The Energy Charter Treaty and 'Compulsory' International State/Investor Arbitration

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Abstract: The Energy Charter Treaty came into force on 16 April 1998. The Treaty contains far-reaching provisions on trade and investment liberalisation within the energy sectors of 49 signatory states. The Treaty arguably offers a basis for multilateral agreement on micro-economic reform of the energy sectors. Some of the most significant initiatives contained in the treaty are the provisions for resolution of disputes. This article examines in detail the provisions dealing with arbitration of disputes between investors and states. These mechanisms build on models developed in other recent multilateral investment treaties. The limitations and potential offered by these provisions are discussed and some conclusions drawn.

1. Introduction

The Energy Charter Treaty[1] (ECT) is the most comprehensive multilateral instrument to date dealing with both international trade and investment. It is so far the only trade and investment instrument which treats one single economic sector exclusively.[2] The ECT came into full force on 16 April 1998,

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1. 1994 European Energy Charter Conference: Final Act, Energy Charter Treaty, Decisions and Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects. The Final Act of the European Energy Charter Conference contains the text of the 1994 ECT together with Understandings, Declarations by a number of states, Decisions by the Conference, Annexes to the Treaty, and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects. The full text of the Treaty is reproduced *in* 34 ILM 360 (1995).
2. The ECT applies exclusively to "Economic Activity in the Energy Sector", defined 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 listed in Annex NI, or concerning the distribution of heat to multiple premises" (Art. 1(5)). The Energy Materials and Products covered by the Treaty are listed in Annex EM: essentially nuclear energy, coal, natural gas, petroleum and petroleum products, electrical energy, wood and charcoal. A Protocol on extension of the Treaty to energy-related equipment is under negotiation. In Understanding 1(a) "the representatives underline that the provisions of the Treaty have been agreed upon bearing in mind the specific nature of the Treaty aiming at a legal framework to promote long-term cooperation in a particular sector and as a result cannot be construed to constitute a precedent in the context of other international negotiations." Under-

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having been opened for signature in Lisbon in December 1994. It has been signed by a total of 49 states and the European Communities,[3] and (as of 16 April 1998) ratified by a total of 35 countries.[4]

The ECT is an attempt to meet two primary concerns. First, recognising the strategic importance of the energy (principally coal, oil, gas, and electricity) sectors in the revitalisation of the economies of the transition countries of Central and Eastern Europe, the initiators[5] envisaged the establishment of a framework within which an environment attractive to foreign investment could be developed in this region. The ECT embodies the philosophy that economic growth depends upon the development and operation of liberal free-market legal and economic systems. Secondly, the Treaty initiative reflected the growing concern in Western Europe, in the light of diminution of North Sea capacity and the uncertain status of Middle Eastern and North African sources, for securing access to the oil and gas resources of Russia and Central Asia. In principle, all the participating countries stood to gain from the liberalisation of energy trade and investment across Europe.

The ECT bears many of the hallmarks of a compromise package reached during hastily completed negotiations, containing a complex mix of both hard but primarily rather soft obligations. The Treaty built on two main pillars: investment (the primary focus of this contribution) and trade. One of the remarkable features of the ECT is the elaborate system of dispute resolution mechanisms which it embodies. There are no less than seven different sets of provisions dealing with resolution of conflicts arising in connection with the various obligations and rights created by the treaty. Of particular interest is the provision in Article 26 for the submission of investment dis-

standing 2(a) confirms that "the Treaty confers no rights to engage in economic activities other than Economic Activities in the Energy Sector", 34 ILM 375 (1995).

