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## Oil, Gas & Energy Law Intelligence

### The Energy Charter Treaty as a Means of Developing National Industry and Commerce in the Exploitation of Petroleum Resources: An Analysis of the Application of Articles 5, 10 and 22 of the Energy Charter Treaty by T. Hunter

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# The Energy Charter Treaty as a Means of Developing National Industry and Commerce in the Exploitation of Petroleum Resources: An Analysis of the Application of Articles 5, 10 and 22 of the Energy Charter Treaty.

by Dr Tina Hunter<sup>1</sup>

## I INTRODUCTION

The exploitation of petroleum resources has the capacity to enhance a nation's economy and promote national industry. This study examines how a state<sup>2</sup> can utilise the Energy Charter Treaty (ECT) to develop national industries and commerce in the exploitation of its petroleum resources. The development of petroleum resources of a state relies on investment in petroleum producing enterprises and the development of infrastructure, in order to produce petroleum. It also relies on the ability of a state to gain access to certain markets in order to sell the petroleum products. The ECT was established to provide a legal framework that creates mutual trade benefits for all parties, to ensure access to energy products, and to secure investment<sup>3</sup> to develop those energy products. This study focuses on two important pillars of the ECT: trade and investment. After a consideration of the history, scope and aims of the ECT, this study will examine how Article 5 of the ECT (Trade Related Investment Measures) can assist a state to develop its petroleum resources through the non-discriminatory access to trade under the GATT provisions in a transparent manner. It will then analyse how the Article 10 investment measures (Promotion, Protection and Treatment of Investments) assists in the development of commerce and industry. In particular, it will focus on how these provisions provide fair and equitable treatment of investors<sup>4</sup> in both the pre-investment and post investment phase. Finally, this study will provide a discussion on the application of the Article 22 measures for State and Privileged Enterprises in energy trade and energy investment.

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<sup>2</sup> The state is referred to as the 'contracting party' in the ECT. See Art. 1 (2) of the Energy Charter Treaty.

<sup>3</sup> Investment means every kind of asset, owned or controlled by an investor, and includes tangible and intangible, moveable and immovable property, and property rights. See Art. 1 (6) of the Energy Charter Treaty.

<sup>4</sup> Investors in the ECT are defined as a natural person, company or organisation See Art. 1 (7) of the Energy Charter Treaty.

## II OVERVIEW OF THE ENERGY CHARTER TREATY

### *History and Outline of the ECT*

The Energy Charter Treaty (ECT) was established as an extension of the European Energy Charter (EEC) of 1991. The EEC was political initiative creating a non-binding agreement between eastern and western European states to foster and encourage East–West cooperation in the energy sector.<sup>5</sup> As the Cold War was drawing to a close, an unprecedented opportunity arose for eastern European States to develop energy cooperation with western European States.<sup>6</sup> The idea of the Charter was that eastern European states possessed energy resources that western European states needed, and western European states could provide access to much needed capital for energy and infrastructure development in Eastern Europe.<sup>7</sup> The parties recognised a need to ensure that a commonly accepted foundation for energy cooperation was defined, giving rise to the establishment of the EEC.

The EEC arose out of mutual benefit, with a recognition that all European countries stood to benefit from a balanced framework for cooperation in the energy sector. Whilst the EEC provided a framework for those benefit, the non-binding nature of the Charter meant that the framework lacked enforcement. Therefore, the ECT was established as a legally binding tool to enforce the EEC.

As the demand for fossil fuels increases, the geographical mismatch between producers and consumers of fossil fuels is likely to lead to an ever increasing trade for oil and gas, making multilateral rules for international cooperation in the energy sector, with binding arbitration essential.<sup>8</sup> The ECT was negotiated with these needs in mind. Indeed, as the arbitral tribunal declared in *Plama Consortium Ltd v Republic of Bulgaria* the ECT is the ‘first multilateral treaty to provide as a general rule the settlement of investor-state disputes by international arbitration’,<sup>9</sup> as well as providing an investor with ‘an almost unprecedented remedy for its claims against a host state’.<sup>10</sup>

Whilst the EEC was created as a declaration of political intent to promote east-west energy cooperation, the ECT is a legally binding multilateral

<sup>5</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004) 13.

<sup>6</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004) 13.

<sup>7</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004) 13.

<sup>8</sup> Edna Sussman, ‘The Energy charter Treaty’s Investor Protection Provisions: Potential to Foster Solutions to Global Warming and Promote Sustainable Development’ (2008) 14 (2) *ILSA Journal of International and Comparative Law* 391, 392.

<sup>9</sup> *Plama Consortium Ltd v Republic of Bulgaria* (2005) 44 I.L.M. 721, 739.

<sup>10</sup> *Plama Consortium Ltd v Republic of Bulgaria* (2005) 44 I.L.M. 721, 742.

instrument, with all of the enforceability afforded to treaties under international law. The ECT is unique in international law, providing a multilateral framework (as opposed to the plurilateral<sup>11</sup> framework of the NAFTA) for energy cooperation. It is the only body of international rules tailored to the specific needs of the energy sector, especially investment and trade provisions.<sup>12</sup> Whereas the EEC focused on European states and the facilitation of east-west trade and investment, the ECT encompasses a broad range of diverse countries from Europe, Eurasia, Asia and the South Pacific. Some of these countries are energy producing countries, some are consumers, whilst others are transit countries.

