Investment Disputes, 1993; *Christoph Schreuer,* The ICSID Convention: A Commentary, 2001.

[35] On this issue, *infra,* E.

[36] As per 16 September 2002, see the list of contracting states available at: http://www.worldbank.org/icsid/constate/c-states-en.htm.

[37] The case was settled out-of-tribunal in January 2002. For details see *Richard Happ,* Investitionsschiedsverfahren unter dem Energiechartavertrag: AES Summit Generation/Ungarn, Recht der Energiewirtschaft 2002, 39–44.

eight parts, fourteen annexes, five conference decisions integrated into the treaty, and several 'understandings' relevant for the interpretation of the treaty as a whole or to certain specific provisions.[38] The Energy Charter Treaty aims to create a legal framework which will promote long-term cooperation in the energy sector (Article 2). Its Part II regulates trade in and transit of energy materials between Contracting Parties. Trade in energy materials and products is regulated by the provisions of the treaty as amended by the Trade Amendment of 1998, pursuant to which the provisions of the General Agreement on Tariffs and Trade (GATT) (meaning both GATT 1947 and GATT 1994) and the law of the World Trade Organization (WTO) apply by reference. Thus, WTO law is applicable between Contracting Parties to the ECT even if one of them is not a WTO member. Article 5 contains an explicit prohibition of trade-related investment measures. Article 7 ensures freedom of transit of energy and obliges states, *inter alia,* to facilitate transit and to encourage "relevant entities" to cooperate in the modernization and construction of pipelines and other transport facilities. The sixth and seventh paragraphs of Article 7 provide for a conciliation mechanism in case of transit disputes. The third part of the ECT (Articles 10–17) contains the substantive obligations on investment promotion and protection, which will be explained in more detail below. Articles 18–25 (Part IV) contain miscellaneous provisions on environment, taxes, and the liability of the state for subnational authorities and state enterprises. The fifth part regulates the settlement of disputes: State-investor disputes (Article 26) and state-state disputes (Article 27). Part VI contains various transitional provisions. The Energy Charter Treaty has also created an international organization known as the Energy Charter Conference (Article 34) with a permanent Secretariat located in Brussels. Article 45 provides that the treaty shall be provisionally applicable[39] for each signatory pending its entry into force for such signatory. Interpreting Article 45 para. 1 in its context with Article 45 para. 2 lit. b and Article 45 para. 3 lit. b, it can be concluded that especially the provisions on the protections of foreign investment are provisionally applicable.[40] Article 47 regulates obligations towards foreign investors in case of

[38] For a comprehensive overview of the Treaty, see Energy Charter Secretariat, Reader's Guide to the Energy Charter Treaty, available at: http://www.encharter.org.

[39] Vienna Convention on the Law of Treaties, 23 May 1969, UNTS, vol. 1155, 331, Art. 25 para. 1 lit a. provides: "A treaty or part of the treaty is applied provisionally pending its entry into force if: the treaty itself so provides."

[40] The author concedes that this interpretation might seem to be in conflict with Art. 1 para. 6 ECT. Pursuant to Art. 1 para. 6 ECT, the Treaty applies to investments existing at the time the Treaty enters into force for the Contracting Party of the Investor, provided that the Treaty shall *only* apply to matters affecting such investments after that date. However, this provision applies only to the entry into force, not to the provisional application. In the context of provisional application, Art. 1 para. 6 must be interpreted *mutatis mutandis,* providing that the Treaty applies also to investments existing at the time of signing, but only to matters affecting such investments after the date of signing.

withdrawal of a party, which obligations shall nevertheless remain in force for an additional 20 years.

II. The Energy Charter Protocols

The provisions of the Treaty can be supplemented by Energy Charter Protocols negotiated between its Contracting Parties. There is only one Protocol currently in force: The Protocol on Energy Efficiency and related Environmental Aspects (PEEREA). However, the Protocol on Energy Transit has been under negotiation since 1999. Its aim is to create a legal framework for grid-bound transit through its Contracting Parties. The Transit Protocol will supplement and expand Article 7 of the ECT by providing for provisions on, *inter alia*, negotiated access to available capacity for transit and transit tariffs. However, negotiations of the Transit Protocol have been fraught with political difficulties and a web of conflicting interests.[41] In its June meeting, the Energy Charter Conference informed the Transit Working Group that it should conclude its negotiation by the end of 2002.

D. Investment Protection Under the Energy Charter Treaty

Every foreign investment is subject to various risks, which can be of a commercial or non-commercial nature. While the investor will be able to calculate the commercial risk for his investment, at least if he is experienced in his line of business, this is not true for the non-commercial or "political" risk. The term 'political risk'[42] connotes the possibility that the foreign state, for political reasons, interferes with the foreign investment to the detriment of the investor. The political risk can realize itself in various forms of governmental interference. As we shall see below, under the Energy Charter Treaty, foreign investors are protected[43] against the most important political risks affecting their investments.

[41] *Cf.* the various documents available at: http://www.encharter.org.

[42] On the concept of political risk, see, *e.g., Alan Berlin,* Managing Political Risk, CEPMLP Internet Journal, vol. 12, 2002; *Abba Kolo,* Managing Political Risk in Transnational Investment Contracts, CEPMLP Online-Journal, vol. 2, 1998, both available at: http://www.dundee.ac.uk/cepmlp/journal/; especially for the oil industry *Andrew Seck,* Investing in the Former Soviet Union's Oil industry: The Energy Charter Treaty and its Implications for Mitigating Political Risk, in: *Thomas Wälde* (ed.), The Energy Charter Treaty, 1996, 110–134.

[43] The ECT bestows direct rights under public international law on investors of Contracting Parties, *cf. Richard Happ,* Schiedsverfahren zwischen Staaten und Investoren nach Artikel 26 Energiechartavertrag, 2000, 138–163. The protection is thus independent of the status of the ECT in the domestic law of the host state.

I. Scope of Protection

The Energy Charter Treaty uses a broad, asset-based definition of the term 'investment.' Similar definitions also appear in most modern investment treaties.[44]

According to Article 1 para. 6 of the ECT, 'investment' means "every kind of asset, owned or controlled directly or indirectly by an investor," including all kinds of property; shares, stocks, or other forms of equity participation in a company; bonds and other debt of a company; claims to money and claims to performance pursuant to a contract having an economic value associated with an investment; intellectual property and returns. Furthermore, Article 1 para. 6 lists as an asset "any right conferred by law or contract or by virtue of any licenses and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector."[45] This covers cases where a right or concession, *e.g.,* to drill for oil, is revoked, but where the physical assets of the investor remain untouched. Since the definition of 'Economic Activity in the Energy Sector' covers activities from exploration to production and sale and marketing of energy materials,[46] within this sectoral scope every lawful economic activity is protected.

II. Protection Against Governmental Measures

The Energy Charter Treaty protects investors against the most damaging governmental measures which render the investment economically unviable: Expropriation (Article 13) and, possibly, breach of contract (Article 10 para. 1 last sentence).[47]

[44] *Cf. Dolzer/Stevens* (note 13), 26–30.

[45] Although this could be read as "*any* right conferred by law or contract," the definition must be understood in the context of its restrictive last part: only rights conferred by law or contract to undertake any economic activity in the Energy Sector are protected as investments. The statement to the contrary in Secretariat's Reader's Guide to the Energy Charter Treaty (note 38) is inconsistent with the object and purpose of the Treaty of creating a regime for the energy sector and comparable provisions in bilateral investment treaties, which refer to concessions, including concessions to exploit natural resources, *cf. Dolzer/Stevens* (note 13), 30.