3. The list of signatories includes, in addition to the EC, almost all countries of Europe, all the (then existing) republics of the former USSR, Japan, and Australia. Important omissions are the United States and Canada, which, although signatories to the European Energy Charter in 1991 and active participants in the negotiations of the Treaty, did not end up signing the Treaty. For an explanation of the US position, *see* W. Fox, *The United States and the Energy Charter Treaty: Misgivings and Misperceptions in* T.W. Waelde (Ed.), The Energy Charter Treaty: An East-West Gateway for Investment and Trade 194 (1996). Application procedures for accession to the Treaty have been commenced by Macedonia and Moldova.
4. Not all of these 35 countries had deposited their instruments of ratification as of 16 April 1998. Significantly, neither Norway nor Russia had as of this date ratified the Treaty. These countries remain subject to the provisional application regime of Art. 45.
5. The concept of a European Energy Charter was first proposed by the former Dutch Prime Minister Ruud Lubbers at the European Council Summit in Dublin in June 1990. A draft text was put forward by the European Commission for discussion in February 1991, and a Declaration was signed in The Hague on 17 December 1991. This declaration, not constituting a binding international treaty is reproduced *in* T. Wäldi & G. Naldi, International Oil & Gas Investment: Moving Eastward?, at 367-373 (1994). By this time, negotiations had already commenced, based in the first instance on a draft text prepared by the UK government, on the "Basic Protocol" (later to develop into the Energy Charter Treaty) and related protocols.

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putes to international commercial arbitration. While there is nothing new about the submission of investment disputes to arbitration, nor about the submission by states to 'compulsory' arbitration with investors or the application of international legal principles to such disputes, the terms of Article 26 introduce a number of novel additions to existing practice. Furthermore, the matrix of relationships in the context of a multilateral instrument, combined with the application of a number of controversial principles in sectors which throughout the world are undergoing significant restructuring, together raise a variety of intriguing issues.

After a brief review of the main provisions of the Treaty, Part III on the protection of investment will be examined. Thereafter application of international commercial arbitration to investment disputes will be described and some of the implications discussed. In the final section some conclusions will be offered.

2. THE TREATY FRAMEWORK

2.1. Trade in energy materials and products

Article 29 of the ECT incorporates the principle of "GATT by reference". All Contracting Parties (even those not party to the GATT/WTO) are, with regard to trade in Energy Materials and Products (as defined), and with certain exceptions set out in Annex G to the Treaty, bound by GATT 1947 and Related Instruments.[6] Disputes arising in relation to such obligations are to be resolved in accordance with the detailed provisions of Annex D, which provide for the establishment and operation of panels under the auspices of the Charter Conference. Of course, for those states which are party to the GATT 1994[7] the latter – including its dispute resolution mechanisms – will apply to their energy trade relations *inter se*. All Contracting Parties are bound to comply with Articles III and XI of the GATT 1994 as far as trade-related investment measures are concerned, Article 5 of the ECT incorporating the terminology of the GATT Uruguay Round Trade Related Investment Measures Agreement.[8]

6. 1947 General Agreement on Tariffs and Trade, 55 UNTS 194 (1948).
7. 1994 General Agreement on Tariffs and Trade, 33 ILM 112 (1994).
8. For a full explanation of the trade provisions of the ECT, *see* M.E. Footer, Trade and Investment Measures in the Energy Charter Treaty, *in* Waelde, *supra* note 3, at 445; and I. Frasl, The Trade Rules of GATT and Related Instruments and the Energy Charter Treaty, *id.*, at 459. For the TRIMs Agreement, *see* Legal Instruments Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, done at Marrakesh on 15 April 1994, GATT Secretariat Publication, Sales No. GATT/1994-7.

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2.2. Transit

Perhaps one of the most successful parts of the Treaty is the terms of Article 7 dealing with transit in energy materials and products. The issue is of fundamental importance in the context of the transportation of oil and gas from the fields of eastern regions of the former USSR to Western markets. Most existing pipelines in the region are owned and/or controlled by monopolistic state-owned entities, the most powerful of which is Gasprom in Russia, whose market power has been demonstrated by its ability to exploit transport capacity to gain access to major gas fields such as the Karachaganac field in Kazakhstan. Oil and gas making their way through the Ukraine has not infrequently been interrupted as a result of disputes of a purely political nature. In the Baltic states and other areas of the former Soviet Union, the continuation of jurisdictional controversies heightens the political risk involved in transporting through these regions, and thus the political risk of major upstream investment projects.

