

**ARBITRATION UNDER  
INTERNATIONAL  
INVESTMENT  
AGREEMENTS**

**A GUIDE TO THE KEY ISSUES**

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## Chapter 2

# The Energy Charter Treaty

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The Energy Charter Treaty (ECT) is a unique international instrument for the promotion of cross-border energy cooperation. It was opened for signature on December 17, 1994 and entered into force on April 16, 1998. Having languished in relative obscurity for several years, the Treaty is today regarded as a vitally important multilateral instrument for the promotion and protection of foreign investment in the energy sector. Indeed, considering its expansive investor protections and broad membership—it is signed by 52 states and the European Communities<sup>1</sup>—the ECT arguably is the most successful achievement to date of the long-standing international efforts to establish a comprehensive investment protection regime that started with the signing of the Havana Charter in 1948.

According to Article 2 of the Treaty, its purpose is to establish “a legal framework in order to promote long-term co-operation in the energy field [ . . . ] in accordance with the objectives and principles of the [Energy] Charter.” While the Treaty covers a broad range of energy-related activities, including nondiscriminatory trade in energy materials, cross-border energy transit, competition, the environment, access to

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<sup>1</sup> At present, the ECT binds 50 out of its 53 signatories, including the Russian Federation and Belarus, which apply the Treaty on a provisional basis. In November 2006, the Energy Charter Conference approved the accession to the ECT of the Islamic Republic of Pakistan, paving the way for Pakistan to become the 51st party to the ECT. Likewise, the accession of The Islamic Republic of Afghanistan was approved at the Eighteenth Meeting of the Energy Charter Conference in December 2007.

capital markets, and transfer of technology, its cornerstone is its protection of foreign investment.<sup>2</sup> The ECT contains investment protections that are commonly found in bilateral investment treaties (BITs), such as fair and equitable treatment; prohibition of discriminatory measures; most-favored-nation treatment; and payment of prompt, adequate, and effective compensation for any nationalization or expropriation. It also contains an important mechanism that allows private investors to enforce those protections against Contracting Parties through binding arbitration.

This chapter contains some brief remarks on the Treaty's genesis. Each subsequent section focuses on a different aspect of the Treaty's investment-related features, including the definitions of "Investor" and "Investment" in Article 1 of the ECT, the denial of benefits provision in Article 17(1), the Treaty's substantive investment protections in Part III, the dispute resolution mechanisms in Articles 26 and 27, the so-called "fork-in-the-road" provision in Article 26(3)(B)(i), the provision on provisional application in Article 45, and the carve-out for taxation in Article 21.<sup>3</sup>

Where useful, this chapter compares the Treaty's text with analogous provisions in other investment agreements. In particular, textual comparisons are made with the North American Free Trade Agreement (NAFTA)—a pivotal multilateral agreement negotiated nearly contemporaneously with the ECT—and the Dominican-Republic-Central America Free Trade Agreement (CAFTA)—a modern agreement whose investment protections are informed by over a decade of experience with investor-state arbitrations.

This chapter also addresses relevant arbitral decisions under the ECT and other agreements, including the award on jurisdiction and admissibility in the three arbitrations brought by the majority shareholders in Yukos Oil Corporation against the Russian Federation. This landmark decision—holding that the Russian Federation is bound by the Treaty despite the fact that the Treaty was not ratified by the Russian Duma, and clarifying a number of provisions of the ECT—was issued on November 30, 2009.<sup>4</sup>

## THE MAKING OF THE ENERGY CHARTER TREATY

The end of the Cold War heralded an unprecedented opportunity for Western European states to forge stronger economic bonds with Eastern Europe and the Union of Soviet Socialist Republics (USSR) and to support those states in their transition to market economies. Western European states were concerned over the security of their energy supplies. Eastern European states were in dire need of capital and

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2 Energy Charter Treaty, A Reader's Guide, p. 19.

3 This article does not purport to exhaustively address the provisions of the ECT, which have been the subject of intensive academic scrutiny. See, in particular, the seminal work edited by the late Professor THOMAS WALDE, *THE ENERGY CHARTER TREATY, AN EAST-WEST GATEWAY FOR INVESTMENT AND TRADE* (Kluwer Law Int'l, London/The Hague/Boston 1996).

4 Shearman & Sterling LLP represented the majority shareholders in these proceedings.

technology to exploit their rich energy sources, particularly in Russia, Kazakhstan, and Azerbaijan.<sup>5</sup>

Against this backdrop, at the June 1990 meeting of the European Council in Dublin, the Dutch Prime Minister, Ruud Lubbers, proposed the idea of a “European Energy Community” to promote East-West cooperation in the energy sector.<sup>6</sup> The Commission of the European Communities undertook a study of how to implement this idea, proposing a “European Energy Charter” in February 1991. The Charter, which is essentially a nonbinding declaration of principles, was negotiated in 1991 among more than 50 states (including some non-European states such as Canada, the United States, Australia, and Japan) and the European Communities. It was signed at The Hague on December 17, 1991.

Before the Charter was even signed, however, the Charter Conference had already begun negotiating a “Basic Agreement”—which became the Energy Charter Treaty—to implement the principles and objectives of the European Energy Charter on a binding basis.<sup>7</sup> The ECT negotiations faced numerous hurdles, both between Eastern and Western states and among OECD members.<sup>8</sup> The negotiations came to a close in mid-1994, and the ECT was signed in Lisbon on December 17, 1994, with the objective “to ensure the creation of a ‘level playing field’ for energy sector investments throughout the Charter’s constituency, with the aim of reducing to a minimum the non-commercial risks associated with energy-sector investments.” Among the signatories to the 1991 European Energy Charter, only two states, Canada and the United States, did not sign the ECT.<sup>9</sup>

The resulting Treaty is a Byzantine collection of eight “Parts,” fourteen “Annexes,” five “Conference Decisions,” and numerous “Understandings,” “Declarations,” and interpretative statements that were made by the chairman of the ECT Conference at the

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5 See, e.g., R. Lubbers, *Foreword*, in *THE ENERGY CHARTER TREATY, AN EAST-WEST GATEWAY FOR INVESTMENT AND TRADE* xiii–xvii (T. Wälde ed., Kluwer Law Int’l, London/The Hague/Boston 1996).

6 Final Act of the European Energy Charter Conference.

7 See C. Bamberger et al., *The Energy Charter Treaty in 2000*, in *ENERGY LAW IN EUROPE: NATIONAL EU AND INTERNATIONAL LAW AND INSTITUTIONS*, section II.1 (M. Roggenkamp et al., eds., Oxford University Press 2001); see also T. Wälde, *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*, 29(5) *J. WORLD TRADE* 5 (1995); *THE ENERGY CHARTER TREATY, AN EAST-WEST GATEWAY FOR INVESTMENT AND TRADE* 251, 271 *et seq.* (T. Wälde ed., Kluwer Law Int’l, London/The Hague/Boston 1996).

8 C. Bamberger et al., *The Energy Charter Treaty in 2000*, in *ENERGY LAW IN EUROPE: NATIONAL EU AND INTERNATIONAL LAW AND INSTITUTIONS*, section II.2. (M. Roggenkamp et al., eds., Oxford University Press 2001).

9 On why the United States ultimately declined to sign the Treaty, see W. Fox, *The United States and the Energy Charter Treaty: Misgivings and Misperceptions*, in *THE ENERGY CHARTER TREATY, An East-West Gateway for Investment and Trade* 194 *et seq.* (T. Wälde ed., Kluwer Law Int’l, London/The Hague/Boston 1996); Emmanuel Gaillard, *How does the so-called ‘fork-in-the-road’ provision in Article 26(3)(b)(i) of the Energy Charter Treaty work? Why did the United States decline to sign the Energy Charter Treaty?*, in *INVESTMENT PROTECTION AND THE ENERGY CHARTER TREATY* 215 *et seq.* (G. Coop and C. Ribeiro eds., Juris Publishing 2008).

time of the Treaty's adoption.<sup>10</sup> In addition, several of the Treaty's provisions are significantly more complex than analogous provisions in other investment agreements—a by-product of the competing interests among the 50-plus negotiating parties and the compromises that were necessary to bring the fragile negotiating process to a successful close.

