INVESTMENT ARBITRATION AND THE ENERGY CHARTER TREATY

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Part 1 – Investments and Investors Covered by the Energy Charter Treaty

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The Energy Charter Treaty ("ECT" or the "Treaty") is the international community's most significant multilateral

[10] *See, e.g.*, 2005 ICSID Annual Report 6.

[11] *See* ECT, Article 26(4)(c).

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instrument for the promotion of cooperation in the energy sector and provides the legal basis for an open and non-discriminatory energy market. It is also, together with the North American Free Trade Agreement ("NAFTA"), one of the most important multilateral treaties providing for the promotion and protection of investments.

The ECT was signed on December 17, 1994 and entered into force on April 16, 1998. It now binds forty-eight States as well as the European Communities.[12] The ECT was adopted with a view to pursuing, on a legally binding basis, the objectives and principles of the European Energy Charter of December 17, 1991.[13] The Treaty's Preamble defines these objectives as including, in particular, the creation of commitments on "a secure and binding international legal basis" and of a "structural framework required to implement the principles enunciated in the European Energy Charter" (ECT, Preamble). The principles referred to are in particular the promotion and development of an "efficient energy market throughout Europe, and a better functioning global market" (Concluding Document of the Hague Conference on the European Energy Charter, adopted on December 17, 1991, Title I: "Objectives").

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[12] As of October 31, 2005, forty-seven signatories, including the European Communities, have ratified the Energy Charter Treaty and two signatories—Belarus and the Russian Federation—have undertaken to apply the Treaty provisionally. Three signatory States—Australia, Iceland and Norway—have neither ratified the Treaty nor are they applying it on a provisional basis. For the official text of the Energy Charter Treaty, *see* 34 ILM 373 (1995). An electronic version as well as a list of the signatories are available on the official Website of the Energy Charter Secretariat at http://www.encharter.org.

[13] *See, e.g.*, Thomas Waelde, International Investment under the 1994 Energy Charter Treaty - Legal, Negotiating and Policy Implications for International Investors within Western and Commonwealth of Independent States/Eastern European Countries, in 29 JWT 5 (Oct. 1995), at 8 et seq. and in THE ENERGY CHARTER TREATY. AN EAST-WEST GATEWAY FOR INVESTMENT AND TRADE, Kluwer (ed. Wälde), 1996, 251, at 271 et seq.; Craig Bamberger, Jan Linehan & Thomas Waelde, The Energy Charter Treaty, in ENERGY LAW IN EUROPE. NATIONAL, EU AND INTERNATIONAL LAW AND INSTITUTIONS, Oxford University Press (eds. Roggenkamp, Rønne, Redgwell, Del Guayo), 2001, 171, at paras. 4.06 et seq.; Lorna Brazell, Draft Energy Charter Treaty: Trade, Competition, Investment and Environment, 12 JERL 299 (1994), at 301 et seq.

In the context of a global energy market, the creation of a single investment area has appeared as one of the means of achieving a unique playing field in the energy sector.[14] One of the chief features of the ECT is indeed the promotion and protection of investments in the energy sector. Part III of the Treaty, entitled "Investment promotion and protection", offers protection that is similar to that accorded by most bilateral investment treaties, including such rights as the fair and equitable treatment, the most constant protection and security of investments, the prohibition of discriminatory measures, the most-favored-nation treatment, and the payment of prompt, adequate and effective compensation for any nationalization, expropriation or measures having an effect equivalent to nationalization or expropriation. The Treaty further provides for binding international dispute settlement, in particular with respect to investment disputes. Under Article 26 of the Treaty, disputes relating to the investment of an investor can be referred to international arbitration if they have not been settled amicably between the disputing parties. The investors are then given the option to choose between ICSID arbitration,[15] the Arbitration Institute of the Stockholm Chamber of Commerce and the Arbitration Rules of the United Nations Commission on International Trade Law ("UNCITRAL").[16]

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[14] *See* ENERGY CHARTER SECRETARIAT, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation*, at 14: "[t]he fundamental aim of the Energy Charter Treaty is to strengthen the rule of law on energy issues, by creating a level playing field of rules to be observed by all participating governments, thus minimizing the risks associated with energy-related investments and trade". *See also* Craig Bamberger, Jan Linehan & Thomas Waelde, *The Energy Charter Treaty, supra* note 2, at paras. 4.125-4.129: "The Energy Charter Treaty is, together with NAFTA, the major multilateral treaty pioneering the extensive use of legal methods increasingly characteristic of global economic regulations. [...] With a paradigm shift away from mere protection by the home State of investors and traders to the legal architecture of a liberal global economy goes a co-ordinated use of trade and investment law methods to achieve the same objective: a global level playing field for activities in competitive markets."