The balance of incentives and restrictions in Article 7, backed up by a concrete dispute resolution mechanism, offers investors a real degree of protection against such risks. Transit constitutes for the purposes of the ECT, carriage from one state through the area of a Contracting Party to either a third state or another part of the originating state, where either the originating state or the state of destination is a Contracting Party.[9] Article 7 is a lengthy and delicately drafted provision requiring the Contracting Parties, *inter alia*, to:

> facilitate Transit [...] consistent with the principle of freedom of transit and without distinction as to the origin, destination or ownership of such Energy Materials and Products or discrimination as to pricing on the basis of such distinctions, and without imposing any unreasonable delays, restrictions or charges.

Entities which seek to transit energy materials or products through the area or another Contracting Party shall have the right, in the event that no commercial agreement can be reached with the owner as to access, to establish new capacity. An Understanding to the ECT states categorically that the provisions of the ECT "do not [...] oblige any Contracting Party to introduce mandatory third party access."[10] Article 7 contains its own internally operative conciliation mechanism for the resolution of disputes arising in relation to Transit.

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9. Art. 7(1) of the ECT, *supra* note 1. Contrast the definition in the EU electricity and gas transit directives (Council Directives 90/547/EEC and 91/296/EEC respectively), where transport involving "the crossing of [at least] one intra-Community frontier" is deemed to constitute transit for the purpose of each directive.
10. 34 ILM 376 (1995).

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2.3. Competition

The Charter had reiterated the importance of competitive conditions and conduct in the energy sectors as the foundation of economic growth. A variety of provisions deal in soft-law terms with the principles of market liberalisation. Article 3 obliges the parties to "work to promote access to international markets on commercial terms, and generally to develop an open and competitive market, for Energy Materials and Products."[11] Pursuant to Article 6 they "shall work to alleviate market distortions and barriers to competition in Economic Activity in the Energy Sector"; in particular, they shall implement and enforce "such laws as are necessary and appropriate to address unilateral and concerted anti-competitive conduct"[12] in such activity.[13]

2.4. Sovereignty over natural resources

The multilateral nature of the negotiations vastly complicated the attempt to reach a compromise between the demands of state sovereignty over resources and the desire to reach meaningful guarantees of access to investment opportunities in the upstream oil and gas sectors in Eastern Europe. Norway, one of the main opponents of extensive guarantees, to which the 'transition' mechanism of the Treaty was not available,[14] eventually accepted a last-minute text on the basis of its then impending entry into the European Union. Article 18 of the final text requires the parties to facilitate access to energy resources (a term not defined in the ECT) by means of transparent and non-discriminatory licensing procedures – requirements which in broad terms reflect the principles contained in recently adopted EU legislation.[15]

2.5. Investment promotion and protection

The Charter was built on the assertion that the key to economic recovery and growth in the transition countries is the stimulation of foreign direct investment by means of liberalisation. The ECT draws an all-important distinction

11. *Id.*, at 385.
12. *Id.*, at 386.
13. "The unilateral and concerted anti-competitive conduct referred to in Art. 6(2) are to be defined by each Contracting Party in accordance with its laws and *may* include exploitative abuses" (emphasis added), *see* Understanding 7(a), 34 ILM 376 (1995).
14. Pursuant to Art. 32 and Annex T, those Contracting Parties constituting countries in transition were entitled to notify "exceptions" to certain obligations under the ECT, subject to a stand-still and roll-back discipline.
15. *See* especially Directive 94/22/EC of the European Parliament and of the Council of 30 May 1994 on the conditions for granting and using authorizations for the prospection, exploration and production of hydrocarbons, OJEC L 164/3, at 3.

