

VOLTERRA FIETTA

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New developments in the energy law

Serbian Chamber of Commerce and Industry - 4 December 2018

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I. Introduction

Historical and political background to the ECT

- The ECT is an international treaty for cross-border cooperation in the energy industry.
- 1991: signing of the EEC, a political declaration setting out principles for cross-border cooperation in the energy industry and focusing on security of energy supply for the EU with a view to:
 - provide legal stability for investments and to secure trade and transit of energy; and
 - promoting energy market reforms as well as greater energy efficiency.
- 17 December 1994: conclusion and provisional application of the ECT (entered into force on 16 April 1998).
- The ECT established the Energy Charter Conference, an inter-governmental organisation which is the governing and decision-making body for the Energy Charter process.
- Serbia is an Observer to the Energy Charter Conference since 2001.
- In 2015, the EC Secretary General and Serbian Minister of Energy and Mining exchanged views on the next steps by Serbia towards acceding to the Energy Charter Treaty.
- By acceding to the ECT, Serbia may be able to boost cooperation with countries in the Balkan region and beyond, thanks to the ECT broad geographic coverage.

II. Overview of investment protection under the ECT

Investment protection under the ECT

- **Article 10(1):**

“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.”

- **Standards of protection set forth by Article 10(1) ECT:**

- 1) Fair and equitable treatment;
- 2) Constant protection and security;
- 3) Protection against unreasonable or discriminatory measures;
- 4) Treatment no less favourable than required by international law including treaty obligations;
- 5) Observance of obligations (the “umbrella” clause).

Investment protection under the ECT

- Fair and equitable treatment (“FET”)
 - Under general investment law, FET encompasses (i) transparency, stability and the protection of legitimate expectations, (ii) procedural propriety and due process, (iii) good faith and (iv) freedom from coercion and harassment. This is no less applicable to the ECT.
 - *Stati and Ascom v Kazakhstan*: FET needs to be considered against all of the factual circumstances; a tribunal must assess a violation of the ECT against all the measures carried out by the host State, “seen cumulatively in context to each other”.
- Constant protection and security
 - It has been defined as “[a] duty [...] to use the powers of government to ensure the foreign investment can function properly on a level playing field, unhindered and not harassed by the political and economic domestic powers”.
 - *Electrabel v. Hungary*: FET and the constant protection standards must have, by application of the legal principle of “*effet utile*”, a different scope and role (*Mamidoil v. Albania* agreed). However, the tribunal in *Stati and Ascom v Kazakhstan* suggested that they overlap.

Investment protection under the ECT

- Protection from unreasonable or discriminatory treatment
 - *Plama v. Bulgaria*: while the standards can overlap on certain issues, they can also be defined separately. Unreasonable or arbitrary measures are not founded in reason or fact but on caprice, prejudice or personal preference. Discrimination entails like persons being treated in a different manner in similar circumstances without reasonable grounds.
- Treatment no less favourable than required by international law including treaty obligations
 - A Contracting Party is vulnerable to a claim under the ECT even in case of a breach of international law which would not constitute a breach of any specific ECT obligation.
- “Umbrella” clause
 - Facts amounting to a contractual breach arguably do not automatically amount to a breach of the ECT. From this perspective, a breach of contract by a State will not amount to a breach of treaty if the State has not made use of its public powers to avoid its contractual commitments.
 - The wording encompasses both contractual and statutory obligations (*Plama v Bulgaria*). The provision does not refer to general obligations of the State arising as a matter of law (*Al-Bahloul v Tajikistan*, Partial Award on Jurisdiction and Liability).

Investment protection under the ECT

- National treatment and most favoured nation treatment – Article 10(7)

“Each Contracting Party shall accord to Investments [...] 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 [...].”

- Denial of justice – Article 10(12)

“Each Contracting Party shall ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights [...].”

- *AMTO v Ukraine:*

“Article 10(12) requires a State not only to ensure legislation and rules are promulgated to recognise and enforce property and contractual rights, but also that the quality of the legislation meets minimum international standards.”

“Bearing in mind the context and the object and purpose of the ECT, the Tribunal considers that “effective” is a systematic, comparative, progressive and practical standard.”

Investment protection under the ECT

- Expropriation – Article 13
 - Expropriation is not prohibited *per se* but legal expropriation of foreign-owned property is subject to certain conditions. Expropriation can be direct or indirect.
 - To be legal, an expropriation must be carried out for public interest purposes and under due process of law, must not be discriminatory and must be accompanied by payment of prompt, adequate and effective compensation. Compensation shall amount to the fair market value of the Investment immediately prior to expropriation or to the intention to expropriate becoming public.

- Indirect expropriation (adverse regulatory changes)
 - The threshold to be met by Investors is high: an Investor must prove (1) that the Investment has been deprived in whole or in significant part of its value or (2) that the Investor has been deprived of possession of the property or effective control of the Investment (*AES Summit v Hungary*).
 - *Electrabel v Hungary*: there must have been a fundamental deprivation of the Investor's rights or a virtual annihilation of the Investment, its value or enjoyment (even higher threshold).
 - *Mamidoil v Albania*: the essential characteristics of the property must have been impacted; *Charanne v Spain*: the loss of value must be of such significance to destroy the value of the Investment.