## **“INVESTMENTS” AND “INVESTORS” COVERED BY THE ECT**

All treaties that provide for the protection of foreign investment define the investments and investors that qualify for that protection. These definitions are key to determining the scope of application of the Treaty's rights and obligations, as well as determining the jurisdiction *ratione personae* of arbitral tribunals.<sup>11</sup> Article 1(6) of the ECT contains a broad and open-ended list of every conceivable right or interest that is in the nature of an investment:

“Investment” means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:

- (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 the 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

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<sup>10</sup> See, e.g., C. Bamberger, *The Negotiation of the Energy Charter Treaty*, presentation at the “Investment Protection and the Energy Charter Treaty Conference,” Washington, D.C., May 18, 2007 (describing the Treaty as “user-unfriendly”).

<sup>11</sup> See generally K. Yannaca-Small, *Definition of Investor and Investment*, in INTERNATIONAL INVESTMENT AGREEMENTS (OECD 2008); See Chapter 11 of the present book, K. Yannaca-Small, *Definition of “Investment”: An Open-ended Search for a Balanced Approach*; B. Legum, *Defining Investment and Investor: Who is Entitled to Claim?*, 22 *ARB. INT’L* 521 (2006); Emmanuel Gaillard, *Investments and Investors Covered by the Energy Charter Treaty*, in INVESTMENT ARBITRATION AND THE ENERGY CHARTER TREATY 66 *et seq.* (C. Ribeiro ed., Juris Publishing 2006).

“Effective Date”) provided that the Treaty shall only apply to matters affecting such investments after the Effective Date.

“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.

Like the ECT, the CAFTA adopts a nonexhaustive definition of investment: “Investment means every asset that an investor owns or controls, directly or indirectly, that has the characteristic of an investment, including. [ . . . ]”<sup>12</sup> The NAFTA, by contrast, contains a closed definition of “investment,” with several express exclusions.<sup>13</sup> In practice, whether a treaty’s definition of investment is open-ended or closed rarely makes a difference given the broad manner in which investment is typically defined. A more meaningful distinction arises from the fact that the ECT and the CAFTA cover investment agreements and investment authorizations, whereas the NAFTA—somewhat unusually among modern treaties containing investment protections—does not.

The main limiting factor in Article 1(6) of the ECT is that it covers only investments “associated with an Economic Activity in the Energy Sector.” Article 1(5) defines Economic Activity in the Energy Sector as “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.”<sup>14</sup> What it means to be “associated with” such activity, however—and the necessary degree of such association that must exist for a dispute to fall under the ECT’s dispute resolution provisions—is not clearly articulated in the Treaty.<sup>15</sup>

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12 Article 10.28 CAFTA.

13 Article 1139 NAFTA.

14 The Final Act of the European Energy Charter Conference provides the following examples 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 Materials and Products, 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.

15 See Emmanuel Gaillard, *Investments and Investors Covered by the Energy Charter Treaty*, in INVESTMENT ARBITRATION AND THE ENERGY CHARTER TREATY 66 *et seq.* (C. Ribeiro ed., Juris Publishing 2006).

The tribunal in the Yukos arbitrations read Article 1(6)(b) of the ECT as containing the widest possible definition of an interest in a company with no indication that the drafters of the ECT intended to limit ownership to “beneficial” ownership, as suggested by the Russian Federation. The tribunal rejected the Russian Federation’s arguments that the shareholdings in Yukos did not qualify as protected “Investment.” It also noted that “the definition of investment in Article 1(6) of the ECT does not include any additional requirement with regard to the origin of capital or the necessity of an injection of foreign capital.”<sup>16</sup>

Finally, by extending the definition of investment to any “right conferred by [ . . . ] contract” to undertake economic activities, Article 1(6)(f) appears to embrace ordinary sales transactions and trade-related activities. The arbitral tribunal in *Petrobart Ltd. v. The Kyrgyz Republic* confirmed this interpretation, concluding that the claimant’s claim for payment under an ordinary sales agreement for gas condensate constituted a covered “investment” within the meaning of Article 1(6)(f).<sup>17</sup>

In contrast, some other treaties expressly exclude such transactions from the definition of investment. Article 1139 of the NAFTA, for example, excludes “claims to money that arise solely from [ . . . ] commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party.”<sup>18</sup> In the *Canadian Cattlemen for Fair Trade* case, the NAFTA Chapter Eleven tribunal dismissed claims challenging the United States’ imposition of a ban on the importation of cattle due to concerns over bovine spongiform encephalopathy (BSE, or Mad-Cow Disease).<sup>19</sup> The tribunal concluded that “NAFTA Chapter Eleven was not intended to cover simple cross-border trading interests” and that “something more permanent—such as a commitment of capital or other resources in the territory of a Party to economic activity in such territory—is necessary for a contractual claim for money based on cross-border trade to rise to the level of an investment.”<sup>20</sup>

Like other treaties, the ECT also defines the type of “Investor” who qualifies for the Treaty’s benefits. Article 1(7) provides:

“Investor” means:

(a) with respect to a Contracting Party:

(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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16 *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, Interim Award on Jurisdiction and Admissibility (November 30, 2009) (Yukos Interim Award), para. 431.

17 *Petrobart Ltd. v. The Kyrgyz Republic*, Case No. 126/2003, Arbitration Institute of the Stockholm Chamber of Commerce, Award, March 29, 2005.

18 Article 1139 also excludes “the extension of credit in connection with a commercial transaction, such as trade financing, other than [certain loans to an enterprise].” The CAFTA likewise provides in footnote 9 of Chapter 10 that “claims to payment that are immediately due and result from the sale of goods or services are not investments.”

19 *Canadian Cattlemen for Fair Trade v. United States*, NAFTA Chapter Eleven/UNCITRAL, Award on Jurisdiction, January 28, 2008.

20 *Ibid.*, paras. 142, 144.

(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.

Accordingly, for a natural person to benefit from the Treaty, he or she must either be a citizen, national, or permanent resident of a Contracting Party. For a corporation to qualify for Treaty benefits, it need only be organized under the laws of a Contracting State. Article 1(7) imposes no further requirements with respect to shareholding, management, *siege social* or location of its business activities.

As the tribunal in the Yukos arbitrations noted, for example, “[o]n its face, Article 1(7)(a)(ii) of the ECT contains no requirement other than that the claimant company be duly organized in accordance with the law applicable in a Contracting Party.”<sup>21</sup> Likewise, in *Plama v. Bulgaria*, the ECT tribunal held that “[t]he Claimant is an ‘Investor of another Contracting Party’ within the definition provided by Article 1(7)(a)(ii) ECT, being a company organized in accordance with the law applicable in Cyprus,” and that it was “irrelevant who owns or controls the Claimant at any material time.”<sup>22</sup>

## DENIAL OF BENEFITS

The broad protections afforded to legal entities in Article 1 of the ECT are potentially qualified by the ability of a Contracting Party to exclude certain claims under

<sup>21</sup> *Yukos interim Award*. Para. 411.

<sup>22</sup> *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, February 8, 2005, 20(1) ICSID REV., p. 262, paras. 124 and 128. Similarly, in its partial award of March 17, 2006, the tribunal in *Saluka Investments BV (the Netherlands) v. The Czech Republic*, noted that it had “some sympathy for the argument that a company which has no real connection with a State party to a BIT [. . .] should not be entitled to invoke the provisions of that treaty,” but that the treaty “required only that the claimant-investor should be constituted under the laws of the [. . .] The Netherlands, and it is not open to the Tribunal to add other requirements which the parties could themselves have added but which they omitted to add.” In contrast, some other multilateral treaties, such as the ASEAN Agreement and the Colonia Protocol of the MERCOSUR Agreement, expressly limit their coverage to companies that are controlled or owned by investors in a contracting state. *See* Agreement among the Government of Brunei Darussalam, The Republic of Indonesia, Malaysia, The Republic of the Philippines, The Republic of Singapore, and the Kingdom of Thailand for the Promotion and Protection of Investments (1987) (“ASEAN Agreement”), Art. 1(2) (where company means “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”); Protocol of Colonia for the Promotion and Reciprocal Protection of Investments in MERCOSUR, Art. 1(2) (unofficial translation) (“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 [. . .]”).