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between the treatment of *existing* investments on the one hand, and the conditions applicable to the "*making of investments*" (the so-called "pre-investment" or "establishment" stage) on the other hand. Only in relation to the former does the Treaty lay down hard obligations. Part III of the Treaty seeks to ensure protection of *existing* investments in two ways. First, the Contracting Parties offer foreign investors guarantees with respect to existing investments of "fair and equitable treatment"[16] and the most favourable National Treatment (NT) or Most Favoured Nation (MFN) Treatment.[17] Article 10(1), furthermore, contains an obligation for Contracting Parties not to impose "unreasonable or discriminatory measures" on existing foreign investors. The non-discrimination concept inherent in MFN/NT provides energy investors with perhaps the most significant protection under the ECT. In the context of network-bound sectors subject to gradual liberalisation policies, the non-discrimination principle embodied in MFN/NT has been described by one commentator as representing "a first real attempt at creating an international competition law" in the energy sector. Increasingly, investment in the energy sectors will be based not on agreements with the state but rather on a free standing basis within a regulated open market situation. State owned or controlled entities entrusted with special authority or rights may retain dominant positions in such markets. Where they have the right or market power unilaterally to determine the terms and conditions of access to gas and electricity networks, the ECT obliges them to exercise their powers fairly and without direct or indirect reference to nationality.[18] Foreign consumers and suppliers may, for example, be able to rely on the non-discrimination principle to argue that owners of essential facilities have unfairly denied access, and on that basis institute international arbitration proceedings under Article 26 (*see* Section 3.2., *infra*).

The application of the MNF/NT standard in the context of investment protection raises a number of difficulties for which the ECT text provides little guidance. MFN/NT essentially involves the making of a comparison; the question is what is the appropriate comparator? In a Declaration to the Final Act the United States and Canada (which did not end up signing the Treaty) stated that they would interpret the NT obligation as requiring a comparison between the foreign investor and domestic investors "in similar circumstances".[19] On this interpretation, the host state would be entitled to

16. Art. 10(1) of the ECT, *supra* note 1, at 389.
17. Art. 10(4) of the ECT, *supra* note 1, at 389.
18. *See* T.W. Waelde, *Investment Arbitration Under the Energy Charter Treaty – From Dispute Settlement to Treaty Implementation*, 12 Arbitration International 429-466 (1997); T. Waelde & P.K. Wouters, *State Responsibility in a Liberalised World Economy: 'State, Privileged and Subnational Authorities' Under the 1994 Energy Charter Treaty*, 27 NYIL, at 172-175 and 189 (1996).
19. 34 ILM 379 (1994).

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take discriminatory action against a foreign investor on the basis of objectively justifiable policy considerations, because in such a situation the foreign investor is simply not in "similar circumstances" to domestic investors. Conversely, the Declaration goes on to make clear that a measure that is motivated by reasons of nationality and which cannot be justified by objective policy considerations, would constitute an infringement of the NT standard. In terms of international law, this is relatively new ground. There is little or no jurisprudence on the application of the MNF/NT standard in the context of investment protection.[20] The fact that Canada and the US made such a declaration suggests that the other Contracting Parties may have a different approach. If the concept of "similar circumstances" is not invoked, MFN/NT arguably may be interpreted to mean that the host state must give the foreign investor no less favourable treatment than it gives to *any* of its domestic investors. In the light of the non-signature by the North American states and the strongly European background to the treaty, it is suggested that EU jurisprudence in the field of both free movement and competition is likely strongly to influence the interpretation of the provisions of Part III of the ECT.

Secondly, the ECT lays down a number of other investment protection provisions in Part III which in large part reflect the principles expressed in many existing Bilateral Investment Agreements (BITs). The most important of these are the provisions of Article 12 requiring Contracting Parties to accord investors MFN/NT in the event of losses suffered as a result of armed conflict or civil disturbance etc., and Articles 13 and 14 governing expropriation and nationalisation and guaranteeing the right of foreign investors to repatriate earnings without delay.

