Investment arbitration under the Energy Charter Treaty

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This Note explains the legal requirements of the Energy Charter Treaty (ECT). It analyzes issues and concepts that commonly arise in arbitration under the treaty.

SCOPE OF THIS NOTE

The Energy Charter Treaty (ECT) creates a legal framework for energy trade, transit and investment among member states. The ECT, a multilateral investment treaty, aims to unite its signatories behind the common goals of setting up open energy markets, securing and diversifying energy supply and stimulating cross-border investment and trade in the energy sector.

The ECT has 52 signatories, 47 of which have ratified it. While a multilateral treaty with binding force, the ECT is limited in scope to the energy sector. It includes provisions on:

- Investment protection.
- Trade.
- Transit.
- Energy efficiency and environmental protection.
- Dispute resolution.

The most commonly chosen forum for investor-state disputes arising under the ECT is international arbitration. At the time of writing, 62 arbitration claims were known to have been brought under the ECT, of which eight were settled, 29 are still pending and 25 resulted in final awards. A list of known ECT cases is available on the ECT website.

This Note explains:

- The definitions that determine which investors and investments enjoy the protection of the ECT.
- The provisions relating to investment protection.
- The dispute resolution provisions, focusing on the arbitration option.

Where possible, these are discussed by reference to awards in cases brought under the ECT.

INVESTMENT PROTECTION UNDER THE ECT

The investment protection provisions of the ECT are contained in Part III of that treaty. To invoke those protections, a claimant must demonstrate that it has made an investment in an ECT contracting state and that it qualifies as an investor from another contracting state. Both "investment" and "investor" are defined in the ECT.

DEFINITION OF INVESTMENT

Article 1(6) of the ECT defines investment as all types of assets directly or indirectly controlled or owned by an investor. These assets include:

- Tangible and intangible, and movable and immovable property.
- Any property rights, such as leases, mortgages, liens, and pledges.
- 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.
- Claims to money and to performance under a contract that has an economic value and is associated with an investment.
- Intellectual property.
- Returns.
- Any right conferred by law or contract or by virtue of any licences and permits granted by law to undertake energy sector economic activity.

In addition, any change in the form of the assets invested does not affect their character as investments.

An 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 'Effective Date') provided that the Treaty shall only apply to matters affecting such investments after the Effective Date."

(*Article 1(6), ECT*.)

Issues commonly arise in relation to the ownership or control of shares in this context. Claimants have often invoked the ownership or control of shares in companies as sufficient to qualify as an investment. States have objected to the jurisdiction of arbitral tribunals on the basis that the claimant investors did not, in fact, own or control the shares invoked as their qualifying investments, asserting that the investors were not the true or beneficial owners of the shares.

For example, in *Veteran Petroleum Limited (Cyprus) v Russian Federation*, *PCA Case No. 228 (2009)*, the tribunal found that it had jurisdiction and dismissed the respondent's objections that the claimant was not the ultimate or beneficial owner or controller of the shares in the Russian company that it had invoked as its qualifying investment. The tribunal noted that there was no indication that the drafters of Article 1(6)(b) of the ECT (which contained "the widest possible definition of an interest in a company") intended to limit the meaning of ownership of shares to the beneficial ownership of shares (*paragraph 477*).

In *Ammar Al-Bahloul v Republic of Tajikistan (SCC Arb. No. V064 (2008))*, the situation was the reverse. The claimant was the beneficial, but not the nominal, owner of the shares in the local joint venture company. Those shares were held by a company registered in the Bahamas (a non-signatory to the ECT), which was in turn entirely owned by the claimant.

The tribunal noted that the ECT's definition includes investments "owned or controlled directly or indirectly," which would include assets held through an intermediary company in a non-ECT state. Consequently, the shares held in the local company by the Bahamian company qualified as an investment under the ECT for jurisdictional purposes (*paragraph 142*).

Tribunals hearing claims brought under the ECT often consider other categories of investments under Articles 1(6)(c) and 1(6)(f), both of which claimants often invoke regarding the same investment due to the overlap between performance claims and all rights conferred under the contract. In *Petrobart v Kyrgyz Republic (SCC Arb. No. 126 (2003)*), the claimant sought arbitration of a claim for unpaid invoices under a contract with a state-owned company, reduced to a judgment in the local civil court, for the supply of gas condensate. The Kyrgyz government objected to the jurisdiction of the tribunal on the basis that no investment had been made.