Article 17(1). Article 17(1), entitled “Non-Application of Part III in Certain Circumstances,” contains the ECT’s so-called denial of benefits provision. It “reserves the right” of the Contracting Parties to deny the substantive treaty protections in Part III to “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, which derives from the U.S. treaty context, is intended to enable states which so desire to prevent nationals of a non-Contracting Party from opportunistically incorporating a “mailbox” company in a Contracting Party so as to indirectly benefit from the protection of the ECT.<sup>23</sup>

The tribunal in the *Plama* case shed important light on the operation of this provision. In considering Bulgaria’s jurisdictional objections, the tribunal held that Article 17(1) contains a reservation of rights mechanism which needs to be exercised to be effective:

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.<sup>24</sup>

The tribunal further held that the invocation of the right in Article 17(1) operates only prospectively from the date of invocation and not retrospectively. The tribunal relied on both the text and the object and purpose of the Treaty, noting as follows:

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’s exercise. 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. [. . .] In the Tribunal’s view, therefore, the object and purpose of the ECT suggest that the right’s exercise should not have retrospective effect.<sup>25</sup>

The tribunal thus concluded that Bulgaria’s exercise of its right under Article 17(1) only affected the claimant’s rights under Part III prospectively from the date of invocation. The tribunal thus proceeded to hear the merits of the case, reserving other issues relating to Article 17(1) to that phase.<sup>26</sup>

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23 P. Pinsolle, *The Dispute Resolution Provisions of the Energy Charter Treaty*, INT ALR 86 (2007).

24 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, February 8, 2005, paras. 155, 157.

25 *Ibid.*, paras. 161–62.

26 After the hearing of the case on the merits, the *Plama* tribunal held that Bulgaria could not rely on Article 17(1) of the ECT because the claimant was owned and controlled by a national of a

The Yukos tribunal agreed with the core propositions in *Plama*. It first clarified that Article 17(1) does not implicate the tribunal’s jurisdiction because it provides for the denial of the advantages of the substantive provisions in Part III of the ECT, and not the provisions for dispute settlement in Part V. The tribunal considered the issue to be one of “merits,” although it addressed the application of Article 17(1) as a preliminary issue in light of the fact that both parties treated the issue as one of admissibility.<sup>27</sup>

The tribunal next determined that “Article 17(1) does not deny *simpliciter* the advantages of Part III of the ECT—as it easily could have been worded to do.” Rather, Article 17(1) merely “‘reserves the right’ of each Contracting Party to deny the advantages of that Part to such an entity,” which right must be exercised to be effective.<sup>28</sup>

Referring to the statements made by the Respondent in its written submissions, the arbitral tribunal considered that, to the extent the statements in the respondent’s memorial could be considered to be an exercise of the Russian Federation’s right under Article 17(1), it could only have *prospective* effect from that date. To treat the denial as retrospective, the tribunal opined, would be incompatible with the Treaty’s object and purpose of promoting and protecting investments.<sup>29</sup>

Although the issue was moot given the tribunal’s rulings noted above, the tribunal also rejected the Russian Federation’s contentions that control of the claimants resided with individuals of Russian nationality, and that Russia was a “third state” for purposes of Article 17(1).<sup>30</sup> The tribunal found that “[t]he Treaty clearly distinguishes between a Contracting Party (and a signatory), on the one hand, and a third State, which is a non-Contracting Party, on the other,” a conclusion that it found was supported by the *travaux préparatoires*, which “demonstrate that the term ‘third state’ was substituted for the term ‘non-Contracting Party.’”<sup>31</sup>

Similar to the ECT, the NAFTA, CAFTA, and many U.S. BITs provide that the State Parties “may” deny the benefits of the treaty to an investor of another Party that is an enterprise of such Party where the enterprise has no substantial business activities in the territory of the Party in which it is incorporated, and persons of a non-Party, or of the

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Contracting Party to the ECT. *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award, August 27, 2008, para. 95.

27 *Yukos Interim Award*, paras. 440-42; see, e.g., P. Pinsolle, *The Dispute Resolution Provisions of the Energy Charter Treaty*, INT ALR 86 (2007) (noting that an objection based on Article 17(1) of the ECT does not implicate the jurisdiction of the tribunal but rather the admissibility of the claim).

28 *Yukos Interim Award*, para. 455.

29 *Ibid.*, para. 457. The ECT tribunal in *AMTO v. Ukraine* likewise confirmed that a state seeking to exercise its right to deny benefits under Article 17(1) of the ECT would need to prove “the factual prerequisites” of that article. The *AMTO* tribunal further noted that the “substantial business activities” prerequisite “means ‘of substance, and not merely of form.’ It does not mean ‘large,’ and the materiality not the magnitude of the business activity is the decisive question.” *Limited Liability Company AMTO v. Ukraine*, Case No. 080/2005, Arbitration Institute of the Stockholm Chamber of Commerce, Final Award, March 26, 2008, para. 69.

30 *Yukos Interim Award*, para. 537.

31 *Ibid.*, para. 543.

denying Party, own or control the enterprise.<sup>32</sup> Unlike Article 17(1) of the ECT, however, the denial of benefits provision in the NAFTA, CAFTA, and many U.S. BITs subjects the right to deny treaty benefits to the requirement that the denying Party first notify and consult with the other Party or Parties, adding yet another hurdle to its effective invocation.<sup>33</sup>

## SUBSTANTIVE INVESTMENT PROTECTIONS

Part III of the ECT sets forth the substantive rights and protections that Contracting Parties are obligated to accord to foreign investors and their investments. Article 10, entitled “Promotion, Protection and Treatment of Investments,” contains some of the Treaty’s most important and broad-reaching investment protections. Paragraph (1) of that article provides as follows:

Each Contracting Party shall, in accordance with the provisions of this Treaty, 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. 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. 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 provision makes clear that Contracting Parties are not merely forbidden from taking unreasonable actions to harm foreign investors and their investments; they are affirmatively obligated to create the conditions necessary for those investments to exist and to thrive.

Debate has surrounded how the fair and equitable treatment standard in paragraph (1) differs from “constant protection and security” and “unreasonable or discriminatory measures.” The arbitral tribunal in *Petrobart*, for example, simply assumed that fair

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32 Prior to the 1990s, denial of benefits provisions in U.S. BITs provided, like Article 17(1) of the ECT, that each Party “reserves the right” to deny the treaty benefits to certain enterprises.

33 See NAFTA Art. 1113(1) (“Subject to prior notification and consultation in accordance with Articles 1803 (Notification and Provision of Information) and 2006 (Consultations), a Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such Party and to investments of such investors if investors of a non-Party own or control the enterprise and the enterprise has no substantial business activities in the territory of the Party under whose law it is constituted or organized.”); see also CAFTA Art. 10.12(1); Treaty Between the United States of America and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment (signed Nov. 2005), Art. 17; Treaty Between the United States of America and the Republic of Zaire Concerning Reciprocal Encouragement and Protection of Investment (signed Aug. 1984), Art. I(b)(ii).

and equitable treatment was redundant with those other standards.<sup>34</sup> While these standards may overlap to some degree, that Article 10(1) lists them separately suggests that the drafters considered them to be distinct, at least conceptually. The protections in Article 10(1)—particularly the duty to refrain from unreasonably impairing an investor’s enjoyment of its investment—are in any case exceptionally broad in their formulation.

Also noteworthy is the obligation to accord investments treatment in accordance with international law, “including treaty obligations.” An Understanding in the Final Act of the European Energy Charter Conference clarifies that this reference excludes “decisions taken by international organizations, even if they are legally binding, or treaties which entered into force before 1 January 1970.” Read literally, this provision seemingly allows an investor or a Contracting Party to submit a claim under the ECT based on the alleged breach of an entirely different treaty, such as a trade agreement or a human rights convention, so long as the alleged breach implicates the “treatment” of an investment (and the relevant treaty postdates 1969). In this respect, the ECT is distinguishable from some other treaties that expressly limit the treatment obligations to those accorded under customary—but not *conventional*—international law.<sup>35</sup>

The last sentence of Article 10(1) of the ECT contains what is often referred to as an “umbrella clause,” and obliges a Contracting Party to observe “any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.” This provision permits a breach of an ordinary contract to be treated as a breach of the ECT. This particular umbrella clause is unusual in that it allows Contracting Parties, at the time of signing, to withhold their consent to arbitrate disputes arising under this provision by listing themselves in Annex IA.<sup>36</sup>

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34 Petrobart v. The Kyrgyz Republic, Arbitration Institute of the Stockholm Chamber of Commerce, Case No. 126/2003, Award, March 29, 2005, p. 76 (“The Arbitral Tribunal does not find it necessary to analyse the Kyrgyz Republic’s action in relation to the various specific elements in Article 10(1) of the Treaty but notes that this paragraph in its entirety is intended to ensure a fair and equitable treatment of investments.”). On fair and equitable treatment generally, see K. Yannaca-Small, *Fair and Equitable Treatment Standard in International Investment Law*, in INTERNATIONAL INVESTMENT LAW: A CHANGING LANDSCAPE 73 (OECD Publishing 2005); Chapter 16 of the present book: *Fair and Equitable Treatment: An Evolving Standard?*

35 Such is the case, for instance, with the NAFTA and the CAFTA. Article 1105(1) of the NAFTA requires the host state to accord investments of investors of another Party “treatment in accordance with international law, including fair and equitable treatment and full protection and security.” In July 2001, the NAFTA Free Trade Commission, which comprises cabinet-level representatives from each of the three NAFTA Parties, clarified that Article 1105(1) requires treatment in accordance with customary international law but does not permit an investor to file a claim based on the alleged breach of “a separate international agreement.” See Statement on NAFTA Article 1105 and the Availability of Arbitration Documents, July 31, 2001, B(3) (“A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).”). The CAFTA includes a similar clarification in Article 10.5(3).