[46] Art. 1 para. 5 ECT: "Economic Activity in the Energy Sector" means an economic activity concerning the exploration, extraction, production, storage, land transport, transmission, distribution, trade, marketing, or sale of Energy Materials and Products, except those included in Annex NI, or concerning the distribution of heat to multiple premises.

[47] Art. 11 ECT regulates the entry of key personnel and the right of the investor to employ any key person of his choice. Art. 12 obliges Contracting Parties to compensate an Investor for any loss suffered due to war, a national emergency or other similar event. This obligation has already been part of customary international law since the early 19th century. Art. 14 provides for the right of the investor of the free transfer of his profits in a freely convertible currency. In the light of the payment crisis in Russia and, recently, Argentinia, comparable provisions may gain in importance.

1. Expropriation

Article 13 provides that an investment shall not be expropriated or subjected to measures having equivalent effect except where such expropriation is for a public purpose, not discriminatory, carried out under due process of law and accompanied by the payment of prompt, adequate, and effective compensation. The 'classical' form of an expropriation deprives the investor of his title and transfers it to the state.[48] However, it is recognized in international law that a state measure need not deprive an investor of his title in order to amount to an expropriation. A "creeping expropriation" may exist if the owner is deprived in fact of fundamental rights of ownership although his title remains untouched, and if that deprivation is not merely ephemeral.[49] Such deprivation might be effected by excessive taxation, a forced sale of property, or rendering the rights of a shareholder of a corporation to vote and obtain dividends meaningless by the installation of a state-appointed manager.[50] Article 13 of the ECT covers such constellations by prohibiting not only expropriations but also "measures having equivalent effect."

A very controversial issue which has arisen recently is whether and under what circumstances a regulatory measure introduced by the state to regulate certain aspects of the economy (*e.g.*, the protection of public health or the environment or some other public purpose) amounts to an expropriation.[51] According to the traditional view, governmental regulatory measures which are non-discriminatory and which pursue a legitimate public interest are non-compensable.[52] To require compensation for every diminution in the value of an investment caused by regulation would, as *Wälde* puts it, render public governance impossible, as governments would be economically crippled by claims of compensation.[53] The modern view accepts that the negative effect of regulatory measures does not *per se* subject them to compensation, but does not deny that regulatory measures may amount to a taking under certain circumstances.[54] In *Pope & Talbot,* the tribunal held: "Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation."[55] Regulatory measures can neither be exempt from the scope of the investment protection provisions, nor justify a breach of those provisions.[56] However, it is so far unclear under which circumstances a regulation turns into an expropriation. The *Pope & Talbot* tribunal applied the threshold of whether the owner was no longer able to "use, enjoy, or dispose of the property" and required a "substantial deprivation."[57] In any case, it must not be discriminatory or arbitrary, as the measure would then be in breach of other provisions of the ECT. To draw the borderline between regulation and expropriation, *Wälde* and *Kolo* have suggested that the decisive factor should be whether the measure in question violates the legitimate expectations of the investor, or whether a 'special

[48] While 'expropriation' refers to the effects of such acts on the property of a certain investor, 'nationalization' always refers to expropriations on a larger scale for the realization of political programs. On expropriation and nationalization, see, *e.g.*, *Isi Foighel,* Nationalization and Compensation, 1964; *Gillian White,* Nationalization of Foreign Property, 1964; *Rudolf Dolzer,* Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht, 1985; *Patrick Norton* (note 9); for a 'Third World' perspective *Muthucumaraswam Sornarajah,* Compensation for Nationalization: The Provision in the Energy Charter Treaty, in: *Thomas Wälde* (note 42), 386–408.

[49] On creeping expropriation, see, *e.g.*, *George C. Christie,* What Constitutes a Taking of Property under International Law?, BYIL, vol. 38, 1962, 307–338; *Rosalyn Higgins,* The Taking of Property by the State: Recent Developments in International Law, RdC, vol. 176/III, 1982, 263–389.

[50] *Sir Robert Jennings/Sir Arthur Watts,* Oppenheim's International Law, vol. I/2–4, 1992, 916–917; *Higgins* (note 49), 263, 322 *et seq. Cf.* also the awards of the Iran-U.S. Claims Tribunal, in: *George Aldrich,* The Jurisprudence of the Iran-U.S. Claims Tribunal, 1996, 171–296.

[51] For a recent article on the subject, see *Thomas Wälde/Abba Kolo,* Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law, International Comparative Law Quarterly, vol. 50, 2001, 811–848.

[52] *Sornarajah* (note 31), 69: "[T]hese interferences are non-compensable, provided there is sufficient justification for the interference."; American Law Institute, Restatement (Third), § 712 para. 1: "A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other actions of the kind that is commonly accepted as within the police powers of states, if it is not discriminatory [...] and is not designed to cause the alien to abandon his property to the state or sell it at a distress price."; *Nii Lante Wallace-Bruce,* Global Investments and Environmental Protection, Netherlands International Law Review, vol. 49, 2002, 195, 213; see also *Wälde/Kolo* (note 51), 811, 827. *Cf.* also *Ian Brownlie,* Principles of Public International Law, 5th ed., 1998, 293 about the theory of the *reserved domain* of states which is exempt from the reach of international law.

[53] *Wälde/Kolo* (note 51), 811, 839.

[54] "The general body of precedent usually does not treat regulatory action as amounting to expropriations. Regulatory conduct of public authorities is unlikely to be subject to Article 1110 NAFTA arbitration, although the treaty does not rule out the possibility. Expropriations tend to involve the deprivation of ownership rights; regulations, a lesser interference. The distinction between expropriation and regulation screens out most potential cases of complaints concerning economic intervention by a state and reduces the risk that governments will be subject to claims as they go about their business of managing public affairs.", *S.D. Myers, Inc. v. Government of Canada,* Partial Award of 13 November 2000 (Schwartz/Hunter/Chiasson), para. 282, available at: http://www.naftaclaims.com. *Cf.* also *Higgins* (note 49), 330–331.

[55] *Pope & Talbot, Inc v. The Government of Canada,* Interim Award of June 26, 2001 (Lord Dervaird/Greenberg/Belman), para. 99, available at: http://www.state.gov/s/l/c3747.htm.

[56] With regard to the Energy Charter Treaty, the 'police powers' clause of Art. 24 para. 2 is not applicable to Part III of the ECT, Art. 24 para. 2 lit. b ECT.

[57] *Pope & Talbot* (note 55), para. 102.

sacrifice' is imposed on the investor.[58] Although several of the disputes which arose under NAFTA so far have been based on regulatory measures for the protection of the environment,[59] awards rendered in that context have not yet clarified the issue: The measures were considered in breach of NAFTA for being unfair or discriminatory but not for constituting an expropriation. A regulatory measure which is discriminatory, arbitrary or unfair would be in breach of the respective obligations but would not be compensated under the expropriation rule.[60]

The scope of Article 13 of the ECT includes cases where the state expropriates the assets of a locally incorporated subsidiary but not the subsidiary itself. Thus, the ECT protects shareholders against governmental measures which decrease the value of the shares while leaving the title to the shares intact – the ECT lifts the 'corporate veil.'[61] In combination with Article 21 para. 5, Article 13 also protects against discriminatory or expropriatory taxation.[62] Whether Article 13 will contribute to a clarification of the standard of compensation under customary international law is unclear. Although it imposes the standard of the *Hull Formula*, the parties have agreed in Understanding 1 lit. a to the ECT that "the provisions of this Treaty have been agreed upon bearing in mind the specific nature of the Treaty aiming at a legal framework [...] and as a result cannot be construed to constitute a precedent in the context of other international negotiations."