The tribunal stated that the contract and the judgment were not, in themselves, assets or investments under Article 1(6), but legal documents or instruments bearing legal rights. These legal rights, depending on their character, may or may not be considered as assets or investments for the purposes of Article 1(6). After confirming that gas condensate, sold under the relevant contract, was an energy material or product (and that the claimant's investment was therefore one associated with an economic activity in the energy sector, as required under Article 1(6)), the tribunal found that a right conferred by contract to undertake an economic activity concerning the sale of gas condensate is an investment according to the ECT and that this also included the right to be paid for this type of sale (*page 72*).

In *Electrabel SA v Republic of Hungary (ICSID Case No. ARB/07/19 (2012)*), the claimant sought damages for alleged termination and breach of a power purchase agreement (PPA). There was no dispute that the claimant's shareholding in the company that was a party to the PPA qualified as an investment under Article 1(6). However, the parties disagreed whether the rights under the PPA constituted separate investments under Articles 1(6)(c) and (f). Hungary argued that the claimant was seeking to subdivide its overall investment into a series of stand-alone investments to be able to claim that it was substantially deprived of an investment, and that therefore an expropriation had taken place.

Regarding the PPA termination claim, the tribunal rejected Hungary's jurisdiction objection, taking the view that the right to undertake electricity sales and distribution under the PPA pursuant to Hungarian law constituted an investment. However, the tribunal then found that the claimant had failed to meet the test for indirect expropriation under international law. To have met that test, the claimant would have needed to establish "the substantial, radical, severe, devastating or fundamental deprivation of its rights or the virtual annihilation, effective neutralisation or factual destruction of its investment, value or enjoyment" (*paragraph 6.62*). See also *Legal Update, ICSID tribunal further clarifies hierarchy between EU law and ECT in investor-state energy disputes (http://us.practicallaw.com/1-523-2546)*.

For detailed discussion on what constitutes an investment, see *Practice note, Definition of investment in international investment law (http://us.practicallaw.com/7-501-5427)*.

DEFINITION OF INVESTOR

An investor under the ECT is either:

- A natural person having the citizenship or nationality of, or who is permanently residing in, a nation that is a member of the ECT.
- An entity organised according to the law applicable to a nation that is a member of the ECT.

(*Article 1(7), ECT*.)

The tribunal in *Veteran Petroleum*, interpreting the definition of investor under the ECT, gave a wide interpretation to that term, just as it had with the definition of investment (see also *Saluka Investments BV (The Netherlands) v The Czech Republic, PCA (2006)*). The tribunal declined Russia's invitation to pierce the corporate veil and find that the investor was actually Russian rather than a resident of another contracting party. This decision is consistent with those of other investment treaty tribunals that have declined to look beyond the place of incorporation of the investor company in determining nationality.

For a detailed analysis of who is an investor under treaties, see *Practice note, What is an investor for the purposes of investment treaty arbitration? (http://us.practicallaw.com/9-502-4628)*

INVESTMENT PROMOTION AND PROTECTION

The investment promotion and protection provisions of the ECT, found in Part III, contain the obligations that states assume under the ECT towards foreign investors. In bringing a claim before an arbitral tribunal, investors must demonstrate a breach of these obligations to be entitled to an award of damages.

PROMOTION, PROTECTION AND TREATMENT OF INVESTMENTS

Article 10 obliges states to provide effective means to investors under domestic law to enforce their rights, stating:

> "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."

Fair and equitable treatment

Many arbitral tribunals hearing claims brought under the ECT and other investment treaties interpret and apply the fair and equitable treatment standard under international law. This has created a considerable body of case law that has added specified meaning and content to the standard.

The fair and equitable treatment standard must be considered against all of the factual circumstances of the particular case in which it is applied. The standard includes:

- The obligation to treat investors and their investments in a transparent manner (see *Micula v Romania ICSID Case No. ARB/05/20 (2013)*).
- The obligation to act in good faith towards investors and their investments (see *Oostergetel v Slovak Republic UNCITRAL, Final Award (2010)*).
- The obligation to refrain from taking arbitrary or discriminatory measures (see *Electrabel*).
- The obligation to afford due process to investors and their investments (see *AES Summit Generation Ltd v Republic of Hungary, ICSID Case No. ARB/07/22 (2010)*).

For a detailed explanation of the fair and equitable treatment standard in investment arbitration, see *Practice notes, Investment treaty arbitration: legal issues: What obligations are placed on the host nation? (http://us.practicallaw.com/9-205-5048)* and *Fair and equitable treatment in international investment law (http://us.practicallaw.com/5-385-7129)*.

