CHAPTER 6

INVESTOR-STATE ARBITRATION UNDER THE ENERGY CHARTER TREATY (ECT)

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I INTRODUCTION: 20 YEARS OF ECT

The Energy Charter process was set up in the early 1990s as a multilateral body designed to provide a new framework for international energy cooperation in the post-Cold War era, based on a common commitment to develop open and competitive energy markets. Europe, Russia and many of their neighbouring countries were rich in energy but in great need of investment to reconstruct their economies. At the same time, the Western European countries were trying to diversify their sources of energy supplies to decrease their potential dependence on the other parts of the world. It was out of this need, the energy charter process was born. This commitment was subsequently enshrined in legally binding form in the Energy Charter Treaty (ECT), which was signed in 1994. The Year 2014 was the 20th anniversary of its signature. It has now been signed by 52 European and Asian states, as well as by the European Communities collectively; the ECT entered into force in April 1998.

The ECT is the only multilateral agreement of its kind specifically devoted to energy cooperation issues. Its provisions ensure the protection of foreign investments in the energy sectors of its signatory states, provide rules concerning energy transit, energy trade and energy efficiency, the so-called four pillars of the ECT. Among the dispute resolution mechanism, the investor-state dispute settlement under the ECT is a great concern. After the publication of the final awards issued in three arbitrations between former shareholders of Yukos and the Russian Federation, the investor-state dispute settlement under the ECT aroused great concern around the world. Since the commencement of the first arbitration on 25 April 2001 under the

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ECT, the number of cases has grown to 61. This paper aims to provide a retrospective on the past 14 years of ECT arbitration first and to see what we can learn from the 61 cases,[1] and to examine the difference between ECT arbitration and International Centre for Settlement of Investment Disputes (ICSID) arbitration. It concludes by identifying the implications ECT arbitration has for China if it becomes a member of Energy Charter Conference.

II ECT INVESTOR-STATE ARBITRATION

About 61 cases (as of January 14, 2015) have been brought under Article 26 of the ECT by private investors against host states, since the first case was registered in 2001. In 34 out of the 61 cases, the investors chose ICSID or the ICSID Additional Facility. In 15 out of the 61, the investors chose UNCITRAL Arbitration Rules.12 out of the 61 investors in ECT cases chose the Stockholm Chamber of Commerce (SCC). 20 out of the 61 cases have been concluded with final awards. In addition, in *Hrvaska v Slovenia*, the specific claims under the ECT were dismissed, but the case is still pending in relation to the BIT claims. Eight cases were settled by the parties and 32 cases are pending. As to the outcome of the concluded cases, 8 cases were settled; 4 cases were dismissed for lack of jurisdiction (including 2 where the claim was found to be fraudulent namely *Cementownia "Nova Huta" v Turkey* and *Europe Cement v Turkey*). Two cases proved no damages arose due to breach of ECT; the State is liable but the investor either failed to prove the damages (*Mohammad Ammar Al-Bahloul v Tajikistan*) or its claim for damages was considered premature and unfounded (*AES v Kazakhstan*). In 8 cases, the investors were successful.

Based on the model of bilateral investment agreements, Article 26 establishes procedures for the settlement of disputes between an individual and an ECT party. This provision grants foreign investors the right to sue the host country, and "depoliticizes" the dispute resolution process by excluding the involvement of the investor's home state.[2] There are, however, certain limitations placed on the availability of these procedures. First, the investor-state dispute resolution procedures only apply to disputes which concern "an alleged breach of an obligation of the host State under Part III of the Treaty" ie the provisions relating to investment promotion and protection. It means that the Investor-State mechanism only applies

1 Information on <www.encharter.org/index.php?id=269>.

2 Olivia Q Swaak-Goldman "The Dispute Resolution Procedures of the Energy Charter Treaty: Made to Measure" (1995) 6(4) American Review of International Arbitration at 317-337.

to investment disputes, and the investors would not have access to Article 26 dispute resolution for other kind of disputes, which do not fall under Part III of the ECT.[3]

Article 26(1) of the ECT provides that disputes that fall within its scope must be settled amicably if possible. If this is not achieved within the initial cooling-off period of three months, the investor may choose to submit the dispute for resolution in (a) the national courts, (b) a previously agreed dispute settlement procedure, or (c) in accordance with the treaty provisions. International arbitration appears to be the favourite choice for resolving energy disputes under the ECT, perhaps because some investors remain concerned, rightly or wrongly, about the neutrality or competence of member states' courts. International arbitration is a powerful tool for investors both to encourage states to abide by their treaty obligations and, if they do not, to resolve disputes with relative equality as compared to circumstances where the investor has to submit to local courts.[4] A binding commitment to arbitrate disputes is particularly significant in the energy sector. Under national laws, it is sometimes the case that disputes cannot be referred to arbitration or that states are reluctant to submit an energy related dispute to an independent third party.