2. *Sanctity of Contracts*

Another form of direct interference with foreign investment is that the state frees itself from a contractual obligation towards the foreign investor by the exercise of its sovereign power. It is an everyday commercial risk for any businessperson that contractual undertakings may not be observed, whether due to inability to fulfill the obligations, or to a dispute about the interpretation of the contract's provisions. However, the special status of the state allows it either to repudiate the contract for

[58] *Wälde/Kolo* (note 51), 811, 843–845.

[59] *S.D. Myers* (note 54); *Ethyl v. Canada; Metalclad v. Mexico; Methanex v. Unites States;* all available at: http://www.naftaclaims.com.

[60] Thus, the argument of *Wälde/Kolo* (note 51), 811, 827, that a regulatory measure must not be discriminatory, and for a legitimate purpose, is not really convincing, as these are also the requirements for a *lawful* expropriation.

[61] Art. 13 para. 3 ECT. In the *Barcelona Traction Case* (note 24), Belgium had filed a claim against Spain on behalf of its nationals who were the shareholders of a Canadian Company. The claim failed as the Court decided not to lift the 'corporate veil,' which would have been necessary to admit Belgium's claim.

[62] For a discussion of the issue of confiscatory taxes, *cf. Thomas Wälde/Abba Kolo,* Confiscatory Taxation under Customary International Law and Modern Investment Treaties, CEPMLP Internet Journal, vol. 4, 2000, available at: http://www.cepmlp.org/journal/.

other than commercial reasons or to change the underlying economic equilibrium by changing the laws to which the contract is subject.[63] As the investor relies on the stability of the economic framework regulated by the treaty and the applicable law, such a 'governmental' breach may have severe consequences for the investor.

Thus, one of the most important provisions of the ECT is its Article 10 para. 1: "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." This *pacta sunt servanda* obligation is not a novel feature of investment treaties.[64] It protects the investor against the risk of a governmental breach of contract, *i.e.* that the economic basis of the contract is changed by the state changing the relevant legislation or a governmental repudiation of the contract. This obligation addresses the existing uncertainty in customary international law as to whether and under what circumstances the breach of a contract between state and investor is a breach of international law.[65]

The scope of Article 10 para. 1 last sentence must be interpreted in the light of its object and purpose. First, despite the clear wording,[66] not all contracts between state

[63] In order to avoid that risk, investors have tried either to subject the contract to international law or to freeze the law applicable to the contract at the date of signing by inserting stabilization clauses. As to the dispute about the effect of these techniques, see *Greenwood* (note 30).

[64] According to *Dolzer/Stevens* (note 13), 81–82, comparable clauses are found in German, U.K., and U.S. BITs, and also in some BITs concluded by France and the Netherlands. However, those clauses prescribe only the duty "to observe obligations entered into with regard to investments of nationals or companies of other contracting Parties" and not to agreements entered into *with* investments. As we will see below, this might make a practical difference. On the topic of protection of contracts under investment treaties, see *Esa Paasivirta,* The Energy Charter Treaty and Investment Contracts: Towards Security of Contracts, in: *Wälde* (note 42), 349–365.

[65] If a breach of contract is discriminatory or amounts to an expropriation, it violates international law. *Cf. Brownlie* (note 52), 550–551 with extensive references. However, in such a case the basis of responsibility is the discrimination or the expropriation, not the breach itself. Furthermore, it is unclear under what circumstances a breach amounts to an expropriation: "Labelling is, however, no substitute for analysis. The words 'confiscatory,' 'destroy contractual rights as an asset,' or 'repudiation' may serve as a way to describe breaches which are to be treated as extraordinary, and therefore as acts of expropriation, but they certainly do not indicate on what basis the critical distinction between expropriation and an ordinary breach of contract is to be made. The egregiousness of any breach is in the eye of the beholder – and that is not satisfactory for present purposes." *Robert Azinian, Kenneth Davitian & Ellen Baca v. The United Mexican States,* ICSID Case no. ARB/97/2, Award of 1 November 1999, para. 90, available at: http://www.naftaclaims.com.

[66] Although it is the primary rule of interpretation: "If the relevant words in their natural and ordinary meaning make sense in their context, that is the end of the matter," with respect to Art. 10 para. 1 last sentence ECT they make no sense in their context.

and investor fall within its scope. Governments conclude a myriad of contracts with local and foreign parties, and protecting each one of them would exceed the object and purpose of a sectoral treaty protecting energy investments.[67] It is far more consistent with the definition of 'investment' in Article 1 para. 6 ECT to restrict the scope of Article 10 para. 1 last sentence to those 'investment agreements' or 'state contracts' which form the basis of an investment. Secondly, the non-observance by the state must also meet the qualification of a 'governmental' breach in contrast to a mere commercial breach.[68] If one were to consider also commercial breaches to fall within the scope of Article 10 para. 1 last sentence, this would, as a recent NAFTA tribunal has held, "elevate [...] a multitude of ordinary transactions with public authorities into potential international disputes."[69] However, it is unclear exactly what conditions an act must meet in order to be 'non-commercial' or 'governmental.' In the light of the nature of the investment protection provisions as being the yardstick for the legality of state measures, it is submitted that such a 'non-commercial breach' exists if changes in the legislation make the non-observance legal under the law of the host state, or if by administrative act, the contract is repudiated. It then would not be possible for the investor to seek recourse with the local courts for breach of contract, as the state measures would be legal under the law of the host state. This suggested interpretation would be in line with the character of an international law obligation of restricting the exercise of the state's sovereign powers but not giving an investor special protection against everyday commercial risk.[70]

Nevertheless, there is still an unclear aspect of Article 10 para. 1 last sentence. It is questionable whether the breach of the investment agreement constitutes a violation of the ECT. As a basic rule, the breach of an international obligation by a state entails the duty on the side of the state to effect *restitutio in integrum.*[71] Although such an interpretation is in line with the wording of Article 10 para. 1, it might be incompatible with Article 18 ECT. In Article 18 para. 1, the Contracting Parties

[67] *Wälde* has argued that it is doubtful that the negotiators wanted to allow, *e.g.*, a Japanese company delivering heating oil for a French village to arbitrate against the French government, *Thomas Wälde,* International Investment under the 1994 Energy Charter Treaty, Journal of World Trade (JWT), vol. 29, 1995, 1, 48.

[68] *Thomas Wälde/Todd Weiler,* Investment Arbitration under the Energy Charter Treaty in the Light of New Nafta Precedents, CEPMLP Internet Journal, vol. 11, 2002, 1, 57, available at: http://www.dundee.ac.uk/cepmlp/journal/.

[69] *Robert Azinian* (note 65), para. 87.

[70] *Wälde/Weiler* (note 68), 57.

[71] As a principle laid down by the PCIJ in the *Chorzow Factory* judgment: "It is a principle of international law, and even a general conception of law, that any breach of an obligation involves the duty to make reparation. [...R]eparation must, as far as possible, wipe out the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if the act had not been committed." PCIJ, *Case concerning the Factory at Chorzow* (Germany *v.* Poland), Judgment of 13 September 1928, Series A, No. 17, 47–48.

recognize state sovereignty and sovereign rights over energy resources, but reaffirm that these must be exercised in accordance with and subject to the rules of international law, which would include Article 10 para. 1 ECT. It has thus been proposed to interpret Article 10 para. 1 ECT as a treaty-based stabilization clause: A breach of the contract by the exercise of governmental power is not a breach of the treaty but entails the duty to pay a higher compensation to the investor.[72] This proposal seems to strike a sound balance between the two provisions.