An issue that remains unsettled is the role of an investor's expectations in deciding fair and equitable treatment claims. In the ECT context, according to the tribunal in *Electrabel*, the protection of the investor's reasonable and legitimate expectations is the most important element of the fair and equitable treatment standard. However, the tribunal acknowledged that fair and equitable treatment is not a guarantee against all regulatory change. The tribunal found no breach of the fair and equitable treatment standard due to changes in electricity prices by regulatory practices or by operation of law. The tribunal found that Hungarian government had not acted unreasonably, irrationally or in bad faith in changing its pricing mechanism. The tribunal added that the claimant could not have had a legitimate expectation that the claimant would have been able to charge prices for electricity under the power purchase agreement free from regulatory changes.

In another ECT case (*Plama Consortium Ltd v Republic of Bulgaria (ICSID Case No. ARB/03/24) (2008), at paragraph 175*), the claimant argued breach of the fair and equitable treatment standard due to, among other things, what it claimed were sudden and unfair amendments to Bulgaria's environmental laws. The tribunal held that the fair and equitable treatment standard includes only "to a certain extent" the protection of legitimate expectations, that is only investment-backed expectations based on conditions specifically offered by the state when the investor makes the investment. The tribunal ruled that the amendment to Bulgaria's environmental legislation was not a breach of the fair and equitable treatment standard because the environmental legislation in place at the time of the claimant's investment did not in fact give any assurances that the claimant would be exempt from liability for past environmental damage.

The argument in *Al-Bahloul*, that the claimant was denied fair and equitable treatment based on frustration of legitimate expectations also failed. The tribunal found that, although the claimant may have had legitimate expectations that exploration licences to conduct oil and gas activities in certain areas would be issued, based on representations by local authorities, it could not demonstrate that its investments were made in reliance on its expectation of the issuance of the licences (*paragraph 210, Al-Bahloul*).

For more information on the fair and equitable treatment standard, see *Practice note, Fair and equitable treatment in international investment law (http://us.practicallaw.com/5-385-7129)*.

Full protection and security

Article 10(1) of the ECT requires states to provide the most constant protection and security to the investments of an investor. This is known as the full protection and security standard. In *Electrabel*, rather than setting out its own detailed interpretation of the scope of the full protection and security standard, the tribunal reproduced the description of the scope of the standard given by another (non-ECT) investment treaty arbitration tribunal in *El Paso Energy International Company v The Argentine Republic* (*ICSID Case No. ARB/03/15 (2011)*), with which it agreed.

The tribunal in *Electrabel* noted that the minimum standard of vigilance and care set by international law comprises a duty of prevention and of repression. This includes the requirement to use due diligence to prevent wrongful injuries to foreign investors and their investments caused by third parties within their territory and, if not possible, at least to exercise due diligence to punish those injuries. The tribunal emphasised that the obligation to show due diligence does not mean that a government has to prevent each and every injury, but rather it is required to take reasonable actions within its power to avoid injury when it is aware, or should be aware, of the risk of injury (see *Legal update, ICSID tribunal further clarifies hierarchy between EU law and ECT in investor-state energy disputes (http://us.practicallaw.com/1-523-2546)*).

The tribunal rejected the claims for breach of the most constant security and protection provision on the basis that Hungary did provide the claimant with the necessary legal measures or tools for protecting its investment against adverse action by private parties.

Another tribunal, in *Liman Caspian Oil BV and NCL Dutch Investment BV v Republic of Kazakhstan (ICSID Case No. ARB/07/14)*, stated that the purpose of the obligation is to protect investments against interference by the use of force and particularly physical damage. Because there was no allegation of force and damage to property, there was no claim under the full protection and security standard.

In *AES Summit*, the tribunal interpreted the standard more broadly, holding that a state must "take reasonable steps to protect its investors (or to enable its investors to protect themselves) against harassment by third parties and/or state actors." Beyond physical security, the state owes the investor legal security and must provide a reasonable measure of prevention that can be expected of a well-administered government (see *Legal update, ICSID decision on relationship between ECT and EU law (http://us.practicallaw.com/8-503-5364)*). The tribunal ultimately declined to find a breach of the provision and rejected the claim.

For more information on the full protection and security standard, see *Practice note, Fair and equitable treatment in international investment law: Obligation to provide full protection and security (http://us.practicallaw.com/5-385-7129)*.

Unreasonable or discriminatory measures

The ECT's prohibition against states impairing investments by unreasonable and discriminatory measures overlaps considerably with the fair and equitable treatment standard.