[15] International Centre for Settlement of Investment Disputes ("ICSID") arbitration, as referred to in Antonio Parra's introduction to this Chapter.

[16] As of October 31, 2005, eight arbitrations were initiated on the basis of the ECT. *Nykomb Synergetics Technology Holding AB v. Latvia* and *Petrobart Limited v. the Kyrgyz Republic*, both under the auspices of the Arbitration Institute of the

The investment protection regime under the ECT is offered to the "investors" and their "investments. " For example, Article 10 of the Treaty makes it an obligation for the States to "encourage and create stable, equitable, favourable and transparent conditions for *Investors* of other Contracting Parties to make *Investments* in its Area. Such conditions shall include a commitment to accord at all times to *Investments of Investors* of other Contracting Parties fair and equitable treatment [...]" (emphasis added). Article 13 of the Treaty prohibits the nationalization, expropriation or measures having effect equivalent to nationalization or expropriation with respect to "*Investments of Investors*" of a Contracting Party. Likewise, Article 26(1) provides for dispute resolution as regards "[d]isputes between a Contracting Party and an *Investor* of another Contracting Party relating to an *Investment* of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III [...]."

As in any other investment protection treaty, the requirements of an "investment" made by an "investor" within the meaning of the Treaty are therefore qualifying conditions for the benefit of the

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Stockholm Chamber of Commerce, have resulted in an award on the merits in favor of the investors (Award of December 16, 2003 and Award of March 29, 2005 respectively, both available on the Website of Investment Treaty Arbitration at http://ita.law.uvic.ca. The award in *Petrobart Limited v. the Kyrgyz Republic* has since been subjected to an action to set aside before the Swedish courts). Three other arbitrations were brought before ICSID. These are the *AES Summit Generation Ltd. v. Hungary* arbitration, which was settled amicably before any decision could be rendered, *Alstom Power Italia SpA v. Mongolia* and *Plama Consortium Limited v. Republic of Bulgaria*, both pending as of October 31, 2005 (In *Plama v. Bulgaria, see* the decision on jurisdiction rendered on February 8, 2005, available on the ICSID Website, and the commentary by E. Gaillard, *Energy Charter Treaty: International Centre for Settlement Decision*, NEW YORK LAW JOURNAL, April 7, 2005). The three last ECT arbitrations were brought under the UNCITRAL Arbitration Rules against the Russian Federation by the majority shareholders in Yukos Oil Company in relation to the expropriation of their investment by the Russian Federation (*Hulley Enterprises Limited v. the Russian Federation; Yukos Universal Limited v. the Russian Federation; Veteran Petroleum Limited v. the Russian Federation*). The author wishes to disclose that he acts as counsel for the claimant in the following arbitrations: *Plama Consortium Limited v. Republic of Bulgaria; Hulley Enterprises Limited v. the Russian Federation; Yukos Universal Limited v. the Russian Federation; Veteran Petroleum Limited v. the Russian Federation.*

substantive protection accorded by the Treaty. These concepts are defined at Article 1 of the Treaty. The examination of these definitions shows that the ECT has adopted a broad approach in identifying the types of investors and of investments that can benefit from its substantive protection.

1. Which "Investments" are Protected Under the Treaty?

The term "Investment" is defined at Article 1(6) of the ECT. This provision first gives a non-exhaustive enumeration of the types of assets that can be considered as an investment. It then specifies the date as of which an investment may benefit from the Treaty's protection. Article 1(6) further stipulates that the notion of "investment" refers to any investment associated with an economic activity in the energy sector, something that is consistent with the sectoral nature of the ECT. The entirety of Article 1(6) reads as follows:

> "'Investment' means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:
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> (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;
> (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;
> (c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;
> (d) intellectual property;
> (e) returns;
> (f) any right conferred by law or contract or by virtue of any licenses and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.
>
> A change in the form in which assets are invested does not affect their character as investments and the term 'Investment' includes all investments, whether existing at or made after the later of date of entry into force of this Treaty for the Contracting

> Party of the Investor making the investment and that for the Contracting Party in the Area of which the investment is made (hereinafter referred to as the 'Effective Date') provided that the Treaty shall only apply to matters affecting such investments after the Effective Date.
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> 'Investment' refers to any investment associated with an Economic Activity in the Energy Sector and to investments or classes of investments designated by a Contracting Party in its Area as 'Charter efficiency projects' and so notified to the Secretariat. "