III. Protection Against Governmental Maltreatment?

Besides these measures which cause damage to the investor due to their content, governmental measures below the threshold of an expropriation can also cause damage to an investor due to their modalities. Political pressure exerted by local lobbying groups may cause a state to distort the level playing field of the economy in favor of its nationals or certain economic groups by discriminating against the investor or acting in protectionist or arbitrary manner. The damage inflicted by such measures is of a relative nature, as its realization depends on the treatment of other economic players. In addition, there is also the absolute risk that a governmental measure treats all comparable players on the field in a manner below what is generally expected.

Article 10 para. 1 ECT obliges Contracting Parties to "encourage and create stable, equitable, favourable and transparent conditions for Investors. [...] 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." These obligations are characterized by the broad wording of blanket clauses covering those situations where the more specific obligations may not be applicable.

1. Fair and Equitable Treatment

It is generally accepted that the purpose of this clause is "to provide a basic and general standard which is detached from the host state's domestic law."[73] Similar clauses may be found in most bilateral and multilateral investment treaties, and first

[72] *Paasivirta* (note 64), 349, 359.

[73] *Dolzer/Stevens* (note 13), 58. On this obligation generally see *Stephen Vasciannie,* The Fair and Equitable Treatment Standard in International Investment Law and Practice, BYIL, vol. 70, 1999, 99–164.

appeared in the 1948 Havana Charta and later in the Abs-Shawcross Draft Convention on Investments Abroad and the OECD Draft Convention on the Protection of Foreign Property.[74] However, the exact content of the obligation is quite unclear and disputed among international lawyers and arbitral tribunals. Basically, two different positions have been put forward in the past, and a third position has been proposed more recently.

According to the first position, the concept of 'fair and equitable treatment' embodies the 'international minimum standard' of customary international law.[75] Precedents for this standard can be found mainly in the jurisprudence of the various claims commissions established in the early 20th century. Those cases prescribed a fairly high threshold for governmental conduct to violate the international minimum standard. For example, in *Neer Claim,* it was observed that "the treatment of an alien, in order to constitute an international delinquency should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency."[76] It has been rightly pointed out that – in the light of the development of customary international law on the protection of the individual – the fairness standard under a modern investment treaty should not be interpreted according to precedents of 1926.[77] Nevertheless, a high threshold has recently been required by a NAFTA tribunal in the *S.D. Myers* arbitration:

[74] On the development of the standard *Vasciannie* (note 73), 107–119.

[75] *Cf. Mondev International Ltd. v. United States of America,* Award of 11 October 2002 (Stephen/Crawford/Schwebel), ICSID Case No. ARB (AF)/99/2, para. 125; *Brownlie* (note 52), 527 with further references; *Patrick Foy/Robert Deane,* Foreign Investment Protection under Investment Treaties: Recent Developments under Chapter 11 of the North American Free Trade Agreement, ICSID Review, 2002, 299, 312–313; *cf.* also UNCTAD (note 13), 53; for a recent example of *opinio iuris cf.* the 'Notes of Interpretation of Certain Chapter 11 Provisions' issued by the NAFTA Free Trade Commission (consisting of the Trade Ministers of USA, Mexico, and Canada) of 31 July 2001, pursuant to which the 'fair and equitable treatment' standard of Art. 1105 para. 1 NAFTA "prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party," available at: http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-e.asp. But see also *Sir Robert Jennings,* Second Opinion in the NAFTA *Methanex* arbitration, and the *Pope & Talbot* damages Award of May 31, 2002, both available at: http://www.naftaclaims.com.

[76] *Neer Claim* (USA *v.* The United Mexican States), 1926, cited in: *Brownlie* (note 52), 528.

[77] *Jennings* (note 75); *Mondev International* (note 75), para. 116: "In the light of these developments, it is unconvincing to confine the meaning of 'fair and equitable treatment' and 'full protection and security' of foreign investments to what those terms – had they been current at the time – might have meant in the 1920s when applied to the physical security of an alien. To the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious."

> The Tribunal considers that a breach of Article 1105[78] occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that it is unacceptable from an international perspective. That determination must be made within the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.[79]

In contrast, the second position proposes that the 'fair and equitable treatment' standard is to be interpreted in light of its plain meaning.[80] Giving the words their plain meaning, treatment is fair "when it is free from bias, fraud or injustice; equitable, legitimate, [...] not taking undue advantage; disposed to concede every reasonable claim."[81] Thus, the standard is one of procedural fairness. A tribunal or a court faced with the claim that the 'fair and equitable treatment' standard had been violated would "not be concerned with a minimum, maximum or average standard. It would have to decide whether in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable."[82] Governmental measures, therefore, would have to be examined on a case-by-case basis, without having regard to any particular threshold.

The third position is based on the recent NAFTA *Metalclad* award[83] and proclaims that 'fair and equitable' could be interpreted as a substantive standard, its content being derived from applicable norms of international law.[84] The tribunal interpreted the 'fair and equitable treatment' obligation in the light of the 'transparency' principle of NAFTA and held:

[78] Article 1105 para. 1 NAFTA: Minimum Standard of Treatment

"Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."

[79] *Myers* (note 54), para. 263.

[80] *Vasciannie* (note 73), 99, 144; *Dolzer/Stevens* (note 13), 60; *Sacerdoti* (note 13), 251, 346.

[81] *Vasciannie* (note 73), 99, 103. On the issue of fairness in international investment law, see *Thomas M. Franck,* Fairness in International Law and Institutions, 1995, 438–473.

[82] *Frederick Alexander Mann,* British Treaties for the Promotion and Protection of Investments, BYIL, vol. 52, 1981, 241, 244. This plain meaning approach was also adopted by the tribunal in *Pope & Talbot,* Award on the merits of phase 2, 10 April 2001 (Lord Dervaird/Greenberg/Belman) paras. 105–118, available at: http://www.naftaclaims.com.

[83] *Metalclad Corporation v. The United Mexican States,* Award of 25 August 2000, ICSID Case no. ARB (AF)/97/1 (Civiletti/Lauterpacht/Siqueiros), available at: http://www.naftaclaims.com.

[84] This seems to have been proposed by *Todd Weiler,* Substantive Law Developments in NAFTA arbitration, available at: http://www.naftaclaims.com.

> The Tribunal understands this to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or to be made, under the agreement should be capable of being readily known to all affected investors of another party.[85]

It then concluded that Mexico's conduct did not meet this standard and "Metalclad was not treated fairly or equitably."[86] The tribunal thus filled the 'fair and equitable treatment' obligation with content derived from other treaty provisions to give it substance. However, the *Metalclad* award has been partially annulled by a Canadian court precisely because of this interpretation of 'fair and equitable treatment,'[87] thus casting doubt as to the validity of the approach adopted by the tribunal.