The tribunal in *Nykomb Synergetics Technology Holding AB v The Republic of Latvia (SCC (Final Award) (2003))* found that Latvia had discriminated against the claimant by providing double tariffs for surplus electric power to two other companies in similar circumstances to claimant, but not to the claimant. The tribunal stated that, when comparing whether there is discrimination under the ECT, one should only compare "like with like." The tribunal ruled that the burden of proof lay with the respondent to show that no discrimination had taken place and that the respondent had failed to meet that burden (page 34, Final Award).

For more information on the unreasonable and discriminatory measures standard, see *Practice note, Fair and equitable treatment in international investment law: Discriminatory and arbitrary conduct*.

Umbrella clause

The last sentence of Article 10(1) of the ECT states that "[a] 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 is a so-called umbrella clause.

An umbrella clause is a provision that obliges the host state to observe specific undertakings towards its foreign investors. It protects investments by bringing obligations or commitments that the host state entered into in connection with a foreign investment under the protective "umbrella" of the BIT. Investors frequently rely on umbrella clauses as a catch-all provision where the state's conduct may not constitute a breach of other treaty obligations. In particular, investors have sought to bring claims under umbrella clauses over alleged failures by states to perform commercial contracts.

For example, the tribunal in *Al-Bahloul* found that Tajikistan had breached the ECT's umbrella clause by failing to perform its contractual obligation to issue licences for geological exploration and natural resource exploitation works.

For a more detailed analysis of umbrella clauses in investment arbitration, see *Practice note, Umbrella clauses (http://us.practicallaw.com/7-381-7477)*.

NATIONAL TREATMENT AND MOST FAVOURED NATION TREATMENT

The national treatment and most-favoured-nation (MFN) treatment standards are found in many investment treaties and aim to provide a level playing field between foreign and local investors, as well as between foreign investors from different countries.

The national treatment standard prohibits discrimination by the host state between nationals of that country and foreign investors. MFN clauses link investment agreements by ensuring that parties to one treaty provide treatment no less favourable than the treatment they provide to investors under other treaties. The national treatment and MFN obligations in the ECT are contained in Article 10(7), which provides:

> "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."

Although arbitral tribunals hearing disputes brought under investment treaties often consider these types of clauses, tribunals have rarely considered the national treatment and MFN clauses of the ECT specifically.

The claimant in *Al-Bahloul* argued a breach of the national treatment standard on the basis that Tajikistan permitted the Tajik co-party to the claimant's joint venture companies to contribute share capital in return for outdated machinery, equipment and other property, while refusing the claimant the opportunity to contribute its share of authorised capital in anything other than cash. The tribunal rejected this claim, stating that the parties freely negotiated the relevant agreements and the claimant freely accepted the obligation to contribute its capital in cash.

In *AES Summit*, the claimant brought a claim for breach of the national treatment standard on the grounds that a domestically owned electricity generator received more favourable energy tariffs than other generators, including the claimants. The tribunal rejected this argument, finding that there was no evidence that Hungary discriminated based on nationality.

For an explanation of how arbitral tribunals have treated MFN clauses in other treaties, see *Practice note, How most favoured nation clauses in bilateral investment treaties affect arbitration (http://us.practicallaw.com/0-381-7466)*.

EFFECTIVE MEANS

Article 10(12) of the ECT provides that the domestic law of each contracting party must provide effective means to assert claims and enforce the rights concerning investments and investment agreements and authorisations.

The claimant in *Limited Liability Company Amto v Ukraine, Arbitration (SCC Arb. No. 080/2005 (Final Award) (2008)*) claimed breach of Article 10(12), on the ground that Ukraine's bankruptcy legislation allegedly did not meet the standard required by international law. According to the tribunal, the state must provide an effective framework for the enforcement of rights, but does not offer guarantees in individual cases. Although individual failures might be evidence of systematic inadequacies, they do not in themselves amount to a breach of the effective means standard. It also noted that a state's taking of appropriate steps to address deficiencies in its legislation should be acknowledged in assessing effectiveness.

EXPROPRIATION

Expropriation is a taking by a state for which compensation is required. Under the ECT, "investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation" (*Article 13(1)*). However, expropriation may be exercised where it is:

- In the public interest.
- Non-discriminatory.
- Executed under due process of law.
- Promptly, adequately and effectively compensated for.

(*Article 13(1), ECT*.)

Measure of compensation

For purposes of compensation, the difference between lawful and unlawful expropriation may be relevant. The Permanent Court of International Justice noted that difference in *The Factory at Chorzów (Germany v Poland) PCIJ Series A, No 17 (1928)* and most, if not all, investment tribunals have made that distinction. An expropriation is usually deemed lawful if it is:

- For a public purpose.
- Non-discriminatory.
- Carried out under due process of law.
- Accompanied by payment of compensation.