The ECT has adopted an approach similar to that of many bilateral investment protection treaties (BITs) and extends its coverage to "every kind of asset."[17] The broad nature of the definition of investments under the ECT has been emphasized in *Plama v. Bulgaria*, the first decision rendered under the auspices of ICSID on questions of jurisdiction under the ECT: the *Plama* Tribunal held that the list at Article 1(6) constitutes "a broad, non-exhaustive list of different kinds of assets encompassing virtually any right, property or interest in money or money's worth [...]."[18]

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[17] Other multilateral investment treaties have adopted the same approach: Article 1(1) of the Protocol of Colonia for the Promotion and Reciprocal Protection of Investments in MERCOSUR of January 17, 1994 defines investments as follows: "The term 'investment' shall mean any type of asset invested directly or indirectly by the investors of one of the Contracting Parties in the territory of the other Contracting Party, in accordance with the laws and regulations of the latter." (Unofficial translation from the original Spanish text). Compare also with the broad definition of "investments" at Article 1 of the 2004 US Model BIT: "'investment' means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include: [...]."

[18] *Plama Consortium Limited v. Bulgaria* (ICSID Case No. ARB/03/24) [hereinafter "*Plama v. Bulgaria*"], Decision on jurisdiction, February 8, 2005, available on the ICSID Website at http://www.worldbank.org. para. 125. On the broad definition of an "investment" under the ECT, *see also* Thomas Waelde, *International Investment under the 1994 Energy Charter Treaty - Legal, Negotiating and Policy Implications for International Investors within Western and Commonwealth of Independent States/Eastern European Countries, supra* note 2, at 24-27.

The broad scope of the definition of investments under Article 1(6) of the ECT is further determined by the fact that every kind of asset may be "owned or controlled directly or indirectly" by an investor. The Treaty itself has provided guidance as to the meaning of "control" and defines it as "control in fact" in the Understandings to the Final Act of the European Energy Charter Conference.[19]

The forms of investment that are protected by the Treaty include rights conferred by contract, including "claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment" (Article 1(6)(c)) or rights conferred "by law or contract or by virtue of any licenses and permits granted pursuant to law" (Article 1(6)(f)).[20] The latter language is worthy of note in the context of claims that may be brought by an investor for the termination of a contract or a license for alleged violations of the law of the host State. The language adopted by the ECT differs from that of certain investment protection treaties. The Sweden-Bosnia BIT, for

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[19] The Understandings with respect to Article 1(6) reads as follows: "For greater clarity as to whether an Investment made in the Area of one Contracting Party is controlled, directly or indirectly, by an Investor of any other Contracting Party, control of an Investment means control in fact, determined after an examination of the actual circumstances in each situation. In any such examination, all relevant factors should be considered, including the Investor's (a) financial interest, including equity interest, in the Investment; (b) ability to exercise substantial influence over the management and operation of the Investment; and (c) ability to exercise substantial influence over the selection of members of the board of directors or any other managing body. Where there is doubt as to whether an Investor controls, directly or indirectly, an Investment, an Investor claiming such control has the burden of proof that such control exists."

[20] In this respect, *see also* the last sentence of Article 10(1) of the Treaty: "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 type of provision, known as an "umbrella clause" or an "observance of undertakings" clause, extends the substantive protection of the Treaty to obligations, including contractual ones, entered into with an investor or with respect to an investment. On observance of undertakings clauses, *see* E. Gaillard, *Investment Treaty Arbitration and Jurisdiction over Contract Claims – the SGS Cases Considered, in* INTERNATIONAL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM THE ICSID, NAFTA, BILATERAL TREATIES AND CUSTOMARY INTERNATIONAL LAW (T. Weiler ed.) 2005, at 325, and the references cited therein.

example, limits its protection to investments that have been "made in accordance with the laws and regulations" of the host State (Article 1(1)). Similarly, the Italy-Morocco BIT defines an investment as "all categories of assets invested [...] by a natural or legal person, [...] on the territory of the other Contracting Party, in accordance with the laws and regulations of the aforementioned party" (Article 1(1)).[21] Where such a requirement has been set forth by the applicable investment protection treaty, it has been interpreted in the arbitral case law as relating to the validity of an investment rather than to its existence. The Italy-Morocco BIT has thus been analyzed by the Arbitral Tribunal constituted in *Salini v. Morocco* in the following terms: "The Tribunal cannot follow the Kingdom of Morocco in its view that paragraph 1 of Article 1 refers to the law of the host State for the definition of 'investment.' In focusing on 'the categories of invested assets (...) in accordance with the laws and regulations of the aforementioned party,' this provision refers to the validity of the investment and *not to its definition.* More specifically, it seeks to prevent the Bilateral Treaty from protecting investments that should not be protected, particularly because they would be illegal" (emphasis added).[22] Similarly, in *LESI-Dipenta v. Algeria,* the Arbitral Tribunal decided that "the reference by the provision to the requirement of the