36 See ECT Annex IA (“List of Contracting Parties Not Allowing an Investor or Contracting Party to Submit a Dispute Concerning the Last Sentence of Article 10(1) to International Arbitration (in Accordance with Articles 26(3)(C) and 27(2))”). Only three Contracting Parties,

It has been suggested that the reference in Article 10(1) to “any obligations [. . .] entered into” limits this clause’s coverage to *contractual* obligations, whereas umbrella clauses in other treaties that refer more generally to all obligations “assumed” by the state may extend to unilateral undertakings, such as obligations under foreign investment legislation.<sup>37</sup> The tribunal in *SGS Pakistan*, however, considered the similar language “commitments entered into” in the Switzerland-Pakistan BIT to be broad enough to embrace unilateral administrative acts.<sup>38</sup> Consistent with that decision, the phrase “entered into” in Article 10(1) of the ECT does not necessarily limit the state’s obligation to contracts but rather extends to all types of general arrangements that may be “entered into” in a general sense, including investment authorizations, licenses, and permits.

Article 10(7) of the ECT establishes the better of national or most-favored-nation (MFN) treatment.<sup>39</sup> Article 10(2) clarifies that national treatment and MFN treatment obligations apply only with respect to investments that have already been made in the territory of a Contracting Party. With respect to the “Making of Investments” (defined as “establishing new investments, acquiring all or part of existing investments or moving into different fields of Investment activity”), however, Contracting Parties need only “endeavor” to accord the better of national treatment or MFN. This type of obligation is often referred to as a “soft-law” or “best efforts” obligation.<sup>40</sup> In contrast, the NAFTA, CAFTA and several U.S. BITs apply binding national treatment and MFN treatment obligations to the entire lifecycle of an investment, starting with its “establishment” or “acquisition.”<sup>41</sup>

Article 10(4) of the ECT envisioned that a supplementary treaty would extend binding national treatment and MFN obligations to the preinvestment phase. This compromise solution was necessitated by, on the one hand, the insistence by the United States that investors have preestablishment rights, and on the other hand, objections by Russia and other transitional states that did not yet have preinvestment laws in place and felt

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Australia, Hungary, and Norway, have exercised that option. Although Canada is listed in Annex IA, it did not sign the ECT.

37 See, e.g., K. Yannaca-Small, *Interpretation of the Umbrella Clause in Investment Agreements* 10-1 (OECD 2006); Chapter 19 of the present book; K. Yannaca-Small: *What about this “Umbrella Clause”?*

38 *SGS Société Générale de Surveillance, S.A. v. Pakistan*, ICSID Case No. ARB/01/13, Decision on Jurisdiction, August 6, 2003, (2003) 18 ICSID REV.-FILJ. 307, 361 *et seq.*

39 ECT Art. 10(7) (“Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any other Contracting Party or any third state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable.”).

40 Paragraph (6)(b) allows a Contracting Party at any time to “make a voluntary commitment to accord to Investors of other Contracting Parties, as regards the Making of Investments in some or all Economic Activities in the Energy Sector in its Area,” the better of national treatment or MFN treatment by listing such commitments in Annex VC of the Treaty. To date, no Contracting Party has listed any such commitments in Annex VC.

41 Articles 1102(1), 1103(1) NAFTA; Article 10.3, 10.4 CAFTA.

disadvantaged by OECD countries that were seeking to “grandfather” their own exceptions to national treatment. Negotiations on this supplementary treaty began in 1996 but were halted in 2002 pending the outcome of discussions in the World Trade Organization regarding a multilateral framework for foreign direct investment.<sup>42</sup>

Article 13 of the ECT contains protections against unlawful expropriations or nationalizations. Paragraph (1) of that article provides:

Investments of Investors of a Contracting Party in the Area of another Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation [ . . . ] except where such Expropriation is:

- (a) for a purpose which is in the public interest;
- (b) not discriminatory;
- (c) carried out under due process of law; and
- (d) accompanied by the payment of prompt, adequate and effective compensation.

Article 13 adopts the familiar “Hull Formula” for prompt, adequate, and effective compensation, first articulated in 1936 by U.S. Secretary of State Cordell Hull in response to Mexico’s nationalization of U.S. petroleum companies. By referring to “measures having effect equivalent to nationalization or expropriation,” Article 13 also protects against “indirect” or “regulatory” expropriations, or interferences by the state that have the effect of gradually eroding the investor’s property interests.

Article 13 of the ECT is not distinguishable in any significant respect from the expropriation provision in Article 1110 of NAFTA. The CAFTA, however, reflects a more cautious approach with respect to foreign investors’ rights to challenge a host state’s nondiscriminatory regulatory actions that are ostensibly taken in the public interest. Annex 10-C of the CAFTA provides that “[e]xcept in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.”<sup>43</sup>

## DISPUTE SETTLEMENT

Article 26 of the ECT sets out the procedures for an investor of a Contracting Party to submit a dispute to arbitration under the Treaty relating to an investment in the area of another Contracting Party. Article 26(1) specifies that it applies to:

Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an

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<sup>42</sup> See Energy Charter Secretariat Web site, section on “Supplementary Treaty.”

<sup>43</sup> Annex 10-C of the CAFTA further provides that the economic impact of a regulation alone does not establish that an indirect expropriation has occurred and that consideration must be given as well to the character of the government action at issue. The annex also clarifies that “[a]n action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in investment.”

alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably [ . . . ].

If the dispute cannot be settled amicably, the investor may submit it to binding dispute resolution pursuant to the remainder of Article 26. By specifying that a dispute must concern a breach of an investment protection in Part III, Article 26 is potentially narrower than some other arbitration agreements that cover, for example, “all disputes arising out of an investment.”<sup>44</sup>

Under Article 26(2), the investor may choose between submitting its claim (i) “to the courts or administrative tribunals of the Contracting Party to the dispute,” (ii) “in accordance with any applicable, previously agreed dispute settlement procedure,” or (iii) in accordance with the remainder of Article 26. The provision for “any applicable, previously agreed dispute settlement procedure” leaves open the possibility that an investor and a state might enter into an *ad hoc* agreement that would embrace disputes arising out of the ECT as well as other instruments or agreements, although the umbrella clause in Article 10(1) will render the use of that mechanism limited in practice.<sup>45</sup> Article 26(3)(b)(i) contains a so-called “fork-in-the-road” provision that potentially bars an investor’s claim that was previously submitted to the local courts or administrative tribunals, or in accordance with any applicable, previously agreed dispute settlement procedure. That provision is addressed in further detail in the following section.

The investor is also afforded a wide choice under Article 26(4) of submitting the dispute to (i) the International Centre for Settlement of Investment Disputes (ICSID), (ii) the ICSID Additional Facility, (iii) an *ad hoc* tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL), or (iv) an arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce (SCC). The investor’s choice among these institutions and rules can have a significant impact on its claim. For example, an investor that chooses ICSID arbitration must satisfy the requirements of the Washington Convention (including the requirement under Article 25 that there exists a legal dispute arising directly out of an investment), and any challenge to the arbitral award must be made before an *ad hoc* committee and cannot be made before the local courts of the state in which the arbitration takes place. The ECT does not designate an appointing authority in the event the claimant opts for *ad hoc* arbitration under the UNCITRAL rules. As a result, pursuant to the UNCITRAL rules themselves, the secretary-general of the Permanent Court of Arbitration must nominate the appointing authority.<sup>46</sup>

Finally, Article 26(8) provides that “[a]n award of arbitration concerning a measure of a sub-national government or authority of the disputing Contracting Party shall provide that the Contracting Party may pay monetary damages in lieu of any other remedy granted.” No similar option is accorded with respect to measures taken at the national level. This provision suggests that Contracting Parties may be bound to comply with

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44 For further discussion of this point, see Emmanuel Gaillard, *Treaty-based jurisdiction: broad dispute resolution clauses*, 68 N.Y. L.J. vol. 234, (2005). See also P. Pinsolle, *supra* n. 23, p. 82.