If unlawful, *Chorzów Factory* holds that "reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed" (*page 47, Chorzów Factory*). This standard was applied in *Kardassopoulos and Fuchs v Georgia (ICSID Case Nos Arb/05/18 and ARB/07/15)*. The tribunal observed that the standard may require damages to be awarded as of the date of the award to compensate the claimant for any gain in value between the date of the expropriation and the date of the award. In that instance, the tribunal found that the date of award was not the appropriate date at which to value the expropriated investment, because the claimant would likely have sold its investment (rights of a local joint-venture company, in which it held an interest, to an oil pipeline) at an earlier date than the award in any event. The tribunal set the date of valuation of the expropriated investment at the date of an action, attributable to the Georgian government, before the actual expropriation, to ensure full reparation and to avoid any diminution of value of the investment by the state's conduct.

In *Yukos Universal Limited (Isle of Man) v Russian Federation (PCA Case No. AA 227, Final Award)*, the tribunal held that, if the expropriated asset could be returned to the investor and its value had decreased since the expropriation, the investor would be entitled to the difference in value. For more detailed discussion about this case, see *Legal update, Majority shareholders in Yukos awarded US$50 billion (http://us.practicallaw.com/0-576-3965)*.

Indirect and creeping expropriation

Article 13(1) of the ECT also protects the investor against indirect or creeping expropriation, which involves measures that effectively prevent the operation or enjoyment of the investment or render the investment useless, even though the investor may retain legal title to its investment. The difference between direct and indirect expropriation depends on whether the legal title of the owner is affected by the measure in question. Direct expropriations are rare because governments are reluctant to attract negative publicity by openly taking foreign property.

Indirect expropriations occur much more frequently. An indirect expropriation lets the investor keep title to the property, but prevents the investor from using it in a meaningful way. Creeping expropriation involves a gradual expropriation through a series of acts.

In *Plama*, the claimant alleged that several actions cumulatively deprived it of all economic benefit and use of its investment. The actions included:

- Amendments to Bulgaria's environmental laws that passed liability for environmental damage from the state to the claimant.
- The failure of the Bulgarian government to amend its corporate income tax laws in a timely manner to enable the claimant to file its annual accounts.
- The unlawful de facto privatisation of a port that the claimant relied on for its crude oil supply.
- The unlawful instigation of a riot at the claimant's oil refinery that resulted in a shutdown of that refinery.
- Deliberate breaches by a state-owned bank of its debt settlement agreement with the claimant.

The tribunal considered the following factors:

- Whether there was substantially complete deprivation of the economic use and enjoyment of the rights to the investment or of identifiable, distinct parts of it (that is, approaching total impairment).
- The irreversibility and permanence of the contested measures.
- The extent of the loss of economic value.

On the facts found by the tribunal, it ruled that there was no expropriation (see *Legal update, ICSID tribunal rejects ECT claim on grounds of investor´s fraudulent misrepresentation (http://us.practicallaw.com/9-384-9825)*.)

On the other hand, in *Yukos*, the claimant proved indirect expropriation, which resulted in an award of US$50 billion, the largest known arbitration award to date. The claim was brought by shareholders of the defunct Yukos oil company. The Russian government's measures against Yukos, which the claimant invoked as amounting to an expropriation of its investment, included:

- Criminal proceedings resulting in the interrogation, arrest or sentencing of 35 of the claimant's top personnel.
- Obstruction of the work of lawyers acting for Yukos.
- Searching and seizing Yukos's property.
- Allegedly frustrating a merger between Yukos and another oil company.
- Imposing tax re-assessments against Yukos for more than $24 billion.
- Seizing shares and other assets belonging to Yukos based on the re-assessed tax debts.

In ruling that the Russian government's actions amounted to an expropriation, in breach of Article 13(1) of the ECT, the tribunal in Yukos noted that the Russian government had not "explicitly" expropriated Yukos or the holdings of its shareholders, but that the measures it took towards Yukos had an effect "equivalent to nationalization or expropriation".

For a detailed explanation of the *Yukos* award, see *Legal update, Majority shareholders in Yukos awarded US $50 billion (http://us.practicallaw.com/0-576-3965)*.

The Russian Federation has filed annulment proceedings in The Hague, requesting that the awards be annulled on the following grounds:

- The tribunal did not have jurisdiction to hear the former Yukos shareholders' claims.
- The tribunal violated its own mandate.
- The tribunal either failed to give reasons, or gave inconsistent reasons, for key aspects of its rulings.
- The awards violated public policy, including the Russian Federation’s fundamental right to due process in defending itself in economic disputes.