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[21] Other types of requirements may be provided for, such as the specific approval in writing of an investment: *see, e.g.,* Article II(1) of the ASEAN Agreement for the promotion and protection of Investments of December 15, 1987: "This Agreement shall apply only to investments brought into, derived from or directly connected with investments brought into the territory of any Contracting Party by nationals or companies of any other Contracting Party *and which are specifically approved in writing and registered by the host country* and upon such conditions as it deems fit for the purposes of this Agreement." (Emphasis added). The ECT does not provide for such a requirement. In this respect, *see* Thomas Waelde, *International Investment under the 1994 Energy Charter Treaty - Legal, Negotiating and Policy Implications for International Investors within Western and Commonwealth of Independent States/Eastern European Countries, supra* note 2, at 27 and 274: "[...] different from most BITs and MIGA - and most bilateral investment insurance arrangements - there is no need for prior approval of the investment by the host State. This Treaty can be considered as *ex ante* blanket approval of foreign investments in the energy sector."

[22] *Salini Costruttori S.p.A. & Italstrade S.p.A. v. Kingdom of Morocco* (ICSID Case No. ARB/00/4), Decision on jurisdiction of July 16, 2001, at para. 46, 42 ILM 606 (2003), with an introductory note by E. Gaillard and Y. Banifatemi.

conformity to the applicable laws and regulations *does not constitute a formal recognition of the notion of investment as defined by Algerian law in a restrictive manner*, but, in line with a standard and perfectly justified rule, the exclusion of the protection for all investments that have been made in violation of the fundamental principles that apply" (emphasis added).[23] Under this interpretation, the alleged non-compliance with municipal laws and regulations does not create an obstacle to treaty coverage *per se* and access to a neutral forum for the resolution of investment disputes, to the extent that the asset under consideration falls under the definition of an investment provided by the applicable treaty; rather, such alleged non-compliance may constitute a limitation with respect to the merits of the claim relating to the covered investment. By contrast, when a claim is brought under a treaty such as the ECT where there is no requirement for an investment to be made in accordance with the laws and regulations of the host State, the question arises as to what consequences would be attached to the alleged non-compliance with the municipal laws and regulations of that State. In particular, the question arises as to whether the host State may invoke such non-compliance in order to exclude the treaty's coverage of contracts or licenses that it has terminated on that basis. In line with the existing case law and the clear language of the ECT, it is fair to assume that, at the very least, there would be no jurisdictional restriction with respect to a contract or license terminated on the basis of an alleged non-compliance: the termination of a contract or a license, the validity of which is challenged by the host State and thus constitutes precisely the issue to be decided on the merits by the arbitral tribunal, cannot provide sufficient ground for a host State to deny the benefit of access to dispute resolution to an otherwise covered investment.[24]

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[23] *Consorzio Groupement LESI–Dipenta v. Algeria*, ICSID Case No. ARB/03/08, Award of January 10, 2005, para. 24 (unofficial translation from the original French text), available on the ICSID Website at http://www.worldbank.org.

[24] For a different view, *see* Thomas Waelde, International Investment under the 1994 Energy Charter Treaty - Legal, Negotiating and Policy Implications for International Investors within Western and Commonwealth of Independent States/Eastern European Countries, supra note 2, at 26 and at 273: "[...] an invalid right or title, not issued by the competent authority, but issued under

The second paragraph of Article 1(6) of the ECT makes it clear that a change in the form of an investment does not preclude its protection. Assets originally invested under one form remain protected throughout their existence even where the changing legislation and/or economic and political situation of a host State result in the alteration of the initial form of investment. This provision is of particular significance with regard to investments made in the former COMECON States.[25]

The second paragraph of Article 1(6) also defines the Treaty's coverage *ratione temporis* as extending to "all investments, whether existing at or made after the later of the date of entry into force of th[e] Treaty for the Contracting Party of the Investor making the investment and that for the Contracting Party in the Area of which the investment is made (hereinafter referred to as the 'Effective Date') provided that the Treaty shall only apply to matters affecting such investments after the Effective Date". This provision is consistent with the customary rule contained at Article 28 of the Vienna Convention on the Law of Treaties which provides that "[u]nless a different intention appears from the treaty or is otherwise established, its provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party." In that context, a question may arise under the ECT in relation to the Treaty's provisions on provisional application[26] and how those provisions

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material breach of mandatory procedures or issued in contravention of peremptory law, does not constitute 'investment'. A contractual right to explore and develop oil and gas issued by an incompetent local entity, or issued without complying with mandatory tender procedures, or issued with material breach of such procedures suggesting illicit practices and, certainly, if issued under the influence of proven corruption, would not seem to constitute 'investment'" (emphasis added). *See also* the same author's views on "ex ante blanket approval" of investments under the ECT, supra note 10.