As far as the *making* of investments is concerned, Article 10 of the ECT lays down more general guidelines and incentives of a soft-law nature for the creation of favourable investment conditions. Under Article 10(1) they shall "encourage and create stable, equitable, favourable and transparent conditions" for foreign investment. These principles are reminiscent of those already embodied in existing non-binding instruments such as the World Bank Guidelines on the Treatment of Foreign Investment; their inclusion in a binding treaty structure backed up by strong enforcement mechanisms is likely to enhance their authority significantly. Furthermore, the establishment of the Charter Conference provides a valuable, on-going forum in which state-sovereignty sensitive issues can be thrashed out between the Contracting Parties behind closed doors.

However, despite the grand hopes of the Charter, true liberalisation of investment – *i.e.* opening up of market access – is not achieved in the ECT. The negotiators were only able to agree on soft-law obligations on the Con-

20. *See generally* Waelde, *supra* note 18.

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tracting Parties to grant access to energy markets – for example, to "endeavour to [...] limit to the minimum" any measures which treat foreign investors less favourably than a MFN or NT standard. Since 1995, the signatories to the ECT have been negotiating a further treaty in which, pursuant to Article 10(4) of the ECT, the negotiators will seek to lay down MFN/NT norms to the establishment phase. This issue goes, of course, to the very heart of national sovereignty in the energy field, affecting the right of the Contracting Parties to organise their industries along national lines. Understanding 10 of the Final Act provides that this Supplementary Treaty will deal, *inter alia*, with the "provisions relating to the sale or other divestment of state assets (privatization) and to the dismantling of monopolies (demonopolization)".[21] The matter is complicated by the prospect that such obligations, even if accepted, could become subject to the arbitration mechanism of Article 26; while the parties (some, such as Norway, extremely reluctantly) were prepared to accept the subjection of post-investment measures to an arbitration discipline, the prospect that licensing and concession authorisation procedures and similar decisions may be adjudicated by an international neutral arbitrator has to date proved unacceptable. As of 16 April 1998 (the date of entry into force of the Treaty) no agreement had yet been reached on the Supplementary Pre-Investment Treaty.

3. Arbitration of Investment Disputes Under Article 26 of the ECT

3.1. Arbitration of investment disputes in the energy sectors

The construction and operation of energy infrastructure and facilities – traditionally in the upstream oil and gas sectors, but increasingly in electricity generation, construction and renewal of gas and electricity transmission and distribution grids, and underground gas storage – involve major capital investments. Where, as is often the case, these are structured on a project finance basis, project developers and equity and debt investors are committed to projects over longer periods of time. Accordingly, investors are exposed to a variety of risks. Not the least of these is political risk: the possibility that political developments in the host state detrimentally affect the economics upon which the investment was entered into and structured. The instabilities inherent in the transition process in Central and Eastern Europe can give rise to a whole scala of situations causing the parties – both public and private – to want to reconsider and possibly renegotiate their positions. International arbitration has long been accepted as offering both investors

21. Understanding 10 of the Final Act, 34 ILM 376 (1995).

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and host states an attractive means for resolving disputes which cannot be resolved by negotiations in those circumstances. The benefits of arbitration in investment disputes is reflected in the incorporation of arbitration clauses in most BITs and the increasing resort to International Centre for Settlement of Investment Disputes (ICSID) arbitration.

3.2. The Article 26 mechanism

Following the trend set in national investment laws since the 1960s, in BITs and most recently in the NAFTA,[22] the negotiators elected international commercial arbitration as the most effective means for resolving investment disputes arising under the Treaty.[23]

Article 27 provides for the determination of disputes between the Contracting Parties themselves by an *ad hoc* arbitral tribunal. Article 26 purports to confer on individual investors the right to initiate arbitration in their own names against foreign states where they claim to have been injured as a result of breach of the state's obligations towards investors. Under Article 26(2) investors may submit disputes concerning "an alleged breach of an obligation of [a Contracting State] under Part III" which cannot be settled amicably to either:

- a national court or administrative tribunal;
- any other previously agreed forum; or
- arbitration under the Treaty.