Where a foreign investor opts for international arbitration in order to settle the dispute, it has the option of submitting its case to one of the three arbitration procedures. The treaty provisions give the aggrieved investor a number of international arbitration options, including: (1) ICSID or ICSID Additional Facility Rules; (2) UNCITRAL arbitration rules; or (3) Arbitration Institute under the Stockholm Chamber of Commerce. An investor may commence arbitration proceedings against a state for an alleged breach of treaty obligations at its preferred international arbitration institution. There is no restriction as to where the arbitration should be held, but the parties can request that it takes place in a country that is a signatory to the New York Convention. The ECT makes it explicit that the governing law in any such arbitration is the treaty itself and international law (and not the national law of any of the states concerned). The arbitral award is final and binding on the parties and each contracting party is obliged under the ECT to make provision for the effective enforcement of the award.[5]

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3 Clarisse Ribeiro Investment Arbitration and the Energy Charter Treaty (JurisNet, LLC 2005). However, see *Plama Consortium Limited v Republic of Bulgaria* case discussed later for an apparently distinct interpretation of this view.

4 Graham Coop and Clarisse Ribeiro *Investment Protection and the Energy Charter Treaty* (Huntington, NY, JurisNet, 2008).

5 Information at <www.encharter.org>.

List of ECT-based Investor-State Dispute Settlement Cases (concluded cases)

Investor	State	Reg. and Procedure	Status
AES Summit Generation Ltd (UK)	Hungary	2001 - ICSID	Settlement agreed by the parties
Nykomb Synergetics Technology Holding AB(Sweden)	Latvia	2003- Stockholm	Award rendered on 16.12.2003
Plama Consortium Ltd. (Cyprus)	Bulgaria	2003 - ICSID	Award rendered on 27.08.2008
Petrobart Ltd (Gibraltar)	Kyrgyzstan	2003 - Stockholm	Award rendered on 29.03.2005
Alstom Power Italia SpA (Italy)	Mongolia	2004 - ICSID	Settlement agreed by the parties
Yukos Universal Ltd. (UK – Isle of Man), Hulley Enterprises Ltd (Cyprus), Veteran Petroleum Trust (Cyprus)[6]	Russia	2005 - UNCITRAL	Award rendered on18.07.2014
Ioannis Kardossopoulos (Greece)	Georgia	2005 - ICSID	Award rendered on 03.03.2010
Amto (Latvia)	Ukraine	2005 - Stockholm	Award rendered on 26.03.2008
Hrvatska Elektroprivreda dd (HEP) (Croatia)	Slovenia	2005 - ICSID	pending
Libananco Holdings Co Ltd (Cyprus)	Turkey	2006 - ICSID	Award rendered on 02.09.2011

6 The three Yukos cases are counted as one case.

Investor	State	Reg. and Procedure	Status
Azpetrol (Netherlands)	Azerbaijan	2006 - ICSID	Award rendered 08.09.2009
Barmek Holding AS (Turkey)	Azerbaijan	2006 - ICSID	Settlement agreed by the parties
Cementownia "Nowa Huta" SA (Poland)	Turkey	2006 - ICSID	Settlement agreed by the parties
Europe Cement SA (Poland)	Turkey	2007 - ICSID	Award rendered on 13.08.2009
Liman Caspian Oil BV (Netherlands)	Kazakhstan	2007 - ICSID	Award rendered on 22.06.2010
AES Summit Generation Limited (UK)	Hungary	2007 - ICSID	Award rendered 23.09.2010
Mohammad Ammar Al-Bahloul (Austria)	Tajikistan	2008 - Stockholm	Award rendered on 08.06.2010
Mercuria Energy Group Ltd (Cyprus)	Poland	2008 - Stockholm	Award rendered in December 2011
Alapli Elektrik BV (the Netherlands)	Turkey	2008 - ICSID	Award rendered on 16.07.2012
Remington Worldwide Limited (UK)	Ukraine	2008 - Stockholm	Award rendered on 28.04.2011
Vattenfall (Sweden)	Germany	2009 - ICSID	Settlement agreed by the parties
EVN AG (Austria)	Macedonia	2009 - ICSID	Award rendered 02.09.2011
AES Corporation and Tau Power BV (the Netherlands)	Kazakhstan	2010 - ICSID	Award rendered 01.11.2013