45 See P. Pinsolle, *supra* n. 23, p. 83.

46 See Articles 6(2), 7(2) UNCITRAL.

any award for “other remedies”—including the remedy of specific performance—with respect to government measures taken at the national level. In theory, then, an ECT tribunal could order the repeal of national legislation or of a judicial decision taken at the national level.<sup>47</sup> This contrasts with NAFTA and CAFTA, which do not distinguish between national and subnational measures, and both provide that a tribunal may “make a final award against a Party” only for “monetary damages and any applicable interest,” or for “restitution of property, in which case the award shall provide that the disputing Party may pay monetary damages and any applicable interest in lieu of restitution.”<sup>48</sup>

Article 27 contains the Treaty’s state-to-state dispute resolution mechanism. It provides for UNCITRAL arbitration in the event Contracting Parties cannot settle their differences through diplomacy. Paragraph (2), however, removes from the purview of Article 27 any dispute concerning the interpretation or application of Article 6 (Competition) or Article 19 (Environmental Aspects), as well as any claims under the umbrella clause in Article 10(1) with respect to states that opted not to apply that clause. Two additional exceptions are found in Article 28: “A dispute between Contracting Parties with respect to the application or interpretation of Article 5 [Trade-Related Investment Measures] or 29 [Interim Provisions on Trade-Related Matters] shall not be settled under Article 27 unless the Contracting Parties parties to the dispute so agree.” Accordingly, while Article 27 may in principle be broader than Article 26 in that it is not expressly limited to investment-related disputes, it contains several noteworthy exceptions to its scope of application. In contrast, there are very few exceptions to the state-to-state dispute resolution mechanism contained in Chapter 21 of NAFTA, the most notable being for antidumping and countervailing duty matters, which are subject to a dedicated dispute resolution regime in a separate chapter of the treaty.<sup>49</sup>

## FORK IN THE ROAD

Like many treaties containing investment protections, the Energy Charter Treaty includes a “fork-in-the-road” provision that may require a claimant to make an irrevocable choice of forum for its claim.<sup>50</sup> Specifically, Article 26(3)(b)(i) potentially bars an

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47 Arbitral tribunals constituted under similarly worded BITs have confirmed their belief that they are empowered to order such relief. In *Enron v. Argentina*, for example, the tribunal stated that “[a]n examination of the powers of international courts and tribunals to order measures concerning performance or injunction and of the ample practice that is available in this respect, leaves this tribunal in no doubt about the fact that these powers are indeed available.” *Enron Corp. and Ponderosa Assets, LP v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on Jurisdiction, January 14, 2004, para. 79; see also *Goetz and others v. Burundi*, ICSID Case No. ARB/95/3, Award, February 10, 1999, (2000) 15 ICSID REV.-FILJ 457, 516.

48 Article 1135(1) NAFTA; Article 10.26(1) CAFTA.

49 Article 2004 NAFTA.

50 Emmanuel Gaillard, *How does the so-called ‘fork-in-the-road’ provision in Article 26(3)(b)(i) of the Energy Charter Treaty work? Why did the United States decline to sign the Energy*



investor from submitting its claim to arbitration if the following conditions can be cumulatively demonstrated: (i) “the Investor party to the dispute”<sup>51</sup> (ii) “concern[ing] an alleged breach of an obligation of the [Contracting Party to the dispute] under Part III” of the ECT<sup>52</sup> (iii) has “previously submitted the dispute”<sup>53</sup> (iv) “to the courts or administrative tribunals of the Contracting Party to the dispute” or to “any applicable, previously agreed dispute settlement procedure.”<sup>54</sup>

Article 21(3)(b)(i), however, is not available to all Contracting Parties but only those that made a declaration that they wish to be listed in Annex ID, entitled “List of Contracting Parties not allowing an Investor to Resubmit the same dispute to International Arbitration at a later stage under Article 26 (in accordance with Article 26(3)(b)(i)).” Contracting Parties *not* listed in Annex ID have extended their unconditional consent to arbitrate a dispute under the Treaty, even if the same dispute has already been submitted elsewhere.<sup>55</sup>

Under Article 26(3)(b)(i), the mere “submission” of the dispute to the relevant forum can result in a forfeiture of the arbitral claim. In contrast, certain other treaties, including NAFTA and CAFTA, contain so-called “no U-turn” provisions that allow the prior submission of the dispute to another forum but require the investor to irrevocably waive the right to “continue” that proceeding as a condition to submitting a claim to treaty arbitration.<sup>56</sup>

Finally, Article 26(1) defines the relevant “dispute” narrowly as one that “concern[s] an alleged breach of an obligation of the [Respondent] under Part III” of the ECT. Accordingly, it bars only a prior dispute in which the claimant alleged a breach of the Energy Charter Treaty itself and not some other source of law. In contrast, the NAFTA and CAFTA require the claimant to broadly waive all proceedings referring to the same “measure” at issue in the treaty arbitration.<sup>57</sup> In practice, given the narrow scope

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*Charter Treaty?*, in INVESTMENT PROTECTION AND THE ENERGY CHARTER TREATY 215 *et seq.* (G. Coop & C. Ribeiro eds., Juris Publishing 2008).

51 Article 26(2) ECT.

52 *Ibid.*, Article 26(1).

53 *Ibid.*, Article 26(3)(b)(i).

54 *Ibid.*, Article 26(2)(a) & (b).

55 The arbitral tribunal in *Petrobart Ltd. v. The Kyrgyz Republic*, for example, confirmed that the claimant could not be barred from submitting a claim to arbitration under the ECT by virtue of the “fork-in-the-road” provision in Article 26(3)(b)(i) because “the Kyrgyz Republic chose not to be listed in Annex ID of the Treaty.” *Petrobart Ltd. v. The Kyrgyz Republic*, Arbitration Institute of the Stockholm Chamber of Commerce Arbitration, Case No. 126/2003, Final Award, March 29, 2005, p. 56. Slightly fewer than half of the Energy Charter Treaty’s signatories opted to retain their rights under Article 26(3)(b)(i) and are listed in Annex ID. Those signatories are Australia, Azerbaijan, Bulgaria, Croatia, Cyprus, the Czech Republic, the European Communities, Finland, Greece, Hungary, Ireland, Italy, Japan, Kazakhstan, Mongolia, Norway, Poland, Portugal, Romania, the Russian Federation, Slovenia, Spain, Sweden, and Turkey.

56 Article 1121(1)(b) NAFTA; Article 10.18(2)(b) CAFTA.

57 NAFTA Art. 1121(1)(b) & 2(b) (providing that a claimant may submit a claim to arbitration only if it waives its right to pursue “any proceeding with respect to the measure of the disputing Party that is alleged to be a breach [of the NAFTA]”); CAFTA Art. 10.18(2)(b) (similarly requiring waiver of “any proceeding with respect to any measure alleged to

of Article 26(1) of the ECT, it will likely be rare that Contracting Parties will successfully invoke that article to bar a claim.

In the Yukos arbitrations, for example, the tribunal rejected the Russian Federation's argument that the claimants' claims were barred under 26(3)(b)(i) of the ECT because various other proceeding had been brought by other entities before the Russian courts and the European Court of Human Rights. The tribunal held that the Russian Federation has failed to satisfy the so-called "triple identity test" under 26(3)(b)(i), which requires a claimant to demonstrate "identity of parties, cause of action and object of the dispute."<sup>58</sup>

The tribunal also rejected the Russian Federation's argument that the tribunal should look beyond the triple identity test in this case because accepting jurisdiction would effectively mean that the tribunal would sit in judgment over the various Russian courts siezed of the proceedings referred to by the respondent. The tribunal held that the purpose of the claim was not to review any decisions by Russian courts, but rather "to determine whether Respondent breached Claimant's rights under the ECT."<sup>59</sup>

## PROVISIONAL APPLICATION

Provisional application is a widely used device in international treaty practice by which states give effect to a treaty before it has entered into force.<sup>60</sup> Article 45 of the ECT thus provides, in pertinent part:

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

(2)(a) Notwithstanding paragraph (1) any signatory may, when signing, deliver to the Depository a declaration that it is not able to accept provisional application. The obligation contained in paragraph (1) shall not apply to a signatory making such a declaration. Any such signatory may at any time withdraw that declaration by written notification to the Depository.