(See *Press Release of the Russian Ministry of Finance*.)

TRANSFERS RELATED TO INVESTMENTS

Article 14(1) of the ECT provides that a contracting party will guarantee the freedom of transfer of:

- Initial capital and any additional capital used to maintain and develop the investment.
- Returns.
- Contract payments, including amortisation of principal and accrued interest payments under a loan agreement.
- Unspent earnings and compensation to "personnel engaged from abroad" as part of the investment.
- Sale or liquidation proceeds for all or any part of the investment.
- Payments from dispute settlements.
- Compensation payments under Articles 12 and 13 of the ECT.

No arbitrations have been brought in respect of this provision of the ECT.

DENIAL OF BENEFITS CLAUSE

The purpose of a denial of benefits clause is to prevent shell or other companies incorporated in a country that is party to an investment treaty with the host state from claiming under that treaty. The ECT includes a denial of benefits clause at Article 17(1), which provides that a contracting party has the right to deny advantages to parties based on a lack of substantial business activities where it is organised.

In *Plama (Decision on Jurisdiction)*, the tribunal found that the claimant had "no substantial business activities in the Area of the Contracting Party in which it is organized" (which it referred to as the "second limb" of Article 17(1)). The tribunal then addressed what it referred to as the "first limb" of Article 17(1), asking whether the claimant company in question was owned or controlled by "citizens or nationals of a third state." The tribunal found third state to mean any state that is not a party to the ECT.

After referring its answer on this issue to the merits, the tribunal found that the claimant company was ultimately owned and controlled by a French national, and with France being a party to the ECT, the denial of benefits clause did not apply to the claimant. For the tribunal, evidence that the shares in the claimant company were held in trust for the French national, through other companies, was enough to establish ownership and control.

In *Amto*, the tribunal considered whether the substantial business activity limb of the ECT's denial of benefits clause could be invoked against the claimant. The tribunal interpreted the word "substantial" to mean "of substance and not merely of form" and decided that it was the materiality not the magnitude of the business activity that was decisive. The tribunal found that investment-related activities conducted from premises in the contracting party, coupled with the employment of a small but permanent staff, was sufficient to amount to substantial business activity.

TAX CARVE-OUT

Article 21(1) of the ECT contains what is known as the ECT's tax carve-out. Article 21(1) provides that the ECT does not create rights or impose obligations with respect to taxation measures of the contracting parties and that article alone prevails over any inconsistency with other provisions in the ECT. Article 21(5) also provides for a claw-back regarding expropriatory taxes.

In *Yukos*, counsel for the Russian government argued that the majority of the actions the claimant invoked as treaty breaches by the respondent were outside the scope of the tribunal's jurisdiction due to the tax carve-out provision in Article 21(1) of the ECT. Regarding the claw-back provision in Article 21(5), Russia's counsel noted the reference to taxes rather than tax measures and argued that the claw-back was therefore applicable only to actual taxes and not to the measures like tax collection, enforcement or penalties that the government took against Yukos.

The arbitral tribunal rejected these arguments on two grounds:

- The tribunal had "indirect" jurisdiction over expropriation claims under Article 13 of the ECT because any measures excluded by the carve-out under Article 21(1) would be brought back within the tribunal's jurisdiction by the claw-back in Article 21(5).
- The carve-out in Article 21(1) did not apply to the measures taken by the government because it could apply only to bona fide taxation actions, which the tribunal described as "actions that are motivated by the purpose of raising general revenue for the State". The Russian actions were taken "only under the guise of taxation", but in reality aimed to achieve an entirely unrelated purpose ("the destruction of a company and the elimination of a political opponent").

DISPUTE RESOLUTION

Investor-state disputes under Part III of the ECT are governed by Article 26. This provides that an investor may, following a cooling-off period of three months, submit the dispute to resolution, at the investor's option:

- To the courts or administrative tribunals of the host state party to the dispute.
- According to a previously agreed dispute settlement procedure.
- To international arbitration.

CHOICE OF ARBITRAL INSTITUTION

Article 26(4) of the ECT provides that investors opting for arbitration may choose any of the following:

- ICSID arbitration (where both the host state and the investor's state are a party to the ICSID Convention).
- Arbitration under the *ICSID Additional Facility Rules* (where either the host state or the investor's state, but not both, are a party to the ICSID Convention).
- A sole arbitrator or ad hoc arbitral tribunal established under the *UNCITRAL Arbitration Rules (http://us.practicallaw.com/8-503-0371)*.
- Arbitration under the Arbitration Institute of the Stockholm Chamber of Commerce.