Now which of the above three positions is to be regarded as the most viable interpretation of the 'fair and equitable treatment' standard? The first and the second positions outlined above do not seem to differ with respect to the content of the obligation but only in whether or not the state conduct must pass a certain threshold in order to constitute unfair and inequitable treatment. The starting point for any interpretation of a treaty obligation is the rules of interpretation of Article 31 of the Vienna Convention on the Law of Treaties. It stipulates that "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." It is therefore fully in accordance with the ordinary meaning of the terms of Article 10 para. 1 to simply inquire whether the measure is unfair and inequitable. The 'international minimum standard approach' also asks whether the measure is unfair or inequitable, but further applies a high threshold. To apply such a threshold would be in conformity with general principles of international law on the treatment of foreigners: States have rather broad discretion in relation to the treatment accorded to aliens on their territory, and may, *e.g.*, restrict their ability to hold

[85] *Metalclad* (note 83), para. 76. The tribunal continued: "There should be no room for doubt or uncertainty on such matters. Once the authorities of the central government of any party (whose international responsibility in such matters has been identified in the preceding section) become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws."

[86] *Id.*, para. 101.

[87] Supreme Court of British Columbia, *The United Mexican States v. Metalclad Corporation*, Judgment of 2 May 2001, para. 70, available at: http://www.naftaclaims.com: "In the present case, however, the Tribunal did not simply interpret the wording of Article 1105. Rather, it misstated the applicable law to include transparency obligations and it then made its decision on the concept of transparency."

property.[88] Arbitration tribunals do not have an "open-ended mandate to second-guess government decision making."[89] While restricting the application to 'shocking' or 'egregious' measures might well be outdated, examining every measure in detail without giving a government a considerable measure of deference would be going too far and would give arbitral tribunals more powers than national or international courts. Furthermore, the argument that in light of the Latin American countries' opposition to the 'international minimum standard,' it would be difficult to assume that those countries would accept that same standard under the cloak of a 'fair and equitable treatment' clause in their investment treaties, is not very convincing.[90] The plain meaning approach is a far more rigorous examination of governmental measures than the 'international minimum standard.' Thus, it is correct to interpret 'fair and equitable treatment' as an obligation to provide exactly that treatment, but which also requires that the conduct must pass a certain threshold before international law considers treatment unfair.

Turning back to the Energy Charter Treaty, one cannot fail to notice that the language differs from the 'usual' provisions found in BITs. It is not that each Contracting Party shall *accord* fair and equitable treatment, but rather *create* conditions which include a commitment to accord at all times fair and equitable treatment. It thus imposes a due diligence standard on states to create such conditions but does not impose strict liability for any measure which an arbitral tribunal might consider unfair. It is only when states fail to act, although they could have acted, that their responsibility towards the investor will be incurred.

2. No Unreasonable and Discriminatory Measures/Treatment Not Less Favorable than Required by International Law

Article 10 para. 1 ECT further prohibits Contracting Parties from impairing, by unreasonable or discriminatory[91] measures, the management, maintenance, use, enjoyment, or disposal of investments. The treatment accorded to such investments must not be less favorable than required by international law, including treaty obligations.

[88] *Jennings/Watts* (note 50), 911; *Brownlie* (note 53), 522–525.

[89] *Myers* (note 54), para. 261; *Mondev International* (note 75), para. 119: "At the same time, Article 1105 para. 1 did not give a NAFTA tribunal an unfettered discretion to decide for itself, on a subjective basis, what was 'fair' or 'equitable' in the circumstances of each particular case. [...] It may not simply adopt its own ideosyncratic standard of what is 'fair' or 'equitable,' without reference to established sources of law."

[90] *Vasciannie* (note 73), 105.

[91] The duty of non-discrimination is expanded in Art. 10 para. 7 ECT, prescribing a combination of national treatment and most favored nation treatment.

The prohibition on impairing by 'unreasonable' or discriminatory measures the use, enjoyment, *etc.* of investments is also based on comparable provisions in bilateral investment treaties.[92] It refers to measures which affect property rights, but which are below the level of a creeping expropriation.[93] As regulatory measures of the state are not exempt from the application of the ECT, such measures trigger the obligation of the state to provide damages to the investor, if they are discriminatory or unreasonable. It is possible to understand 'unreasonable' in two different ways: Either as a procedural concept, that is whether the governmental measure furthers the government's objectives, is the least restrictive measure and whether the impairment is proportional to the achieved end; or as a substantive concept. However, since it is always in the eye of the beholder whether a measure is substantially reasonable or not, the substantive concept approach must be rejected.

Of special interest for any international economic lawyer is the obligation to treat investments no less favorable than required by international law, including treaty obligations.[94] This obligation can be understood to make a violation of WTO law, such as the TRIMS Agreement, actionable under the ECT. With regard to the comparable provision of Article 1105 NAFTA, the *Myers* tribunal concluded that "the fact that a host Party has breached a rule of international law that is specifically designed to protect investors will tend heavily in favour of finding a breach of Article 1105."[95] Commentators have interpreted this as a possible statement that a breach of WTO law constitutes a breach of Article 1105 NAFTA.[96] Interpreting Article 10 para. 1 ECT in the context of the other provisions of the Energy Charter Treaty indicates that this is a tenable proposition for the ECT. Article 5 para. 1 ECT prohibits Contracting Parties from imposing any trade-related investment measure inconsistent with Article III or XI of the GATT.[97] Article 10 para. 11 states that any such breach of Article 5 para. 1 shall be considered a breach of the obligations under Article 10 ECT, thus making a breach of these GATT provisions

[92] *Dolzer/Stevens* (note 13), 61. *Cf.* the U.K. Model Treaty, in: *Dolzer/Stevens* (note 13), 231, the Netherlands Model Agreement, in: *Dolzer/Stevens* (note 13), 211 and the U.S. Model Treaty, in: *Dolzer/Stevens* (note 13), 243.

[93] *Cf.* the Iran-U.S. Claims Tribunal which had jurisdiction not only over 'expropriations,' but also over 'other measures affecting property rights,' *Charles N. Brower/Jason D. Brueschke,* The Iran-United States claims tribunal, 1998, 381.

[94] The reference to treaty obligations does not include decisions taken by international organizations, even if binding under international law, Understanding No. 17 to the ECT.

[95] *Myers* (note 54), para. 264.

[96] *Weiler* (note 84).

[97] 'GATT' is defined as encompassing GATT 1947 and GATT 1994, Art. 1 para. 11 lit. a, b ECT. Pursuant to Understanding No. 6 to the ECT, nothing can be derived from Art. 5 para. 1 as to whether the TRIMS agreement is part of Arts. III and XI GATT.

actionable under Article 26 ECT.[98] Whether further provisions of the GATT will be actionable under Article 26 ECT is unclear but not very likely. If the Contracting Parties had wanted to make such a general reference to the GATT, Article 10 para. 11 ECT and Article 5 ECT would be superfluous. However, further treaty obligations might be actionable, if their content is investment-related and is directly applicable[99] to the case.

IV. Piercing the Corporate Veil: Responsibility for Conduct of Private and State-owned Enterprises ?

Disputes can also arise with respect to measures of state enterprises. It is especially in the so-called "economies in transition" in Eastern Europe and the Commonwealth of Independent States (CIS), that the energy sector is controlled by state enterprises – such as SOCAR in Azerbaijan – which exercise a quasi-governmental monopoly with regard to the energy sector. In those countries, investment agreements are concluded solely with the enterprise; and discriminatory or arbitrary conduct of the state enterprise, *e.g.*, concerning the access to pipelines, can damage the investor. The state is not formally involved in those actions, and thus will not be directly responsible under international law.