[25] *See also* Lorna Brazell, Draft Energy Charter Treaty: Trade, Competition, Investment and Environment, supra note 2, at 320.

[26] Article 45(1) the ECT provides that: "[e]ach signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its constitution, laws or regulations."

can be read in conjunction with Article 1(6): in other words, if the "Effective Date" is meant to be the date at which the Treaty becomes binding on a State as a result of its entry into force for that State, can it also correspond to the date at which the Treaty becomes binding on a State as a result of its provisional application by that State? The question of how the provisional application of the ECT should be interpreted in the context of Article 1(6) has not been raised in practice.[27] Some authors have justifiably taken the view that "Effective Date" includes the date at which a State is internationally bound by the Treaty as a result of its provisional application: "This Treaty [...] aims at becoming effective by provisional application (Article 45). Apart from countries which have opted out of provisional application (under Article 45(2) and Annex PA), the effective date moves forward to the signature date of 17 December 1994. From this date, the investment regime of the Charter becomes mandatory on non opt-out countries. Although the Treaty's investment regime covers an investment (existing or future), both the sending and the receiving States must be subject to the Treaty's obligations, either by ratification or by provisional application under Article 45 (Article 1(6), last paragraph)."[28]

The last paragraph of Article 1(6) associates the notion of "investment" to "an Economic Activity in the Energy Sector", which is consistent with the sectoral nature of the Treaty. The drafting history of the Treaty shows that, during the course of the negotiations, the drafters inserted in the definition of an "investment"[29] the notion of "energy asset,"[30] every kind of "asset

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[27] On provisional application, however, *see Plama v. Bulgaria, supra* note 7, para. 140; *see also* the award in *Petrobart Limited v. the Kyrgyz Republic, supra* note 5, at 62-63.

[28] Thomas Waelde, International Investment under the 1994 Energy Charter Treaty - Legal, Negotiating and Policy Implications for International Investors within Western and Commonwealth of Independent States/Eastern European Countries, supra note 2, at 29-30 and at 276 (citations omitted).

[29] The first drafts referred to "every kind of asset" in the provision on the definition of an "investment", but provided for a sectoral restriction in the definition of an "investor", requiring that the investor "make[s] investments in the Territory of another Contracting Party in connection with Energy Materials and Products", *see* draft of October 31, 1991. A later draft of January 20, 1992

in energy field,"[31] or every kind of asset "employed in association with the exploration, production, conversion, storage, transport, distribution and [supply] of Energy Materials and Products [and related services]."[32] The requirement of an association with the energy sector thus evolved to form part of the definition of an "investment" covered by the Treaty. A later draft specified, in a separate paragraph relating to the definition of an investment, that "[f]or the purposes of this Agreement, 'investment' refers to any investment associated with an economic activity in the Energy Sector."[33] The language that was eventually adopted excluded from the first paragraph of Article 1(6) any reference to the energy sector and maintained instead a reference in the last paragraph of that provision with respect to "any investment associated with an 'Economic Activity in the Energy Sector.'"[34]

The notion of Economic Activity in the Energy Sector is defined at Article 1(5) of the ECT as meaning "an economic activity concerning the exploration, extraction, refining, 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."[35] The Understandings to the Final Act of the European Energy Charter Conference further clarify this definition and enumerates various activities "illustrative" of the

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added, in the definition of "investment": "every kind of asset, which are used in connection with the implementation of the principles of the Charter and in accordance with the provisions of this Agreement."

[30] Draft of September 16, 1992.

[31] Draft of November 25, 1992.

[32] Draft of December 21, 1992.

[33] Draft of February 9, 1993.

[34] *See* draft of March 15, 1993.

[35] Annex NI of the ECT lists oils and other products of the distillation of high temperature coal tar, fuel wood and charcoal. *See also* Annex EM of the ECT, entitled "Energy Material and Products" and relating to the definition of "Energy Materials and Products" at Article 1(4), which lists nuclear energy, coal, natural gas, petroleum and petroleum products, electrical energy, fuel wood and charcoal.