If the investor chooses the latter, there are four possible arbitral forums:

- the ICSID, in accordance with the 1965 Washington Convention;[24]
- the ICSID 'Additional Facility' in the event that either or both of the investor's country or the host state are not party to the Washington Convention;

22. The North American Free Trade Agreement was concluded between the US, Canada, and Mexico in 1993, during the course of the ECT negotiations. It is reproduced *in* 32 ILM 296 (1993). Chapter 11 of the NAFTA provided the most important model for the drafting of the arbitration mechanism ultimately contained in Art. 26 of the ECT. The NAFTA/ECT model appears to be strongly influencing formulation of the dispute resolution mechanisms in the negotiation of the OECD-based Multilateral Investment Agreement in Paris.
23. *See* the discussion *in* T.W. Waelde, *Investment Arbitration Under the Energy Charter Treaty*, 12 Arbitration International 442-450 (1997), where the author compares arbitration with the other mechanisms which were potentially open to the negotiators.
24. The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, opened for signature on 18 March 1965, entry into force: 14 October 1966, *in* 16 YBCA 683-703 (1991).

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- a single arbitrator or *ad hoc* tribunal established under the UNCITRAL Arbitration Rules[25]; or
- the Arbitration Institute of the Stockholm Chamber of Commerce (SCC).[26]

3.3. Compulsory arbitration

Each Contracting Party gives its "unconditional consent to the submission of a dispute to international arbitration";[27] this consent is deemed[28] to satisfy the requirements for written consent under the ICSID and UNCITRAL Rules, as well as the requirement for an "agreement in writing" under the New York Convention.[29] While this concept of "arbitration without privity"[30] is not new in the context of the regulation of international investment protection, the ECT appears to be the first instrument in which the contracting parties expressly give their "unconditional" consent to submit to arbitration. Although it remains open in principle for a state to argue that arbitration remains a consensual process, and therefore that it will be a relevant question of fact in each case as to whether or not in all the circumstances the state was entitled to withdraw its consent to arbitration,[31] the clear intent of the drafters by adding this unilateral qualification is to render it extremely difficult if not impossible for a recalcitrant state to withdraw consent even prior to the institution of arbitration proceedings in writing by an investor.

Not only are states which are party to the ECT bound to arbitrate investment disputes at the election of the investor, but they must do so even if the parties had previously agreed that such disputes should be resolved by recourse to some other mechanism (such as an International Chamber of Commerce (ICC) arbitration).[32] This is at the investor's sole discretion; the Contracting State itself cannot insist on application of procedures previously agreed. Given that the questions of the dispute resolution procedure and of the law governing disputes can often play an important part in the negotiation of a total investment package, this provision swings the bargaining balance significantly in the investor's favour.

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25. UN Doc. E.93.V.6 (1977).
26. Rules of Arbitration of the Arbitration Institute of the Stockholm Chamber of Commerce, adopted by the Stockholm Chamber of Commerce, entry into force: 1 January 1988, *in* 43 The Arbitration Journal 11-14 (1988).
27. Art. 26(3) of the ECT, *supra* note 1, at 400.
28. *Id.* Art. 26(5).
29. The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 10 June 1958, 330 UNTS at 38.
30. *See* J. Paulsson, *Arbitration Without Privity* 10 ICSID-Rev/FIRJ (1995).
31. *See, e.g.*, Pyramids Oasis Award, reproduced (in excerpts) *in* 16 YBCA (1991), and comments by Delaume & Craig *in* ICSID/FIRJ 231, at 264 (1993).
32. Art. 26(2) and (3) of the ECT, *supra* note 1, at 399.