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constitute a breach [of the CAFTA]."). As the NAFTA tribunal in *Waste Management* explained with respect to pending domestic proceedings, "when both legal actions have a legal basis derived from the same measures, they can no longer continue simultaneously." *Waste Management, Inc. v. United Mexican States*, Case No. ARB(AF)/98/2, Award, June 2, 2000, (2003) ICSID REV.-FILJ 214, 235-36. The United States-Chile Free Trade Agreement arguably contains an even broader waiver requirement, conditioning jurisdiction on the investor's forfeiture of its right to pursue any claim "with respect to the *events* alleged to give rise to the claimed breach" of the Treaty. United States-Chile FTA, Art. 10.17(2)(b) (emphasis added).

58 *Yukos Interim Award*, para. 592.

59 *Ibid.*, para. 598-99.

60 Article 25(1) of the Vienna Convention on the Law of Treaties 1969 allows for the provisional application of treaties in stipulating: "A treaty or a part of a treaty is applied provisionally pending its entry into force if: (a) the treaty itself so provides; or (b) the negotiating states have in some other manner so agreed."

(b) Neither a signatory which makes a declaration in accordance with subparagraph (a) nor Investors of that signatory may claim the benefits of provisional application under paragraph (1).

(3)(a) Any signatory may terminate its provisional application of this Treaty by written notification to the Depository of its intention not to become a Contracting Party to the Treaty. Termination of provisional application for any signatory shall take effect upon the expiration of 60 days from the date on which such signatory's written notification is received by the Depository.

(b) In the event that a signatory terminates provisional application under subparagraph (a), the obligation of the signatory under paragraph (1) to apply Parts III and V with respect to any Investments made in its Area during such provisional application by Investors of other signatories shall nevertheless remain in effect with respect to those Investments for twenty years following the effective date of termination, except as otherwise provided in subparagraph (c).

(c) Subparagraph (b) shall not apply to any signatory listed in Annex PA. A signatory shall be removed from the list in Annex PA effective upon delivery to the Depository of its request therefor.

Contracting Parties thus “agree” to apply the ECT provisionally unless they make a declaration that they are “unable to accept” provisional application. Signatories may terminate provisional application by giving written notification to the depository, and termination then becomes effective 60 days later. As an indication of the importance of provisional application, any terminating party is still bound to honor the Treaty's investment protections and dispute resolution obligations with respect to existing investments for an additional 20 years, unless the signatory opts out of that obligation by listing itself in Annex PA.<sup>61</sup>

To date, four arbitral tribunals have addressed Article 45 of the ECT. In its Decision on Jurisdiction of February 8, 2005, the arbitral tribunal in *Plama*, for example, clarified that the application of the ECT on a provisional basis extends to the investor-state mechanism in Article 26:

Article 45(1) ECT provides that each signatory agrees to apply the treaty provisionally pending its entry into force for such 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.<sup>62</sup>

In its final award of March 29, 2005, the tribunal in *Petrobart* addressed the issue whether a company incorporated in Gibraltar could submit a claim against the Kyrgyz Republic where the United Kingdom had not listed Gibraltar as a territory applying the Treaty provisionally at the time the United Kingdom ratified it (although it had done so at the time it signed the ECT).<sup>63</sup> The tribunal concluded that provisional application

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61 The only states listed in Annex PA include The Czech Republic, Germany, Hungary, Lithuania, Poland, and Slovakia.

62 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, February 8, 2005, 20(1) ICSID Rev., para. 140.

63 *Petrobart Ltd. v. The Kyrgyz Republic*, Arbitration Institute of the Stockholm Chamber of Commerce Arbitration, Case No. 126/2003, Final Award, March 29, 2005.

nonetheless continued in Gibraltar and that an investor from a state such as Gibraltar that applies the Treaty provisionally is entitled to submit a claim to arbitration under Article 26 of the ECT.<sup>64</sup>

In its decision on jurisdiction of July 6, 2007, the tribunal in *Ioannis Kardassopoulos v. Georgia*<sup>65</sup> shed further light on Article 45 of the ECT. In that case, the claimant, a Greek national, alleged that the Republic of Georgia had expropriated his concession for the construction of energy pipelines and infrastructure. The respondent relied on Article 1(6) of the ECT, which accords jurisdiction only over matters affecting investments after the “effective date,” which is defined as the later of the dates on which the ECT entered into force for Greece or Georgia. In both cases, that was the date the Treaty itself entered into force, April 16, 1998.<sup>66</sup> The respondent argued, *inter alia*, that because, on the claimant’s own case, the alleged expropriation was consummated before the effective date, the tribunal lacked jurisdiction *ratione temporis* over the claims.<sup>67</sup>

The tribunal first rejected the respondent’s contention that provisional application was merely “aspirational” in nature. While recognizing that provisional application was “not the same as entry into force,” the tribunal held that provisional application under Article 45(1) of the ECT obliged signatories to apply the whole Treaty as if it had entered into force:

It is “this Treaty” which is to be provisionally applied, *i.e.*, the Treaty as a whole and in its entirety and not just a part of it; and use of the word “application” requires that the ECT be “applied.” Since that application is to be provisional “pending its entry into force” the implication is that it would be applied on the same basis as would in due course result from the ECT’s (definitive) entry into force, and as if it had already done so. It follows that the language used in Article 45(1) is to be interpreted as meaning that each signatory State is obliged, even before the ECT has formally entered into force, to apply the whole ECT as if it had already done so.<sup>68</sup>

The tribunal observed that, in the context of provisional application, interpreting “entry into force” (and therefore the “effective date”) in Article 1(6) literally to refer only to *definitive* entry into force under Article 44 of the ECT would “strike at the heart of the clearly intended provisional application regime.”<sup>69</sup> The tribunal resolved this seeming conundrum by ascribing an “effective date” to provisional application—*i.e.*, the later of the dates on which the ECT became provisionally applicable in both Georgia and Greece.<sup>70</sup>

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64 *Ibid.*, pp. 62–63.

65 *Ioannis Kardassopoulos v. Georgia*, ICSID Case No. ARB/05/18, Decision on Jurisdiction, July 6, 2007.

66 *Ibid.*, para. 72.

67 *Ibid.*, paras. 71–73.

68 *Ibid.*, paras. 210–11.

69 *Ibid.*, para. 222.

70 *Ibid.*, para. 223. The tribunal noted that the parties’ arguments concerning reciprocity were irrelevant and that the need to consider the laws of both states arises directly from Article 1(6). *Ibid.*, para. 226.

The tribunal next rejected the claimant's argument that Georgia's failure to make a declaration under Article 45(2) is an acknowledgment that provisional application is consistent with its laws.<sup>71</sup> The tribunal noted that a Contracting Party may have reasons other than an inconsistency between provisional application and its domestic law for making an Article 45(2) declaration. It also held that a state that had such an inconsistency was entitled to rely on the "to the extent" clause in Article 45(1) without the need to make a declaration under Article 45(2), and indeed that there was no definitive link between Article 45(1) and 45(2):

There is no necessary link between paragraphs (1) and (2) of Article 45. A declaration made under paragraph (2) may be, but does not have to be, motivated by an inconsistency between provisional application and something in the State's domestic law; there may be other reasons which prompt a State to make such a declaration. Equally, a State whose situation is characterized by such inconsistency is entitled to rely on the proviso to paragraph (1) without the need to make, in addition, a declaration under paragraph (2). The Tribunal is therefore unable to read into the failure of either State to make a declaration of the kind referred to in Article 45(2) any implication that it therefore acknowledges that there is no inconsistency between provisional application and its domestic law.<sup>72</sup>

The tribunal nevertheless rejected the respondent's position that provisional application of the ECT was inconsistent with Georgian law. Specifically, the tribunal rejected the respondent's attempt to rely on a domestic law addressing provisional application that had come into force *after* the actions at issue and two other laws that provide simply that international treaties must enter into force to prevail over domestic Georgian law.<sup>73</sup>

The negotiating history to the ECT, however, suggests that the negotiators recognized the potential conflict between provisional application in Article 45(1) and the "effective date" in Article 1(6). On November 8, 1994, the head of the legal subgroup circulated an internal memorandum to the rest of the subgroup proposing that the following understanding be included in the Treaty to clarify that provisional application was effective from the date of signature and was therefore not subject to any "effective date":

WITH RESPECT TO ARTICLES 1(6) AND 45(1)

With regard to matters affecting Investments, it is intended, notwithstanding the provisions of Article 1(6) with respect to Effective Date, that the Treaty apply provisionally under Article 45(1) for a signatory which has not made a declaration in accordance with Article 45(2)(a), as if that signatory and the other signatories were Contracting Parties and the dates of their respective signatures were the dates of the Treaty's entry into force for them.