Investor	State	Reg. and Procedure	Status
Anatolie and Gabriel Stati, Ascom Group SA, Terra Raf Trans Traiding Ltd	Kazakhstan	2010 - Stockholm	Award rendered on 19.12.2013
Energoalians SARL	Moldova	2010--UNCITRAL	Award rendered on 25.10.2013
Türkiye Petrolleri Anonim Ortaklığı (Turkey)	Kazakhstan	2011 - ICSID	Settled by agreement
Slovak Gas Holding BV(the Netherlands)	Slovak	2012--ICSID	Settled by agreement
EZ (Czech Republic)	Albania	2013--UNCITRAL	Settlement agreed by the parties

III COMPARISON BETWEEN ECT ARBITRATION AND ICSID ARBITRATION

ECT investment arbitration is quite different from the traditional investment arbitration, ICSID arbitration in particular. ICSID provides three self-defence rights for host countries, such as the right of case-by-case consent, priority of local remedies, and application of host country's laws. However, ECT investment arbitration excludes the above three rights totally, and confers the investors more initiatives and choices. ECT is the first global multilateral investment treaty, which grants investors the right to initiate arbitration in accordance with the treaty itself, namely, ECT gives the investors the right of compulsory arbitration. This challenges the ICSID "consent" system and represents the newest development trend in investment dispute arbitration.

The compulsory arbitration of ECT permits investors to initiate an international arbitration directly. However, ICSID takes the host country's interests into account, which gives more freedom to host countries to determine whether investment arbitration can be initiated. In ICSID Convention, whether arbitration can be started depends on whether the contracting parties (host country) agree to submit to

international arbitration, namely, the case-by-case approval rights.[7] ECT cancels the case-by-case approval rights of host countries totally, as provided in Article 26 (3). Each Contracting Party gives its unconditional consent to the submission of a dispute to international arbitration or conciliation in accordance with the provisions of this Article. Obviously, the investors are entitled to file an arbitration in accordance with ECT directly, and the host countries shall give unconditional consent. "Arbitration without privity" is not common in international investment treaties; ECT is the first treaty which provides unconditional arbitration explicitly.[8] Under ECT, it is not necessary for the investor and the host country to sign an arbitration agreement beforehand and the investor can just submit the case to international arbitration in written form. In *Plama Consortium Limited v Republic of Bulgaria*, the investor Plama is a company registered in Cyprus, which bought 96.78% shares from Plama AD (Nova Plama later). Nova Plama is an oil refinery plant and it was interfered with by Bulgaria legislature, judicial and other public organs. On 24 December 2002, Plama initiated arbitration to ICSID. Bulgaria made a defence that Bulgaria's consent to arbitration is a precondition, which means Bulgaria breaches Part III of ECT, or Bulgaria will not give unconditional consent to arbitration. The tribunal refused to accept the respondent's defence, and rendered an award that Bulgaria abide by the obligation of ECT and the claimant was entitled to file an arbitration on the following grounds: First, Bulgaria is a contracting party, who accepted article 26 unconditionally by signing the treaty. Second, ECT Article 46 provides that no reservation shall be permitted, so Article 26 applies to all contracting parties. Third, in accordance with ICSID Convention Article 26, neither of the parties shall revoke the arbitration once the two parties agree to arbitration.[9]

When disputes arise between an investor and a host country, according to ICSID Article 26, if the host country and the investor agrees to arbitration, local remedies may prevail over arbitration, if the exhaustion of local remedies is required as a condition to arbitration by the host state. The exhaustion of local remedies is a precondition for the host country's consent to arbitration, which means, the host country is entitled to require the investor to exhaust local remedies before submitting the dispute to international arbitration. Under ECT, there is no such rule of exhaustion of local remedies. The investors can initiate arbitration at any time. However, the investor's arbitration right is not absolute and there are some

7 Jiang Xin and Zhou Linfeng "The Comparison between ECT Investment Arbitration and ICSID System (in Chinese)" (2009) 33(3) Journal of Xiangtan University (Philosophy and Social Sciences).

8 Andrew E L Tucker "The Energy Charter Treaty and 'Compulsory' International State/Investor Arbitration" (1998) 11(3) Leiden Journal of International Law at 513-526.