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Furthermore, and more radically, with respect to all Contracting Parties except the 22 signatory countries listed in Annex ID,[33] this principle applies even where proceedings have already commenced – *or even concluded* – in one of these jurisdictions. This truly – but asymmetrical – 'compulsory' mechanism not only represents a radical departure from principles of *res iudicata* but also stands in stark contrast to the notion of arbitration as a consensual, alternative process of dispute resolution.

3.4. Article 26 applies only to Part III disputes

Article 26 of the ECT applies only to disputes involving alleged infringement by a Contracting Party of a Part III obligation. This can be contrasted with the terms of some national laws and BITs which purport to give the investor arbitration rights in relation to *any* dispute arising out of a relevant investment.[34] Nevertheless, the scope of Part III obligations, while in many respects unclear,[35] is potentially extremely broad. The concept of "Investment" itself is under the ECT defined widely to include any kind of asset owned directly or indirectly by an investor, including contractual, intellectual property and real property rights. On the other hand, the distinction drawn between "Making Investments" (the pre-investment or establishment phase) and treatment of existing investments – the former being subject to basically soft-law obligations – significantly limits the current scope of the arbitration mechanism under the treaty. If – as seems likely – these concepts are intended to be mutually exclusive, the scope of application of Articles 10(1) and (7) is for practical purposes greatly limited.

Particular reference should be made to the last sentence of Article 10(1) which provides that "[e]ach Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party." To the extent that this provision merely encapsulates the doctrine of *pacta sunt servanda* it arguably does not extend the host state's existing obligations under customary international law. On the other hand, the reference to "any obligations which it has entered into" potentially goes much further than simply contractual commitments; arguably, it would also cover undertakings of an administrative or public law nature entered into in respect of one or more identified investors, for example via licence conditions imposed by legislation or administrative commitments to energy concessionaires. All parties, with the exception of Australia, Canada, Hun-

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33. Including Norway, Russia, Azerbaijan, and Kazakhstan.
34. *See, e.g.*, Art. 12 of the People's Republic of China – Australia BIT, cited in Paulsson, *Arbitration Without Privity*, in Waelde, *supra* note 3, at 424.
35. *E.g.*, the distinction between the 'pre-investment' and 'post-investment' stages.

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gary, and Norway have all agreed to allow disputes under the last sentence of Article 10(1) to be submitted to arbitration under Article 26.

The scope of the state's liability under Part III, and thus of foreign investors' rights under the Article 26 mechanism, is perhaps further expanded by the rather novel terms of Article 22. Under this provision the Contracting Parties undertake commitments regarding compliance with the Treaty by entities subject to their control. Contracting Parties "shall ensure that any state enterprise which it maintains or established" shall act consistently with the state's obligations under Part III, nor shall they encourage such entities to act inconsistently with such obligations.[36] Under Article 22(3) the Contracting Parties "shall ensure" that entities which they set up with regulatory, administrative, or governmental authority shall exercise that authority consistently with the state's own obligations under the Treaty (nb. not just Part III). Finally, "[n]o Contracting Party shall encourage or require any entity to which it grants exclusive or special privileges to conduct its activities in its Area in a manner inconsistent with the Contracting Party's obligations under this Treaty."[37] The precise scope of these provisions is not entirely clear, and the extent to which these provisions extend the existing principles of public international law governing treaty parties' responsibility for the actions of third parties may be open to debate.[38]

3.5. Applicable law

The question of the applicable law is dealt with in Article 26 in a rather confusing and, in the present author's view, ultimately unsatisfactory manner, indicative of the considerable haste in which Article 26 was drafted. Article 26(6) provides that "[a] tribunal established under paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law." To the extent to which the dispute involves solely a question of breach of one of the provisions of the Treaty, this formula is logical and is likely to present no significant difficulty. But the reality is that many investment conflicts arise against the background of a complex of contractual arrangements in which the parties are likely already to have given thought to the law which they agree should apply to the substance of disputes arising thereunder. Where no express agreement has been reached, or not conclusively, each of the Washington Convention, the UNCITRAL Rules and the SCC Rules provide for the principles which an arbi-

36. Art. 22(1) and (2) of the ECT, *supra* note 1, at 397.
37. *Id.*, Art. 22(4).
38. One question which arises is whether Art. 22(4) in effect requires states to put into place and ensure the operation of a regulatory regime supervising the conduct of entities entrusted with special or exclusive rights, such as electricity and gas network operators; *see* generally Waelde & Wouters, *supra* note 18.