Economic Activity in the Energy Sector.[36] Many of those activities are traditional activities associated with the energy industry and should not, in practice, raise particular difficulty. The question arises however of what type and degree of association with defined energy activities is needed for a non-energy activity in order for an investment to be covered. This question remains to be tested in practice,[37] but it has been argued that "the extension of the definition of 'Investment' to investments (i.e. assets) 'associated with' an 'Economic Activity in the Energy Sector' attenuates the sectoral restriction of the Treaty's protections and dispute resolution mechanisms; it can provide a basis for claiming coverage, for example, with respect to otherwise uncovered petrochemical facilities within an oil refinery complex, or maritime transportation that is 'associated with' a covered on-land investment."[38]

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[36] The understandings with respect to Article 1(5) provide that: "(a) It is understood that the Treaty confers no rights to engage in economic activities other than Economic Activities in the Energy Sector. (b) The following activities are illustrative of Economic Activity in the Energy Sector: (i) prospecting and exploration for, and extraction of, e.g., oil, gas, coal and uranium; (ii) construction and operation of power generation facilities, including those powered by wind and other renewable energy sources; (iii) land transportation, distribution, storage and supply of Energy Materials and Products, e.g., by way of transmission and distribution grids and pipelines or dedicated rail lines, and construction of facilities for such, including the laying of oil, gas, and coal-slurry pipelines; (iv) removal and disposal of wastes from energy related facilities such as power stations, including radioactive wastes from nuclear power stations; (v) decommissioning of energy related facilities, including oil rigs, oil refineries and power generating plants; (vi) marketing and sale of, and trade in Energy Material and Product, e.g., retail sales of gasoline; and (vii) research, consulting, planning, management and design activities related to the activities mentioned above, including those aimed at Improving Energy Efficiency."

[37] By way of example, the first ECT case *Nykomb v. Latvia* involved the construction of a power-generation facility followed by an electricity production and supply contract. The *Petrobart v. Kyrgyzstan* award was rendered with respect to a gas supply contract. The *Plama v. Bulgaria* case concerns an oil refinery.

[38] Craig Bamberger, Jan Linehan & Thomas Waelde, *The Energy Charter Treaty, supra* note 2, at para. 4.16. On the open-ended nature of the term 'association", *see also* Thomas Waelde, *International Investment under the 1994 Energy Charter Treaty - Legal, Negotiating and Policy Implications for International*

2. Which "Investors" are Protected Under the Treaty?

The definition of an "investor" under the ECT is provided at Article 1(7) in the following terms:

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

It is a firmly established principle of international law that nationality is defined by each State's domestic laws. Natural persons that are covered by the ECT are defined by reference to each State's domestic laws determining citizenship or nationality. The Treaty also extends the coverage of investors to permanent residents,[39] something that is in line with the notion that the ECT creates a single energy area.[40] Similarly, legal entities are defined

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Investors within Western and Commonwealth of Independent States/Eastern European Countries, supra note 2, at 27 and at 274; Lorna Brazell, *Draft Energy Charter Treaty: Trade, Competition, Investment and Environment, supra* note 2, at 319-321.

[39] The drafting history of the Treaty shows that the first drafts referred to natural persons having the citizenship or nationality of the Contracting Party but did not provide for the coverage of permanent residents. The addition of permanent residents was achieved later in the negotiations, in the draft of November 25, 1992.

[40] Compare with other multilateral treaties creating a common area of protection, *e.g.*, Article 201 of the NAFTA: "national means a natural person who is a citizen or permanent resident of a Party [...]." *See also* Article 1(2) of the Protocol of Colonia for the Promotion and Reciprocal Protection of Investments in MERCOSUR of January 17, 1994: "The term 'investor' shall mean: a) any natural person who is the national of one of the Contracting Parties, or resides

by reference to the domestic laws of each Contracting State as regards the organization of legal entities. In this respect, the ECT differs from certain other multilateral investment treaties that restrict their coverage by setting forth additional requirements such as the place of effective management[41] or the place where the headquarters are situated.[42] The ECT offers a broader coverage by simply requiring that a legal entity be "organized" in accordance with the law applicable in a Contracting State. By contrast, other treaties expressly extend their coverage to companies incorporated in third countries provided that control or ownership is exercised by investors situated in a contracting State.[43] Depending on the circumstances, however, the same result may be reached under the ECT in situations where, in accordance

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permanently or is domiciled in the territory of said Contracting Party, in accordance with its legislation. The provisions of this Protocol shall not apply to any investment made by natural persons who are nationals of one of the Contracting Parties within the territory of the other Contracting Party, in the event that such natural persons, at the time of the investment, were permanent residents or were domiciled in the latter Contracting Party, save where it is proven that the resources appertaining to said investments have originated abroad." (Unofficial translation from the original Spanish text.)

[41] *See* Article 1(2) of the ASEAN agreement, which defines the term "company" as meaning "a corporation, partnership or other business association, incorporated or constituted under the laws in force in the territory of any Contracting Party wherein the place of effective management is situated."