Subsequently, on November 29, 1994, the legal subgroup issued a Final Report to the Charter Conference (distributed as Message 278L) stating its belief that no

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71 *Ibid.*, paras. 22–28.

72 *Ibid.*, para. 228.

73 *Ibid.*, paras. 229–39.

Understanding was necessary because the language in Article 45 made sufficiently clear that the “effective date” in Article 1(6) was not applicable to provisional application:

We were asked to consider the need for a new Understanding to avoid any doubt that the ECT is intended to apply to investment during the period of provisional application in accordance with Article 45(1), notwithstanding the “Effective Date” in Article [1(6)]. A recently published law review article that was based on an early draft of the ECT questioned whether the “Effective Date” would preclude such application. Since that article was written, however, paragraph (3)(b) has been added to Article 45; in our opinion, the addition of paragraph (3)(b) to Article 45 eliminates any doubt that the drafters of the ECT intended it to apply provisionally to investment in accordance with Article 45(1), notwithstanding the “Effective Date.”

This aspect of the *travaux préparatoires* should make clear in any future disputes in which a similar issue arises that the drafters did not intend provisional application of the ECT to be subject to the “effective date” provision in Article 1(6).

Finally, in its interim award on jurisdiction and admissibility of November 30, 2009, the tribunal in the Yukos arbitrations rejected the Russian Federation’s challenge to jurisdiction based on Article 45(1) of the ECT.

The tribunal first concluded that a signatory State’s reliance on the “to the extent” language in Article 45(1)—labeled the “Limitation Clause” by the tribunal—did not require the submission of a declaration under Article 45(2):

Article 45(1), while establishing a binding obligation for each signatory to apply the ECT provisionally, on its face limits the scope of that obligation through the Limitation Clause beginning with “to the extent.” Nothing in the language of Article 45 suggests that the Limitation Clause in Article 45(1) is dependent on the mandatory making of a declaration under Article 45(2). To the contrary, as argued by Respondent, the use of the word “may” rather than “shall” in relation to the making of a declaration makes clear that a declaration under Article 45(2)(a) is permissive, not obligatory. Furthermore, the use of the word “[n]otwithstanding” to introduce Article 45(2) plainly suggests that the declaration in Article 45(2)(a) can be made whether or not there in fact exists any inconsistency between “such provisional application” of the ECT and a signatory’s constitution, laws or regulations.<sup>74</sup>

In this regard, the tribunal found significant the fact that six states (Austria, Luxembourg, Italy, Romania, Portugal and Turkey) relied on Article 45(1), or the ability to opt out of provisional application for inconsistency with their domestic legal regime, without delivering a formal declaration to the Depository under Article 45(2).<sup>75</sup> The tribunal “acknowledge[d] that the preparatory work of the Treaty could lead to a finding of linkage between Article 45(1) and 45(2),” but concluded that the Vienna Convention on the Law of Treaties permits recourse to such supplementary means of

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<sup>74</sup> *Yukos Interim Award*, para. 262.

<sup>75</sup> *Ibid.*, para. 265.

interpretation only where the application of the general rule of interpretation leaves the treaty's meaning ambiguous or obscure or leads to a result that is manifestly absurd or unreasonable—which the tribunal concluded was not the case here.<sup>76</sup> Finally, the tribunal noted that its interpretation was in harmony with the conclusion reached by the ICSID tribunal in *Kardassopoulos*.<sup>77</sup>

The tribunal next concluded that the Russian Federation could rely on Article 45(1) of the ECT even though it had never served any prior notice under that provision that it could not apply the Treaty provisionally, and indeed had *supported* provisional application during the Treaty negotiations:

The Tribunal accepts that, throughout the ECT negotiations, great emphasis was put on transparency by different actors, including the Russian Federation. However, the fact remains that, at the end of the day, when the negotiations were concluded and the ECT signed by the Russian Federation, Article 45(1) did not expressly require any form of declaration or notification in order to allow a signatory to invoke the Limitation Clause. Transparency did not trump the clear inconsistency provision of Article 45(1) [. . .] [T]he Tribunal cannot read into Article 45(1) of the ECT a notification requirement which the text does not disclose and which no recognized legal principle dictates. The Tribunal therefore concludes [. . .] that the Russian Federation may, even after years of stalwart and unqualified support for provisional application and, until this arbitration, without ever invoking the Limitation Clause, claim an inconsistency between the provisional application of the ECT and its internal laws in order to seek to avoid the application of Part V of the ECT.<sup>78</sup>

Applying the standard established by the International Court of Justice in the *North Sea Continental Shelf Cases*, the tribunal concluded that the Russian Federation was not estopped from relying on Article 45(1) by virtue of its support for provision application of the ECT during the negotiations because that support “never ‘clearly’ excluded the possibility that Respondent was in fact relying on its interpretation of the operation of the Limitation Clause in Article 45(1) which would in any event exclude or limit provisional application of the Treaty.”<sup>79</sup>

The tribunal, however, rejected the Russian Federation's position that the “to the extent” language in Article 45(1) required a “piecemeal” approach calling for an analysis of the consistency of each provision of the ECT with the Constitution, laws and regulations of the Russian Federation. The tribunal held that, “by signing the ECT,

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76 *Ibid.*, paras. 266–68.

77 *Ibid.*, para. 269.

78 *Ibid.*, paras. 282–84.

79 *Ibid.*, paras. 286–88. The ICJ noted in paragraph 30 of the *North Sea Continental Shelf Cases*:

[I]t appears to the court that only the existence of a situation of estoppel could suffice to lend substance to [the contention that the Federal Republic was bound by the Geneva Convention on the Continental Shelf] [. . .], —that is to say if the Federal Republic were now precluded from denying the applicability of the conventional régime, by reason of past conduct, declarations, etc., which not only clearly and consistently evidence acceptance of that régime, but also had caused Denmark or the Netherlands, in reliance on such conduct, detrimentally to change position or suffer some prejudice.

the Russian Federation agreed that the Treaty *as a whole* would be applied provisionally pending its entry into force unless *the principle* of provisional application itself were inconsistent ‘with its constitution, laws or regulations.’”<sup>80</sup>

The tribunal analyzed the text of Article 45(1) as follows:

[T]he key to the interpretation of the Limitation Clause rests in the use of the adjective “*such*” in the phrase “*such provisional application*.” “Such” [. . .] means “that or those; having just been mentioned,” [. . .] [or] “of the character, quality, or extent previously indicated or implied.” The phrase “*such provisional application*,” as used in Article 45(1), therefore refers to the provisional application previously mentioned in that Article, namely the provisional application of “this Treaty.”<sup>81</sup>

The tribunal concluded that “the provisional application of this Treaty” must mean the provisional application of the “*entire Treaty*” and not “some parts of the Treaty,” and that the “to the extent” language in Article 45(1) therefore presented an “all-or-nothing” proposition.<sup>82</sup>

According to the tribunal, the alternative interpretation advanced by the Russian Federation was contrary to the object and purpose of the ECT, the public international law principle of *pacta sunt servada*, and indeed the very purpose of provisional application:

The alternative—that the question hinges on whether, in fact, each and every provision of the Treaty is consistent with a signatory’s domestic legal regime—would run squarely against the object and purpose of the Treaty, and indeed against the grain of international law. Under the *pacta sunt servanda* rule and Article 27 of the VCLT, a State is prohibited from invoking its internal legislation as a justification for failure to perform a treaty. In the Tribunal’s opinion, this cardinal principle of international law strongly militates against an interpretation of Article 45(1) that would open the door to a signatory, whose domestic regime recognizes the concept of provisional application, to avoid the provisional application of a treaty (to which it has agreed) on the basis that one or more provisions of the treaty is contrary to its internal law. Such an interpretation would undermine the fundamental reason why States agree to apply a treaty provisionally. They do so in order to assume obligations immediately pending the completion of various internal procedures necessary to have the treaty enter into force. Allowing a State to modulate (or, as the case may be, eliminate) the obligation of provisional application, depending on the content of its internal law in relation to the specific provisions found in the Treaty, would undermine the principle that provisional application of a treaty creates binding obligations.<sup>83</sup>

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80 *Ibid.*, para. 301 (emphasis in original).