For detailed explanation of the procedure in ICSID arbitration, see *Practice notes*, *Procedure in ICSID arbitration (http://us.practicallaw.com/4-205-5055)* and *ICSID arbitration: a step-by-step guide (http://us.practicallaw.com/2-382-0019)*. For discussion about UNCITRAL arbitration, see *Practice note, Arbitrating under the UNCITRAL Rules 2010 and 2013: a step-by-step guide (http://us.practicallaw.com/9-503-2671)*.

JURISDICTIONAL CONSIDERATIONS

In *Anatolie Stati*, *Gabriel Stati, Ascom Group SA and Terra Raf Trans Trading Ltd v Republic of Kazakhstan (SCC Arb. No. V116/2010 (2013))*, the Kazakhstan government lodged a jurisdictional objection on the ground that the claimants did not provide a notice of the dispute before they filed the notice of arbitration and that, therefore, the three month cooling-off period was not satisfied.

The tribunal rejected the jurisdictional objection, stating that the three-month waiting period set out in Article 26(2) was a procedural and not jurisdictional requirement. The tribunal stated that a three-month negotiation period had taken place after the initiation of proceedings, when the proceedings were suspended for such purpose, and that as the intention of Article 26(2) was to provide a period for negotiating settlements, no prejudice had occurred and there was no reason to deny jurisdiction.

Similarly, the tribunal in *Amto* considered claim letters as notification of the dispute invoking the ECT three months before initiating proceedings as sufficient, even though the letters did not expressly request amicable settlement.

However, tribunals in non-ECT investment treaty arbitration have taken a contrary view. For example, in *Burlington Resources Inc. v Republic of Ecuador (ICSID Case No ARB/08/5 (2012)*) and *Murphy Exploration and Production Company International v Republic of Ecuador (ICSID Case No ARB/08/4 (2010)*), the tribunals found that they lacked jurisdiction over claims under the US-Ecuador bilateral investment treaty (BIT) where the claimants were deemed not to have observed the waiting period (see *Legal updates, Ecuador successfully challenges jurisdiction (http://us.practicallaw.com/1-502-7188)* and *Tribunal lacks jurisdiction as claim filed before expiry of the "cooling-off" period (http://us.practicallaw.com/8-504-3118)*).

In addition, in *Tulip Real Estate Investment and Development Netherlands BV v Republic of Turkey (ICSID Case No ARB/11/28 (2013)*), the tribunal held that requirements to negotiate in good faith and not to commence arbitration until a year after notice of the dispute arising were pre-conditions to the tribunal's jurisdiction. However, the claimant narrowly satisfied the requirements, so the tribunal had jurisdiction (see *Legal update, Pre-arbitration negotiation period mandatory (ICSID) (http://us.practicallaw.com/0-525-6514)*).

FORK IN THE ROAD CLAUSE

Article 26(3)(b)(i) bars a claimant from submitting a dispute to international arbitration under the ECT if it has already submitted that dispute to the national courts of the host state. The fork in the road clause only applies in the case of the contracting states listed in Annex ID to the ECT.

Numerous investment treaty arbitral tribunals, including those hearing disputes brought under the ECT, have considered when a dispute subject to a claim before an investment treaty tribunal can be said to have already been submitted to a national court.

In *Yukos*, the Russian government objected to the jurisdiction of the tribunal on the basis that the claimant had submitted the matters complained of in its statement of claim to various Russian courts and the European Court of Human Rights. In deciding the jurisdictional objection, the tribunal applied the "triple identity test", which examines the identity of parties, the cause of action and the object of the dispute. The tribunal found that none of the actions invoked by the claimants against the Russian government in other cases contained alleged breaches of the ECT and so the test was not satisfied (*award, paragraph 1257*).

In contrast, in *Pantechniki SA Contractors & Engineers v Republic of Albania (ICSID Case No ARB/07/21 (2009))* (a claim under the Greece/Albania BIT), the claimant's pursuit of claims in the Albanian courts resulted in a successful jurisdictional challenge on the basis of the fork-in-the road provision in the relevant BIT (see *Legal Update, "Fork in the road" provision applied (http://us.practicallaw.com/0-422-1842)*).

APPLICABLE LAW

Article 26(6) of the ECT provides that tribunals hearing disputes brought under the ECT shall apply the provisions of the ECT and "applicable rules and principles of international law."