[42] *See* Article 1(2) of the Protocol of Colonia for the Promotion and Reciprocal Protection of Investments in MERCOSUR: "The term 'investor' shall mean: [...] b) any legal person incorporated in accordance with the laws and regulations of one Contracting Party, and with its seat in the territory of said Contracting Party. c) all legal persons established in the territory where the investment is made, and which are effectively controlled, directly or indirectly, by legal or natural persons as defined in a) and b) above." (Unofficial translation from the original Spanish text.)

[43] *See, e.g.*, Article 1 of the Swedish-India BIT of July 4, 2000 which provides that: " (b) 'investors' mean any national or company of a Contracting Party; [...] (d) 'companies' mean any corporations, firms and associations incorporated or constituted under the law in force in the territory of either Contracting Party, or in a third country if at least 51 percent of the equity interest is owned by investors of that Contracting Party, or in which investors of that Contracting Party control at least 51 percent of the voting rights in respect of shares owned by them."

with Article 1(6) of the Treaty, a covered investor has an indirect control in an investment situated in an ECT country.

It is worthy of note that the ECT has envisaged the situation where a legal entity that defines as an "investor" under Article 1(7) is in fact a national of the host State. In the event that such entity decides to bring a claim under the Washington Convention, it needs meet the requirement of Article 25(2)(b) of the Washington Convention that it be considered as a national of another Contracting State. This situation is resolved under the ECT by Article 26(7), which provides that a legal entity that is incorporated in the host State will be treated as a national of another Contracting State for the purposes of Article 25(2)(b) of the Washington Convention if it is controlled by investors of another Contracting State: "An Investor other than a natural person which has the nationality of a Contracting Party to the dispute on the date of the consent in writing referred to in paragraph (4) and which, before a dispute between it and that Contracting Party arises, is controlled by Investors of another Contracting Party, shall for the purpose of article 25(2)(b) of the ICSID Convention be treated as a 'national of another Contracting State' and shall for the purpose of article 1(6) of the Additional Facility Rules be treated as a 'national of another State.'"

This situation is different from that contemplated by Article 17 of the ECT, also referred to as the "denial of benefits" clause. Article 17(1) provides that:

> "Each Contracting Party reserves the right to deny the advantages of this Part to:
>
> (1) a legal entity if citizens or nationals of a third State own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized [...]".

This provision has been analyzed by some authors as a limitation of the scope of protection of the ECT.[44] It was tested in

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[44] *See, e.g.*, Thomas Waelde, International Investment under the 1994 Energy Charter Treaty - Legal, Negotiating and Policy Implications for International

practice in the *Plama v. Bulgaria* case, which is the first decision to interpret the wording of the ECT relating to the protection of investments and provides unprecedented insight into the interpretation of ECT provisions. In particular, the *Plama* decision provides valuable guidance as to the interpretation and application of Article 17 in relation to the notion of a "covered investor" under the Treaty.

In analyzing the effect of Article 17, the *Plama* decision puts strong emphasis on the effect of a State's consent to arbitrate its investment dispute under Article 26 of the ECT. Indeed, the protection regime established by the ECT contains in particular the arbitration clause contained at Article 26 of the Treaty, which provides for a Contracting Party's unconditional consent to investor-State arbitration:

> "[...] Article 26 ECT provides to a covered investor an almost unprecedented remedy for its claim against a host state. The ECT has been described, together with NAFTA, as *'the major multilateral treaty pioneering the extensive use of legal methods characteristic of the fledging regulation of the global economy'*, of which *'perhaps the most important aspect of the ECT's investment regime is the provision for compulsory arbitration against governments at the option of foreign investors ...'*; and these same distinguished commentators concluded: *'With a paradigm shift away from mere protection by the home state of investors and traders to the legal architecture of a liberal global economy, goes a coordinated use of trade and investment law methods to achieve the same objective: a global level playing field for activities in competitive markets.'* By any standards, Article 26 is a very important feature of the ECT which is itself a very significant treaty for investors, making another step in their transition from objects to subjects of international law." (*Plama v. Bulgaria*, para. 141.)[45]

Investors within Western and Commonwealth of Independent States/Eastern European Countries, supra note 2, at 28 and at 275.