9 Information on <www.encharter.org/fileadmin/user_upload/document/Plama.pdf>.

limitations. ECT Article 26 provides the "fork clause", which means if the investor seeks local remedies or a dispute procedure previously agreed, ECT permits the parties to move into Annex ID and the parties in Annex ID have no obligation to give unconditional consent to arbitration. Many contracting parties are not willing to confer all the rights to international arbitration, and they do not allow the dispute to local remedies or previously agreed dispute procedure to arbitration again. In other words, the contracting parties in Annex ID give conditional consent and they have to explain its policy, custom and condition in written form, which also constitutes one part of its international obligation. [10] Except the countries listed in Annex ID, an investor can enjoy the forum shopping (seek remedies): they can seek local remedies first. Once local remedies fail, they can apply for international arbitration again.

A host country's law application plays an important role in settling investment arbitration. Any host country hope an international tribunal can apply its own law to settle the disputes and ICSID Convention also provides that a host country's law can be applied; even if the parties fail to choose applied laws, the host country's law shall be one of the applicable laws.[11] However, in ECT arbitration, the applicable laws are just international law rules and ECT, excluding host countries' laws totally, which is rare among the international conventions. In *Ioannis Kardassopoulos v Georgia*, Plama Tramex Company and the Georgia state-owned company SkNavtobi signed an agreement to set up a joint venture GTIltd. The joint venture signed a contract with Transneft the administrator, which provided that the joint venture, would construct an oil pipeline and enjoy and use the pipeline for 30 years and would not be expropriated or nationalised. The contract was approved by Georgian government. Later the Georgian government conferred the charted rights on another company. Disputes arose between the joint venture and Georgian government as to compensation. On August 2nd, Mr Ioannis Kardassopoulous initiated an arbitration in ICSID. The respondent argued that the contract was void and null as it was in violation of Georgian laws and the respondent was not bound to protect the investment based on ECT. The tribunal considered that ICSID, as an international institution, must abide by the international law rules when settling the disputes arising out of ECT and apply the ECT rules to protect the investment.[12] From the case, it can be concluded the tribunal takes international law rule as a priority over

10 Wang Guiguo *International Investment Law* (in Chinese), (Peking University Press, 2001).

11 Chen An *The New Development of International Investment Law and China's Practice of Bilateral Investment Treaties* (in Chinese) (Fudan University Press, 2007).

12<www.encharter.org/fileadmin/user_upload/Investor-State_Disputes/Award_-_Ioannis_Kardassopoulos_vs_Georgia.pdf>.

host country's domestic law in ECT arbitration, which represents the trend of future investment arbitration.

IV CONCLUSION: IMPLICATIONS FOR CHINA

Since the 1990's, China's energy demand has increased significantly and energy dependence on foreign origins kept rising. The inadequacy of energy supplies restricted China's economic development in some sense. The most effective way to secure energy development is to enhance international energy cooperation, to hasten the steps of "going out" and put more foreign investment in energy sector, and thereby diversify the energy supply sources. With more energy companies "going out" and foreign energy companies "coming in", the disputes between Chinese energy enterprises and relevant parties arise out of the investments, among which disputes between Chinese energy companies and host governments and the disputes between foreign energy companies and Chinese governments at all levels are common. For disputes between Chinese investors and host countries, if China is a member of ECT, ECT can provide most comprehensive protection for Chinese investors. Chinese investors can initiate arbitration against the host country without agreement, which undoubtedly increases Chinese investors' confidence, and safeguards Chinese investors' interests. However, Article 26 is a two-edged sword, and it is a sword which challenges host country's state sovereignty. Obviously, it over-protects the investors' interests and Article 26 may be a barrier for China to become a member of ECT, as China is still an investment-input country. Under such circumstances, if China considers being a member of ECT, it can put itself into Annex ID, by which China will not give unconditional consent to investment arbitration and explain policies and conditions. For doing so, if investors choose to use Chinese administrative or judicial procedures, or use the dispute settlement procedures previously agreed, the investors cannot use Article 26 to initiate an arbitration, which in some sense can alleviate the pressure which Article 26 brings. When China attains the balance between investment input and output, and when China improves its domestic laws and trade environment, it can consider accepting Article 26 investment arbitration. This can attract more energy investment and improve the investment environment.

The investor-state arbitration is a two-edged sword. On the one hand, it is beneficial to protect the interests of Chinese energy companies; on the other hand, if China accepts ECT investment arbitration comprehensively, it may endanger Chinese energy security. However, overall, entry into ECT is beneficial to China to improve its energy supply, to stabilise energy prices, and to enhance energy efficiency. To ECT, China's entry will enhance ECT's role, and promote the energy charter process. To China, entry into ECT will promote China's economic and social development.