III. Dispute settlement mechanisms under the ECT

Dispute settlement mechanisms under the ECT

- Article 26 (Investor-State disputes)
- Article 26(1):

“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 alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably.”
- Article 26(2) offers the Investor three options after a cooling-off period of 3 months in relation to breaches of Part III of the ECT (investment promotion and protection):
 - National courts of the host State (option 1);
 - Other applicable means of dispute settlement previously agreed (option 2); or
 - International arbitration or conciliation (option 3).
- Contracting Parties give their unconditional consent to arbitration unless they have opted out in relation to certain circumstances (Annexes ID and IA).

International arbitration under the ECT

Jurisdiction of ECT tribunals

- Conditions *ratione materiae*:
 - 1) There must be an alleged breach of Part III of the ECT;
 - 2) The breach must relate to an investment as defined under Article 1(6) associated with an Economic Activity in the Energy Sector or designated as a “Charter efficiency project”;
 - 3) The investment must be in an Area of a Contracting Party.
- Condition *ratione personae*: the claimant must be an Investor of a Contracting Party as defined under Article 1(7):
 - Individuals who are (i) citizens, nationals or permanent residents of an ECT State or (ii) a company or legal entity organised in accordance with the laws of an ECT State.
 - ECT States have a right to deny “mailbox companies” access to ECT provisions under Article 17(1).
- Condition *ratione temporis*: Article 1(6) specifies that the term “Investment” includes all investments, whether existing at or made after the later of the date of entry into force of the ECT between the Contracting Parties to the dispute (the “Effective Date”).

IV. ECT jurisprudence's contribution to international investment law

States' rights to regulate under the ECT

- Article 10(1) is invoked by claimants as a limitation to a State's right to regulate. Investors challenging a State's right to regulate rarely succeed.
- FET standard
 - Tribunals will apply a two-tier test: (1) the objective of the public policy must be rational and (2) the act of State must be reasonable and proportional in relation to that objective. *Mamidoil v Albania*: the proportionality assessment must take into account the political context.
- Unreasonable or discriminatory measures
 - Unreasonable measures: the *AES Summit* tribunal applied the FET two-part test (i.e. rational objective and reasonable measures).
 - Discriminatory measures: whether a State applies its laws in a discriminatory way is more significant than the discriminatory potential of the laws themselves (*Nykomb v Latvia*).
- Constant protection and security
 - This standard has been interpreted as to include an “obligation actively to create a framework that grants security” (*Plama v Bulgaria*) “in appropriate circumstances” (*AES Summit v Hungary*).

Denial of benefits under the ECT

- Article 17(1):
 - “Each Contracting Party reserves the right to deny the advantages of this Part to:
 - (1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized [...]”.
 - *Plama v. Bulgaria*: the “denial of benefits” clause does not affect jurisdiction. Rather, it concerns substantive protections, and the conditions under which a Contracting Party may deny benefits to an otherwise protected investor. “Denial of benefits” operates in perspective, i.e. from the moment in which the Contracting Party makes a declaration under Article 17(1).
 - Subsequent ECT jurisprudence came to similar findings (*Liman v. Kazakhstan*; *Stati v. Kazakhstan*; *Yukos v. Russia* and *Isolux v. Spain*).
 - Several non-ECT investment tribunals have found that a “denial of benefits” clause may operate retrospectively. The tribunal in *Guaracachi America, v. Bolivia* found that:
 - “The very purpose of the denial of benefits is to give the Respondent the possibility of withdrawing the benefits granted under the BIT to investors who invoke those benefits. As such, it is proper that the denial is ‘activated’ when the benefits are being claimed”.

Provisional application of the ECT

- Article 45:

“(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 [...].”

- *Kardassopoulos v. Georgia*: Article 45(1) allows a signatory not to apply the treaty provisionally due to inconsistency with its domestic law (no declaration necessary); Article 45(2) permits a signatory to avoid provisional application for reasons not necessarily related to its domestic law (declaration required).
- Provisional application of the Treaty as a whole or only of the parts of it (“piecemeal approach”) is debated.
- *Yukos v. Russia* rejected Russian piecemeal argument under Article 45(1): the ECT provisionally applied in its entirety to Russia from the date of its signature until 60 days after the notification.
- However, these findings were overturned by the Hague District Court, which held that held that Russia was only bound by those treaty provisions which were reconcilable with Russian law.

V. Modernisation of the ECT

Modernisation of the ECT

- Contracting Parties and Signatories are analysing current investment policy tendencies incorporated in international investment agreements for the sake of modernising the ECT.
- Main topics under consideration are:
 - **Covered investments** (add specific characteristics such as commitment of capital, an effective contribution to the host State’s economy, and a certain duration, and/or include a legality requirement, i.e. compliance with domestic laws);
 - **Covered investors** (add additional criteria for the definition of covered investors - a company must have its “seat” and engage in “real/substantial business” activities in the home State, exclusion of individuals with dual nationality, etc.);
 - **FET** (replace the general clause with an exhaustive list of what the Parties would consider a breach of the standard);
 - **Most constant protection and security** (limit protection to physical security);
 - **Denial of benefits** (specify that the denial of benefits clause can also be invoked once Investment proceedings have started);
 - **States’ right to regulate** (add a provision specifying the State’s right to regulate to achieve legitimate policy objectives).