The obligations of Part III incumbent on the Contracting Parties to the Energy Charter Treaty are of no avail to the aggrieved investor if the harm has been inflicted not by the state, but by a state enterprise or a private enterprise having a monopoly in a certain sector, such as national pipeline or grid operators.[100] As the state enterprise is not bound by investment protection treaties such as the ECT, one of the current issues in international investment law is whether and to what extent the investor can hold the state liable for the conduct of its enterprise. In order for

[98] This interpretation is strengthened by an *e contrario* argumentation. Upon the signing of the treaty, Australia had made a declaration with respect to Arts. 5 and 10 para. 11, noting that it would not be appropriate for dispute settlement bodies established under the Treaty to give interpretations of GATT Arts. III and XI in the context of disputes between an Investor of a party to the GATT and another party to the GATT. In Australia's opinion, the only issue that can be considered under Art. 26 is the issuance of arbitral awards in the event that a GATT panel or WTO dispute settlement body first established that a trade-related investment measure maintained by the Contracting Party is inconsistent with its obligations under the GATT or the Agreement on Trade-Related Investment Measures. On the relationship between WTO law and general international law, see *Joost Pauwelyn,* The Rule of Public International Law in the WTO: How far can we go?, AJIL, vol. 95, 2000, 535–578.

[99] On the concept of direct applicability, see *Thomas Buergenthal,* Self-executing and non Self-executing Treaties, RdC, vol. 235/IV, 1992, 303–400.

[100] Such companies are, *e.g.*, Transneft in Russia or Latvenergo in Latvia. The first case which arose under the Energy Charter Treaty, *AES Summit Generation Ltd. v. Hungary,* concerned the conduct of the Hungarian grid operator, see *Happ* (note 36), 39–44.

this conduct to constitute a breach of the Contracting Party's obligation under Part III, it would need to be attributable to that Party under the general rules of state responsibility in international law. The current state of the law is embodied in the Draft Articles on Responsibility of States for Internationally Wrongful Acts, which were adopted by the International Law Commission of the United Nations in 2001.[101] To what extent the conduct of state enterprises is attributable to the state under general international law of state responsibility is far from clear.[102]

Article 22 of the Energy Charter Treaty addresses this problem by establishing several obligations addressing different subjects and entities. Article 22 para. 1 and para. 2 contain obligations with regard to state enterprises. Pursuant to Article 22 para. 1, a Contracting Party shall ensure that state enterprises which it maintains or establishes conduct their activities in relation to the sale or provision of goods and services in a manner consistent with the Contracting Party's investment protection obligations under Part III of the ECT. Article 22 para. 2 prohibits Contracting Parties from encouraging or requiring such a state enterprise to conduct its activities in a manner inconsistent with the Contracting Party's obligations under the ECT, not restricted to Part III. Thus, Contracting Parties are responsible for the conduct of state enterprises insofar as their obligations under the investment protection provisions are concerned. With respect to the other provisions of the Treaty, *e.g.*, the transit provisions of Article 7, the Contracting Parties are under the far less restrictive obligation of not circumventing their obligations under the ECT by encouraging state entities to act in their stead. Article 22 paras. 3 and 4 have a similar differentiation with respect to entities.[103] Pursuant to Article 22 para. 3, a Contracting Party has to ensure that entities established or maintained by a Contracting Party and entrusted with regulatory, administrative or governmental authority exercise that authority in a manner consistent with the Contracting Party's obligations under the ECT. Article 22 para. 4 prohibits Contracting Parties from encouraging or requiring any entity to which it grants exclusive or special privileges to conduct its activities in its area in a manner inconsistent with the Contracting Parties obligations under the ECT.

To determine whether a Contracting Party has violated its obligations under Article 22 paras. 1 to 4, it will thus first become necessary to determine whether the conduct or actions of the state enterprise/entity are inconsistent with the Contracting Party's obligations under Part III of the ECT. While the obligations under Article 11, 12, and 13 require the exercise of governmental power[104] and, thus, might not be applicable, it should be undisputed that state enterprises can act inconsistently with the non-discrimination obligation of Article 10 para. 1, *e.g.*, by charging higher prices/paying lower prices for oil and gas to investors than to nationals.[105]

[101] Available at: http://www.un.org/law/ilc/texts/State_responsibility/responsibility_articles(e).pdf.

[102] International Law Commission, First Report on State Responsibility by Mr. *James Crawford*, UN Doc. A/CN.4/490/Add.5, 21, available at: http://www.un.org/law/ilc/sessions/50/doclist.htm.

[103] Pursuant to Art. 22 para. 5, "entity" includes any enterprise, agency or other organization or individual.

What is unclear is whether by virtue of Article 22 para. 1 ECT, the *pacta sunt servanda* obligation of Article 10 para. 1 last sentence ECT also applies *mutatis mutandis* to contracts concluded between state enterprises and foreign investors.[106] If that were the correct interpretation, Contracting Parties would be liable under Article 22 para. 1 ECT if state enterprises breached their contracts concluded with foreign investors – an attractive position from the viewpoint of an investor. However, irrespective of whether or not an interpretation is attractive, it must conform with the rules of interpretation of Article 31 of the Vienna Convention on the Law of Treaties. Pursuant to the wording of Article 22 para. 1 ECT, each Contracting Party has to ensure that "any state enterprise [...] shall conduct its activities [...] in a manner consistent with the *Contracting Party's obligations* under Part III of this Treaty."[107] Among the obligations under Part III is Article 10 para. 1 last sentence ECT: "Each Contracting Party shall observe any obligations *it has entered into* with an Investor or an Investment of any other Contracting Party."[108] Thus, under Article 22 para. 1 ECT, a Contracting Party has to ensure that a state enterprise shall conduct its activities in a manner consistent with the obligation of the Contracting Party under Article 10 para. 1 ECT. In other words, a Contracting Party must ensure that a state enterprise does not act inconsistently with its (public international law) obligation under Article 10 para. 1 ECT to observe its (private law) obligations towards the foreign investor. This 'restrictive,' state-centered interpretation is consistent with the current law of state responsibility, as it would attribute the conduct of the state enterprise to the state and constitute conduct in breach of the state's obligation.

[104] Art. 11 regulates the entry of key personnel and obliges Contracting Parties to permit investors to employ key persons of the investor's or his investment's (*i.e.* the locally incorporated company) choice. Art. 12 obliges a Contracting Party to compensate investors for losses suffered due to civil war *etc.*, and Art. 13 requires the payment of compensation after expropriation. Such expropriation has to be for a public purpose and must be carried out under due process of law – requirements which connect the expropriatory conduct to the state. It might be possible that the conduct of state enterprises might have effect equivalent to an expropriation, but the obligation to pay compensation is always incumbent on the state.

[105] *Thomas Wälde/Patricia Wouters*, State Responsibility in a Liberalised World Economy: 'State, Privileged and Subnational Authorities' under the 1994 Energy Charter Treaty, Netherlands Yearbook of International Law, vol. 28, 1996, 143, 172.

[106] This interpretation has been suggested by *Wälde/Wouters* (note 105), 171, 174; *Thomas Wälde*, Treaties and Regulatory Risk in Infrastructure Investment, JWT, vol. 34, 2000, 1, 31.

[107] Emphasis added.

[108] Emphasis added.