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tral tribunal should apply in order to determine the applicable law. In case of the ICSID, Article 42 of the Washington Convention provides that in the absence of agreement both national law and international rules are applicable. UNCITRAL and the Stockholm Chamber of Commerce Rules provide for application of normal conflict of laws principles. Because disputes based on investment agreements are brought in via the *pacta sunt servanda* principle of Article 10(1) last sentence of the ECT, a tribunal may be faced with resolving the questions whether international principles are applicable to the dispute and if so in relation to which issues, determining the nature and scope of those 'principles', and resolving possible conflicts between those principles and provisions of national law. The matter may become more complicated where issues of national law become involved, for example, where the state argues (perhaps by way of counter-claim) that the investor has infringed domestic law; may the tribunal take such claims into account?[39]

Ultimately, the most important question appears to be whether Article 26(6) is intended to exclude the application of other conflict of laws rules, or whether it is intended simply to express the priority of international norms over other rules to the extent of any conflict.

3.6. Enforcement of arbitral awards

Every effort is made to ensure that awards made under the Article 26 mechanism will be fully recognisable and enforceable. Where ICSID is chosen of course the enforcement provisions of the Washington Convention will apply (as between those states which are party to that Convention). In addition, Article 26(5.b) states *ex abundante cautio* that parties to an arbitration under Article 26 may request that the arbitration be held in a state that is party to the New York Convention: "[c]laims submitted to arbitration hereunder shall be considered to arise out of a commercial relationship or transaction for the purposes of Article 1 of that Convention."

4. CONCLUSION

The combination of the provisions of Part III of the ECT, together with the investor/state arbitration mechanism of Article 26, creates a significant range of novel rights and remedies for energy operators against discriminatory and injurious state measures. In doing so it raises a whole scala of issues raising questions for which no clear answers can yet be given. The nov-

39. This is not to forget the fact that in a number of countries the ECT will take direct effect upon ratification (or perhaps earlier) as part of the domestic legal order.

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elty of the ECT in this respect appears to derive from a convergence of factors. The first of these concerns the multilateral nature of the ECT. For the first time, the states of Western Europe have exposed themselves (wittingly or unwittingly) *inter se* to the risk of challenge for failure to observe international standards for the treatment of foreign investors, and this in a sector which is dominated by national interests. The availability of international commercial arbitration – at the discretion of the investor – as a forum to determine allegations of failure to respect these standards is, as regards investors in the EU, a radical step.

The second main factor which makes Article 26 of interest is the potential for development of the concept of MFN/NT in the context of liberalised gas and electricity sectors. This will be of importance both within the EU in the context of the electricity and gas liberalisation directives, as well as in Central Europe. Together with the extension of state responsibility under Article 22, new market entrants may well have a powerful weapon in their hands to combat unfair and anti-competitive treatment by incumbent monopolists.

Thirdly, the extension of the concept of 'compulsory' arbitration set out in Article 26, to arbitration as previously developed in international investment instruments, will render it a more attractive mechanism for dispute settlement, or at least support negotiations "in the shadow of the law".

On the other hand, the practical effectiveness of these provisions is likely to be dampened by the difficulties of giving concrete content to the Part III obligations. The vagueness and uncertainty of many of the provisions of Part III – the result of the process of compromise which is inherent in international treaty-making touching on issues of state sovereignty – may in practice constitute a significant barrier to taking advantage of the Article 26 mechanisms except in the most extreme circumstances.

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