81 *Ibid.*, para. 304 (emphasis in original).

82 *Ibid.*, paras. 308, 311.

83 *Ibid.*, paras. 312–14. Interestingly, the tribunal also relied on principles of transparency and predictability—noting in particular the unfair surprise that would result were a signatory state allowed to raise alleged “inconsistencies” after an arbitral dispute has arisen—notwithstanding its conclusion that such considerations did not prevail in respect of the broader question whether formal notice was required to invoke the “to the extent” clause:

Provisional application as a treaty mechanism is a question of public international law. International law and domestic law should not be allowed to combine, through the



The tribunal's conclusion was further supported by state practice. In particular, the tribunal noted that the six states referenced above that had expressly relied on the "to the extent" language in Article 45(1) all declared that they could not apply the *entire* Treaty. As the tribunal remarked, "not one of [them] relied on the Limitation Clause in Article 45(1) for the interpretation now posited by Respondent, namely the selective or partial provisional application of the ECT based on the non-application of only those individual provisions that are claimed to be inconsistent with a signatory's domestic law."<sup>84</sup>

Finally, the tribunal concluded that the principle of provisional application *per se* was consistent with Russian law, a point that was hardly challenged by the Respondent.<sup>85</sup> The tribunal in particular relied on Article 23(1) of the Russian Federal Law on International Treaties of 1995, which states that "[a]n international treaty or a part thereof may, prior to its entry into force, be applied by the Russian Federation provisionally if the treaty itself so provides or if an agreement to such effect has been reached with the parties that have signed the treaty."<sup>86</sup> Finally, the tribunal observed that there are currently some 45 treaties being applied provisionally by the Russian Federation, which again was not disputed.<sup>87</sup>

On August 20, 2009, the Russian Federation notified the Portuguese Republic, as the ECT Depository, of its intention not to become a party to the ECT by invoking Article 45(3)(a) of the Treaty. Article 45(3)(a) provides that termination of provisional application takes effect 60 days after notification, or on October 19, 2009.<sup>88</sup> Accordingly, the tribunal held that the Russian Federation was bound to accord treaty protections to qualifying foreign investments for a period of 20 years from that date:

[P]ursuant to Article 45(3)(b) of the Treaty, investment-related obligations, including the obligation to arbitrate investment-related disputes [. . .] remain in force for

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deployment of an "inconsistency" or "limitation" clause, to form a hybrid in which the content of domestic law directly controls the content of an international legal obligation. This would create unacceptable uncertainty in international affairs. Specifically, it would allow a State to make fluctuating, uncertain and un-notified assertions about the content of its domestic law, after a dispute has already arisen.

*Ibid.*, para. 315.

84 *Ibid.*, para. 321. The tribunal further observed that the preliminary lists maintained by the ECT Secretariat to identify states that intended to opt out of provisional application describes the listed states as those "which will not apply the Treaty provisionally in accordance with Article 45(1)"—again suggesting an all-or-nothing proposition for provisional application. *Ibid.*, para. 322.

85 *Ibid.*, para. 330. The tribunal held that this determination "must be made in the light of the constitution, laws and regulations at the time of signature of the ECT" on the basis that "[a]ny other interpretation would allow a State to modify its laws after having signed the ECT in order to evade an obligation that it had assumed by agreeing to provisional application of the Treaty." *Ibid.*, paras. 343–44 (emphasis in original).

86 *Ibid.*, para. 332.

87 *Ibid.*, para. 337. The tribunal also noted that the Russian Federation had confirmed that provisional application was consistent with Russian law in response to the a question posed in the context of a study commissioned by the Committee of Legal Advisers on Public International Law of the Council of Europe. *Ibid.*, para. 336.

88 *Ibid.*, para. 338.

a period of 20 years following the effective date of termination of provisional application. In the case of the Russian Federation, this means that any investments made in Russia prior to 19 October 2009 will continue to benefit from the Treaty's protection for a period of 20 years—i.e., until 19 October 2029.<sup>89</sup>

## TAXATION CARVE-OUT

Like other investment treaties, the ECT contains a carve-out to the Treaty's coverage for taxation. Article 21 of the ECT is remarkable, first of all, for its complexity. It runs for two and a half pages and distinguishes between several categories of taxation, including "Taxation Measures other than those on income or on capital," "Taxation Measures aimed at ensuring the effective collection of taxes," and "advantages accorded by a Contracting Party pursuant to the tax provisions of any convention, agreement, or arrangement described in subparagraph 7(a)(ii)." By comparison, tax exclusions in other treaties tend to be simple affairs. Article 7(b) of the U.K.-Belarus BIT, for example, provides in a single sentence that the treaty's national treatment and MFN provisions do not extend to any treatment, preference, or privilege arising under "any international agreement or arrangement relating wholly or mainly to taxation or any domestic legislation relating wholly or mainly to taxation."<sup>90</sup>

Article 21's signature feature is its definition of the "Taxation Measures" that are excluded from the Treaty's coverage. Paragraph (1) of the article contains the basic exclusion for "Taxation Measures":

Except as otherwise provided in this Article, nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties. In the event of any inconsistency between this Article and any other provision of the Treaty, this Article shall prevail to the extent of the inconsistency.

"Taxation Measures" are then defined in Paragraph (7) as "provisions" of domestic tax law or tax conventions. By limiting the scope of the exclusion in Paragraph (1) to "provisions," Article 21 preserves each Contracting Party's right to enact tax legislation but does not apply to the implementation or enforcement of such legislation or treaties. It also ensures the primacy of provisions of tax conventions over potentially conflicting provisions of the ECT. In contrast, some other investment treaties accord the term "taxation measure" a significantly broader definition. NAFTA and CAFTA, for example, both define "measures" to include "any law, regulation, procedure, requirement or practice." That definition appears to govern the term "taxation measure" in the respective taxation provisions.

This distinction between a narrow and broad definition of "taxation measure" appears to have been of significance for the arbitral tribunal in *EnCana Corporation v.*

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<sup>89</sup> *Ibid.*, para. 339.

<sup>90</sup> See also ASEAN Agreement, Art. V ("The Provision of this Agreement shall not apply to matters of taxation in the territory of the Contracting Parties. Such matters shall be governed by Avoidance of Double Taxation between Contracting Parties and the domestic laws of each Contracting Party.").

*Republic of Ecuador*. The treaty at issue in that case, the Canada-Ecuador BIT, defined “taxation measures” broadly to include any “law, regulation, procedure, requirement, or practice.” The tribunal expressly noted that “[h]aving regard to the breadth of the defined term ‘measure,’ there is no reason to limit Article XII(1) to the actual provisions of the law which impose a tax.”<sup>91</sup> Rather, the tribunal concluded that such term should be interpreted broadly to include “any executive act [. . .] implementing” those provisions. Based on that interpretation, the tribunal excluded part of the claimant’s claim under Article XII(1) of the BIT. In light of the tribunal’s observations concerning the scope of Article XII(1), it is very possible the tribunal would have allowed the excluded claim to proceed had that article been limited to taxation “provisions,” like Article 21 of the ECT.<sup>92</sup>

The parties to the Yukos arbitration extensively briefed the issues concerning the scope of Article 21 of the ECT, whether the measures at issue fell within that article, and whether the article relates to jurisdiction or admissibility. The tribunal concluded that “the background to, and motivation behind, the Russian Federation’s measures that gave rise to the present arbitration, be they ‘Taxation Measures’ or not, go to the heart of the present dispute,” and it could not “rule on this crucial issue in a vacuum,” and joined those issues to the merits phase of the arbitration.<sup>93</sup>

## CONCLUSION

Critics of the Energy Charter Treaty often focus on the Treaty’s perceived textual flaws. One leading commentator has referred to it as “everything but a model of clarity.”<sup>94</sup> One need only consider, however, the failure of all other efforts—most notably the Multilateral Agreement on Investment—to create multilateral investment rules to understand what a remarkable achievement is the ECT. The Treaty’s importance is now well recognized, and it will surely have an enduring impact on the field of investment arbitration, and the energy sector generally.

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91 *EnCana Corporation v. Republic of Ecuador*, LCIA Case No. UN3481, UNCITRAL (Canada/Ecuador BIT), Award, February 3, 2006, para. 142.

92 *Ibid.*, paras. 141–43. (emphasis added).

93 *Yukos Interim Award*, paras. 583–84.

94 Thomas Wälde, *Energy Charter Treaty Based Investment Arbitration*, 1(3) TDM (2004).