In spite of the wording favoring the restrictive interpretation, the object and purpose of Article 10 para. 1 ECT would be consistent with the 'wide' interpretation. If a state monopolist enterprise, such as SOCAR in Azerbaijan, enters into an agreement with a foreign investor, it is consistent with the object and purpose of the ECT to hold the state liable if the company it established and controls violates such an agreement. In that case, the restrictions already spelled out with respect to Article 10 para. 1 would apply *mutatis mutandis:* First, the obligation under Article 22 para. 1 and Article 10 para. 1 ECT would apply only to investment agreements and not to purely commercial contracts; and secondly, the nature of the breach committed by the state enterprise must be tied to more than misconduct of a 'commercial nature,' but to elements of an abuse of the special position as a state enterprise, be it the market power, a monopoly position or special rights.[109] Such restrictions are consistent with the current draft articles on state responsibility.[110]

Both the 'restrictive' and the 'wide' interpretations are tenable, although the better arguments seem to speak in favor of the 'restrictive' interpretation. However, arbitral tribunals will have to decide which interpretation to adopt on the basis of a concrete case, and the specific situation will certainly influence the decision. If the number of ECT arbitrations rises as fast as the number of NAFTA arbitrations, conflicting awards are to be expected.

E. Direct State-Investor Arbitration Under the Energy Charter Treaty

I. The Concept of Direct State-Investor Arbitration

Every arbitration is based on the consent of the parties concerned. Usually, this consent is given in an arbitration clause in a contract, or, if the dispute already has arisen, in a submission agreement (*clause submissoire*). In case of an investment dispute, the legal framework of the investment might prevent the investor from relying on such an arbitration agreement. Although major infrastructure and energy investments nearly always are based on a complex contractual architecture with the state as the contractual partner, about two thirds of all foreign direct investment do not involve the direct contractual participation of the state. The state may still be bound by a contractual arbitration clause if the contract has been entered into with subnational authorities or state-owned companies and the lifting of the "corporate veil" is possible.[111] However, the practice of tribunals has been restrictive in this matter,[112] and if no consent of the state can be established, investors will have to rely on diplomatic protection to pursue their interests.

[109] *Wälde/Wouters* (note 105), 143, 174.

[110] *Supra*, note 101.

[111] On this issue, see the references, *supra*, note 33.

Already during the negotiation of the ICSID Convention, the possibility of the state giving its consent in investment legislation, and the investor accepting this offer by the state, was discussed and is expressly mentioned in the *travaux préparatoires.*[113] This possibility was used by several states in their national laws and confirmed in several ICSID arbitrations.[114] In practice, states have given their consent not only in national investment laws, but also in bi- and multilateral investment treaties. Typically, such clauses provide that all the parties to the treaty give their consent to submit disputes between a contracting party and an investor from another contracting party to arbitration. Arbitral practice and relevant literature have considered these clauses to be effective offers which the investor can accept by submitting the case to arbitration.[115] As these clauses allow an investor who is not a contracting party to the treaty to claim a violation of the treaty, this mechanism is referred to as "arbitration without privity."[116]

II. Direct State-Investor Arbitration Under Article 26 ECT

The state-investor dispute resolution mechanism of Article 26 is based on this concept of direct state-investor arbitration. Article 26 para. 1 regulates that any dispute 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 concerns an alleged breach of an obligation of the Contracting Party shall be settled amicably, if possible. If no amicable settlement can be reached, the investor may submit the dispute for resolution to the courts of the Contracting Party, to any previously agreed dispute resolution mechanism or to one of the options mentioned in Article 26 para. 4: The ICSID or its Additional Facility,[117] an *ad-hoc* arbitration pursuant

[112] *Cf.* the *Pyramids Arbitration* (SPPL *v.* Egypt), reprinted in: ILM, vol. 22, 1983, 752 *et seq.*; *Westland Helicopters Ltd. v. Arab Organisation for Industrialisation and [...] Saudi Arabia, [...] Egypt*, reprinted in: ILM, vol. 23, 1984, 1071 *et seq.*

[113] *Schreuer* (note 34), Article 25, marginal notes 257, 258.

[114] *Id.*, Article 25, marginal notes 259–284 (citing *SPP v. Egypt* and *Tradex v. Albania*).

[115] *Id.*, Article 25, marginal notes 285 *et seq.* For a critical view, see *Sornarajah* (note 31), 211–217.

[116] *Jan Paulsson*, Arbitration without Privity, in: *Wälde* (note 42), 422–442, referring to the producer's liability which is without 'privity,' *i.e.* without contract with the buyer.

[117] Besides providing facilities for conciliation and arbitration under the ICSID Convention since 1978, the ICSID has had a set of Additional Facility Rules authorizing the ICSID Secretariat to administer certain types of proceedings between States and foreign nationals which fall outside the scope of the Convention. These include conciliation and arbitration proceedings where either the State party or the home State of the foreign national is not a member of ICSID.

to the UNCITRAL arbitration rules, or arbitral proceedings under the Arbitration Institute of the Stockholm Chamber of Commerce.

The Contracting Parties have already given their unconditional consent to such arbitration in Article 26 para. 3 lit. a. Together with the written consent of the investor given under Article 26 para. 4, a written arbitration agreement satisfying the requirements of the New York Convention and the various arbitration rules is deemed to be in existence.[118] However, there are two exceptions to the scope of the consent. Pursuant to Article 26 para. 3 lit. b, the investor who wants to submit a dispute with a Contracting Party listed in Annex ID[119] faces a 'fork in the road' decision: Those Contracting Parties do not give their consent to arbitration where the investor has previously submitted it to local courts or a previously agreed dispute settlement mechanism. From this – and the option to submit the dispute to arbitration or the local courts – it follows that the Energy Charter Treaty does not impose the requirement of the exhaustion of local remedies before starting arbitral proceedings against a Contracting Party.[120] Furthermore, Contracting Parties listed in Annex IA do not give their consent with respect to disputes arising under Article 10 para. 1 last sentence, *i.e.* breach of contract (see below).[121]

The arbitration tribunal (or the sole arbitrator) has to decide the dispute in accordance with the ECT and applicable rules and principles of international law. As has been discussed, the reference to international law may even include the application of the GATT agreements, Article 10 para. 11 and Article 5 para. 1 ECT. It is not, however, a blanket clause which would allow a tribunal to apply rules which do not even relate to international investment: The rules must be applicable and somehow relate to the case.

On the request of a party to the dispute, the arbitration shall be held in a state that is a party to the New York Convention,[122] and any claims submitted to

[118] Art. 26 para. 5 lit. a ECT.

[119] Australia, Azerbaijan, Bulgaria, Croatia, Cyprus, The Czech Republic, European Communities, Finland, Greece, Hungary, Ireland, Italy, Japan, Kazakhstan, Norway, Poland, Portugal, Romania, The Russian Federation, Slovenia, Spain, Sweden.

[120] *Happ* (note 43), 131; see generally *Stephen Schwebel*, Three Salient Problems in International Arbitration, 1994, 115.

[121] Australia, Hungary, Norway.