[45] The unprecedented remedy provided by Article 26 was further underlined by the Tribunal as it observed that the application of the ECT on a provisional basis extends to its Article 26: "Article 45(1) ECT provides that each signatory agrees to apply the treaty provisionally pending its entry into force for such

The arbitration clause of Article 26 is contained in Part V of the Treaty concerning "Dispute settlement," whereas Article 17 of the ECT is found in Part III of the Treaty, which concerns "Investment promotion and protection" and contains the provisions relating to the Treaty's substantive protection. The *Plama* decision points out that the denial of benefits provision operates only with respect to Part III of the ECT: "Article 17(1) does not operate as a denial of all benefits to covered investor under the treaty but is expressly limited to a denial of the advantages *of Part III* of the ECT" (*Plama v. Bulgaria,* para. 149, emphasis added). Indeed, the wording of Article 17 ("Each Contracting Party reserves the right to deny the advantages *of this Part* [...]") can be compared with the language used by other treaties. For example, Article 1(c) of the Sweden-Bulgaria BIT of April 19, 1994 provides, with respect to the definition of an investor, that "[e]ach Contracting Party reserves the right to deny to any legal person the advantages *of this Agreement* if nationals of any third State control such legal person and the said legal person is established on the territory of one of the Contracting Parties with the only or predominant purpose to invest in the territory of the other Contracting Party" (emphasis added).

As noted by the *Plama* Tribunal, the circumstances mentioned in Article 17 could not impede the operation of Article 26 of the ECT:

> "As a matter of language, it would have been simple to exclude a class of investors completely from the scope of the ECT as a whole, as do certain other bilateral investment treaties; but that is self-evidently not the approach taken in the ECT [...].
>
> [...] the object and purpose of the ECT, in the Tribunal's view, clearly requires *Article 26 to be unaffected by the operation of Article 17(1).*" (*Plama v. Bulgaria,* para. 148, emphasis added)

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signatory; and in accordance with Article 25 of the Vienna Convention, it follows that Article 26 ECT provisionally applied from the date of a state's signature, unless that state declared itself exempt from provisional application under Article 45(2)(a) ECT. (Bulgaria made no such declaration.)" (*Plama v. Bulgaria,* para. 140.)

Another issue was whether the denial of benefits under Article 17(1) operates automatically and requires no further action from the host State as argued by Bulgaria, or whether it requires the right to deny to be exercised through positive action taken by the host State as argued by the Claimant. The Tribunal adopted the latter approach and established that Article 17(1) sets forth a reservation of rights mechanism which, to be effective, must be exercised:

> "In the Tribunal's view, the existence of a 'right' is distinct from the exercise of that right. [...] a Contracting Party has a right under Article 17(1) ECT to deny a covered investor the advantages under Part III; but it is not required to exercise that right; and it may never do so. The language of Article 17(1) is unambiguous [...].
>
> The Tribunal has also considered whether the requirement for the right's exercise is inconsistent with the ECT's object and purpose. The exercise would necessarily be associated with publicity or other notice so as to become reasonably available to investors and their advisers. [...] By itself, Article 17(1) ECT is at best only half a notice; without further reasonable notice of its exercise by the host state, its terms tell the investor little; and for all practical purposes, something more is needed [...].
>
> [...] the interpretation of Article 17(1) ECT under Article 31(1) of the Vienna Convention *requires the right to be exercised by the Contracting State.*" (*Plama v. Bulgaria*, paras. 155-158, emphasis added)

Once established that the State must manifest its intention to deny the benefits of the ECT to a covered investor, such exercise of the right to deny advantages cannot be retroactive and operates only prospectively:

> "The covered investor enjoys the advantages of Part III unless the host state exercises its right under Article 17(1) ECT; and a putative covered investor has legitimate expectations of such advantages until that right is exercised. A putative investor therefore requires reasonable notice before making any investment in the host state whether or not that host state has exercised its right under Article 17(1) ECT [...].

> [...] the object and purpose of the ECT suggest that *the right's exercise should not have retrospective effect.*" (*Plama v. Bulgaria*, paras. 161-162, emphasis added)

The *Plama* decision adds in passing an important indication as to the factual assessment, in a given case, of the requirements of Article 17(1). The Tribunal indicated that, where the right is exercised, "[...] ownership includes indirect and beneficial ownership; and control includes control in fact, including an ability to exercise substantial influence over the legal entity's management, operation and the selection of members of its board of directors or any other managing body." (*Plama v. Bulgaria*, para.170).

In conclusion, it is clear that the object and purpose of Article 17(1) is not to define the coverage of the ECT as regards ECT investors. Rather, the notion of "covered investor" is defined by Article 1(7) of the Treaty, whereas Article 17(1) establishes the conditions under which a State may deny the benefits of Part III of the Treaty to a covered investor. This point further establishes the broad nature of the coverage accorded by the Treaty, as defined by Articles 1(6) and 1(7), and illustrates the Treaty's protective philosophy in the field of energy investments.