The issue of which law, or laws, should be applied in determining claims under the ECT has been examined in a number of cases, most of which consider the relationship between the ECT and European Union (EU) law. Tribunals have reached different conclusions on this issue and because previous decisions of investment arbitration tribunals, including ICSID tribunals, are not binding as precedent on other parties, there is uncertainty on this issue (although the tribunal in Electrabel did observe that "tribunals in investor-state arbitrations should take into account earlier decisions and also should not distance themselves from an existing series of consistent decisions save for compelling reasons" (*Decision on Jurisdiction, Applicable Law and Liability, paragraph 4.15*)).

For example, in *AES Summit Generation Ltd and AES-Tisza Erömü Kft v Republic of Hungary (ICSID Case No ARB/07/22)*, the tribunal held that the applicable law was the ECT, together with applicable rules of international law (see *Legal update, ICSID decision on relationship between ECT and EU law (http://us.practicallaw.com/8-503-5364)*).

By contrast, in *Electrabel SA v the Republic of Hungary (ICSID Case No. Arb/07/19)*, the tribunal held that, where a dispute arises under the ECT between EU member states in circumstances where one of the parties acceded to the EU after becoming party to the ECT, EU law will prevail over the ECT (see *Legal update, ICSID tribunal further clarifies hierarchy between EU law and ECT in investor-state energy disputes (http://us.practicallaw.com/1-523-2546)*).

In *Yukos*, the tribunal found the applicable substantive law to be the *Vienna Convention on the Law of Treaties* and other applicable rules and principles of international law.

In determining principles of international law, arbitral tribunals often look to Article 38(1)(c) of the Statute of the International Court of Justice, which refers to "general principles of international law recognized by civilized nations" (see *Inceysa Vallisoletana S.L. v Republic of El Salvador, ICSID Case No. ARB/03/26 (2006), at paragraph 225*).

For information on developments in this area, see *Intra-EU bilateral investment treaties: tracker*.

FINAL PROVISIONS

ENTRY INTO FORCE

Under Article 44(2), the ECT enters into force for each state or regional economic integration organisation that ratifies, accepts, approves or accedes to it on the 90th day after the date of deposit of the instrument of ratification, acceptance or approval by that state or regional economic integration organisation.

PROVISIONAL APPLICATION

Article 45(1) of the ECT provides that all signatories agree to apply the ECT provisionally pending its entry into force in accordance with Article 44, to the extent that provisional application is not inconsistent with its constitution, laws or regulations.

Article 45(2)(a) of the ECT provides that any signatory may, when signing the treaty, make a declaration that it is not able to accept provisional application, meaning that provisional application does not apply to that signatory. The list of countries that do not accept provisional application of the ECT is contained in Annex PA to the ECT. Investors with the nationality of states that do not accept provisional application of the ECT cannot invoke Article 45(1), meaning that they cannot bring claims against states under the ECT.

Under Article 45(3)(a) of the ECT, any signatory may terminate its provisional application of the ECT by written notification of its intention not to become a contracting party. Article 45(3)(b) provides that, in the event that a signatory terminates provisional application under Article 45(3)(a), provisional application of the investment protection and dispute resolution provisions of the ECT will remain in effect for investments of investors made during the period of provisional application for 20 years following the date of termination.

The effect of the provisional application regime has been considered in cases where contracting states have sought to argue that they are not bound by the ECT because they have signed it, but not ratified it.

In *Kardassopoulos*, the tribunal considered an argument by the Georgian government that provisional application is only aspirational in character. The tribunal rejected this argument, finding that Article 45(1) should be interpreted as meaning that each signatory state is obliged to apply the whole ECT as if it had entered into force, before it had actually done so.

In *Yukos (Interim Award on Jurisdiction and Admissibility)*, the arbitral tribunal considered the implications of the Russian government terminating its provisional application of the ECT by notification on 19 October 2009 of its intention not to become a contracting party under Article 45(3)(a). The tribunal found that, as of that date, the entire ECT was no longer provisionally applicable, but that under Article 45(3)(b), the investment protection and dispute resolution provisions of the ECT remained in force for 20 years from 19 October 2009 for any investments made before that date. The tribunal found that as a consequence, the Russian government was bound by the dispute resolution provisions invoked by the claimant (*Interim award, paragraph 395*).

WITHDRAWAL

Under Article 47(2), withdrawal from the ECT takes effect one year after the date of the receipt of the notification of withdrawal. Under Article 47(3), the provisions of the ECT continue to apply to investments made by investors for 20 years from the date of notification of withdrawal.

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