[122] Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 21 June 1958, New York, German Federal Law Gazette (BGBl.), vol. 1961 II, 121. The New York Convention has 158 contracting states. By regulating that the recognition and enforcement of foreign arbitral awards may only be denied in certain specific cases, it has contributed to the success of international commercial arbitration. On the New York Convention, see generally *Albert Jan van den Berg*, The New York Arbitration Convention of 1958, 1981.

arbitration shall be considered to arise out of a "commercial transaction" or relationship for the purpose of that convention.[123] In combination with the written consent of the parties, this ensures the worldwide enforceability of the awards. The state party to the dispute will not be able to invoke sovereign immunity against execution, as the object and purpose of Article 26 ECT imply a respective waiver.[124]

III. The Possible Conflict Between ECT Arbitration and Contractually Agreed Dispute Settlement

One of the unresolved issues of the ECT is the possible conflict between arbitration under Article 26 ECT and contractually agreed dispute settlement. This conflict is especially apparent if the dispute is based on the alleged violation of the state's obligation to observe the contracts it has entered into with foreign investors, and if these contracts contain a prorogation clause in favor of the local courts. Even if it is not the investor, but his investment (the local subsidiary) that has concluded the contract with the prorogation clause, the investor can submit the dispute to arbitration due to the broad scope of Article 10 para. 1 last sentence. This raises the specter of double litigation: the investor successfully claims damages under the ECT and subsequently – after the investor sold his shares in the company – the investment itself claims damages for breach of the investment agreement in the local courts.

One possible means of avoiding such a 'double dip' would be to deny the tribunal the competence to decide whether the contract subject to the national law of the host state has been violated. Two recent awards of ICSID arbitration tribunals seem to give support to such a restricted competence. The case *Compania de Aguas de Aconquija SA v. Argentinia*[125] arose under the French-Argentine Bilateral Investment Treaty and concerned the alleged violation of a concession contract which provided for the exclusive jurisdiction of the local courts. While the tribunal explicitly denied a procedural local remedies requirement, it held that it could not decide whether the contract had been violated, as the parties had opted for the exclusive jurisdiction of the local courts.[126] That holding, although it seems attractive

[123] Art. 26 para. 5 lit. b ECT.

[124] *Happ* (note 43), 136.

[125] *Compania de Aguas del Aconquija and Compagnie Generale des Eaux v. Argentine Republic*, Case. No. ARB/07/3, Award of 21 November 2000 (Rezek/Buergenthal/Trooboff), available at: http://www.worldbank.org/icsid.

[126] *Id.*, para. 51: "[...I]t is not possible for this tribunal to determine which actions of the Province were taken in the exercise of its sovereign authority and which in the exercise of its rights as a contracting party to the Concession Contract, considering, in particular, that much of the evidence presented in this case has involved detailed issued of performance and

and conclusive, has a serious flaw: It mistakes the forum selection clause in the contract, which in its scope is restricted to the legal relations arising under the contract, with the legal relations under the treaty and the legal consequences arising from a breach of treaty. These legal relationships are separate, and possible interdependence is restricted to the violation of the contract being only one of the requirements for a breach of treaty.[127] Consequently, the Argentine Republic filed a claim for annulment with the ICSID, and the award has been annulled.[128]

In *Robert Azininan et al v. Mexico,* no contractually agreed dispute settlement clause existed. The investor claimed breach of contract and had exhausted the Mexican court system's remedies before resorting to arbitration. The tribunal held that once a national court had reviewed and validated a governmental measure, an international tribunal could only review whether the court decision or the law it is based upon violates international law but could no longer review the measure itself.[129] Although this holding seems similar to the *Aguas de Aconquija Case,* it is consistent with general principles of international law, as national courts' interpretations of their own laws are considered binding on an international tribunal.[130] It also

rates under the Concession Contract. To make such determinations, the Tribunal would have to undertake a detailed interpretation and application of the Concession Contract, a task left by the parties to that contract to the exclusive jurisdiction of the administrative courts of Tucuman."

[127] On international tribunals deciding issues of national law see *Brownlie* (note 52), 36–42, pointing, *inter alia,* to the *Serbian Loans Case,* in which the Permanent Court of International Justice had to decide whether a contract subject to Serbian and French law had been violated.

[128] ASIL, International Law in Brief, 19 August 2002, available at: http://www.asil.org/ilib/ilib0512.htm.The annulment decision of July 3, 2002 (Fortier/Crawford/Rozas) has not been published.

[129] "A governmental authority surely cannot be faulted for acting in a manner validated by its courts unless the courts themselves are disavowed at the international level. As the Mexican courts found that the Ayuntamiento's decision to nullify the Concession Contract was consistent with the Mexican law governing the validity of public service concessions, the question is whether the Mexican court decisions themselves breached Mexico's obligations under Chapter Eleven. [...]

The possibility of holding a State internationally liable for judicial decisions does not, however, entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seized has plenary appellate jurisdiction. This is not true generally, and it is not true for NAFTA. What must be shown is that the court decision itself constitutes a violation of the treaty. Even if the Claimants were to convince this Arbitral Tribunal that the Mexican courts were wrong with respect to the invalidity of the Concession Contract, this would not per se be conclusive as to a violation of NAFTA. More is required; the Claimants must show either a denial of justice, or a pretence of form to achieve an internationally unlawful end.", *Robert Azinian* (note 65), para. 97, 99.

[130] *Brownlie* (note 52), 40.

does not lead to unacceptable restriction of the competence of arbitral tribunals, as they can still review whether the laws on which the measure is based, or the decisions which uphold it, violate international law.

As no general restriction of a tribunal's competence to decide whether governmental conduct is in breach of a treaty can be derived from these two decisions, or even from the ECT itself, a solution to the 'double dip' problem may be the extension of the *res judicata* effect of an arbitral award. An arbitral award has *res judicata* effect on the parties for the dispute submitted to arbitration.[131] Although the locally incorporated company (*i.e.* the investment) is not party to the dispute, it is under the direct control of the investor. Thus, it would not be totally incompatible with the concept of arbitration to extend the *res judicata* effect to it. That decisions of international tribunals are generally not binding on national courts and *vice versa*[132] does not prevent such an extension. The awards rendered under Article 26 ECT have legal force in each national system, as the proceedings under Article 26 para. 4 lit. b and c ECT are subject to the *lex arbitri* of their seat and thus 'normal' international commercial arbitration proceedings. Proceedings under the ICSID regime brought in accordance with Article 26 para. 4 lit. a are international proceedings, but the awards have the force of a binding judgment in every contracting state to the ICSID Convention.[133]

F. Enforcing the Rule of Law in International Investment Law?

By bestowing on the investor direct rights and allowing them to hold states responsible for violation of these rights, the ECT has changed the relationship between state and investor from one of *disequilibrium* to one of *equilibrium.* From the perspective of a foreign investor in the energy sector, the dispute settlement mechanism of the Energy Charter Treaty is a safeguard against the uncertain political risk in the host state. Its asset-based standard of protection is broad, and nearly every governmental measure that damages the investor can be reviewed by a tribunal – albeit with uncertain success. By making the host state – to a certain extent – also explicitly responsible for actions of state and 'privileged' enterprises, it adapts to the reality in most of the Contracting Parties to the ECT and prevents them from circumventing their obligations by letting their enterprises act in their stead. By obliging states to afford a reasonable, non-discriminatory and fair treatment, the ECT imposes a standard similar to the Rule of Law and allows the investors to claim damages for the violation of this standard. However, it seems too farfetched

[131] *Alan Redfern/Martin Hunter,* Law and Practice of International Commercial Arbitration, 1999, 8–66.

[132] *Brownlie* (note 52), 52–54.

[133] Art. 54 para. 1 of the ICSID Convention.

to state that the ECT provides remedies for 'poor regulatory treatment' or allows the enforcement of 'good governance standards.' Caution should also be exercised in the interpretation of the ECT. The statement of the NAFTA foreign trade ministers[134] relating to the 'fair and equitable treatment' clause indicates that too extensive an interpretation of the protection under such clauses might lead to backlash and seriously endanger the concept of foreign investment arbitration.

[134] *Supra,* note 75.