### *Aims of the ECT*

The fundamental aim of the ECT is to strengthen the rule of law on energy issues, by creating a level playing field of rules to be observed by all participating governments.<sup>13</sup> By creating a level playing field, the ECT aims to minimise the risks associated with energy-related trade and investments. The strength of the ECT is the binding nature of its provisions in relation to trade and investment. The energy sector requires a separate treaty because of the special requirements of the sector. Energy, especially in petroleum, is crucial to the functioning of other sectors. In addition, it creates natural monopolies especially in pipelines and transmission. The ECT is specific to the sector, establishing the legal rights and obligations with respect to a broad range of trade, investment and transit issues, as well as addressing other important areas of competition, antitrust, transfer of technology and the environment.<sup>14</sup> Together with the North American Free Trade Agreement (NAFTA), the ECT pioneers the extensive use of legal methods to enforce economic liberalism.<sup>15</sup>

These fundamental aims of the ECT are reflected in Article 2 of the ECT: 'This Treaty establishes a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the principles of the Charter'.<sup>16</sup> The principles of

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<sup>11</sup> The term plurilateral indicates more than two parties but only a few parties. See Deardorff's *Glossary of International Economics* <http://www-personal.umich.edu/~alandear/glossary/p.html> at 10 September 2010.

<sup>12</sup> Craig Bamberger, Jane Linehan, and Thomas Waelde, 'The Energy Charter Treaty' in Martha M. Roggenkamp, Anita Rønne, Catherine Redgwell and Inigo Del Guayo (eds) (*Energy Law in Europe* (Oxford University Press, 2001), 208.

<sup>13</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004) 14.

<sup>14</sup> Craig Bamberger, Jane Linehan, and Thomas Waelde, 'The Energy Charter Treaty' in Martha M. Roggenkamp, Anita Rønne, Catherine Redgwell and Inigo Del Guayo (eds) (*Energy Law in Europe* (Oxford University Press, 2001), 171.

<sup>15</sup> Craig Bamberger, Jane Linehan, and Thomas Waelde, 'The Energy Charter Treaty' in Martha M. Roggenkamp, Anita Rønne, Catherine Redgwell and Inigo Del Guayo (eds) (*Energy Law in Europe* (Oxford University Press, 2001), 208.

<sup>16</sup> The 'Charter' referred to in Art. 12 of the Energy Charter Treaty is the European Energy Charter. The Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004) Art. 2.

the EEC include improving security of energy supply, maximising the efficiency of production, transportation, distribution and use of energy, enhance safety and minimise environmental problems, within the framework of state sovereignty over energy resources.<sup>17</sup>

It is important to recognise that the ECT has both political and legal dimensions. The political dimension is seen in the ECT's origin as the EEC, which was clearly a political undertaking designed for mutual economic benefit after the collapse of the former Soviet Union.<sup>18</sup> The ECT strives to reduce political risks associated with economic activities in transitional economies by creating stable, comprehensive and non-discriminatory legal foundations for cross-border energy relations.<sup>19</sup> The binding nature of the ECT provides assurances for investors, thereby generating energy security by addressing major issues that have traditionally existed in the energy investment sectors. In particular, the ECT seeks to address the lack of transparency in energy investments and trade transactions, traditional positions of legally privileged market power, and discrimination in licencing and access to energy resources.<sup>20</sup>

### *Scope of the ECT*

The provisions of the ECT focus on four main areas of energy development:

1. free trade in energy materials, products and energy-related products based on the WTO rules regulating trade;
2. the protection and promotion of foreign energy investments, based in the extension of national treatment or most favoured nation treatment, whichever is more favourable, including, mechanisms for the resolution of investor-state and state-state disputes;
3. freedom of energy transit through pipelines and grids; and
4. reducing the negative environmental impact of the energy cycle through improving energy efficiency.<sup>21</sup>

Whilst the ECT requires that member states<sup>22</sup> conform to Treaty requirements on relation to these areas of energy development, it reiterates

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<sup>17</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004) 214.

<sup>18</sup> C P Andrews-Speed and T W Wälde, *Will the energy Charter Treaty Help International Energy Investors* (CEPMLP, 1996), 11-12.

<sup>19</sup> Energy Charter Secretariat, *The Energy Charter Treaty: A Reader's Guide* (2009), 9.

<sup>20</sup> Craig Bamberger, Jane Linehan, and Thomas Waelde, 'The Energy Charter Treaty' in Martha M. Roggenkamp, Anita Rønne, Catherine Redgwell and Inigo Del Guayo (eds) (*Energy Law in Europe* (Oxford University Press, 2001), 209.

<sup>21</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004).

<sup>22</sup> The term member state refers to the parties the states that are members of the Energy charter treaty. In the ECT members are referred to as a Contracting Party under Article 1(2) of the Energy charter Treaty. However,

the principle of national sovereignty over its energy resources.<sup>23</sup> Furthermore, the treaty respects that member countries may be required to take appropriate measures to protect national security, in times of war, for the benefit of indigenous groups,<sup>24</sup> or other exceptions as described in Article 24 of the ECT.

This paper will focus on the first two areas of energy development, namely trade and investment. Considering the rules that have been laid down by the ECT regarding the requirement for 'national treatment' (NT) or 'most favoured nation' (MFN) treatment in investment and trade, this study will assess whether the trade provisions of Article 5 and the investment provisions of Article 10 of the ECT encourage the development of national industry and commerce in a member state. This analysis will also necessarily consider the effect of the trade and investment provisions on state-owned enterprises.

### **III THE ARTICLE 5 TRADE PROVISIONS AND THE DEVELOPMENT OF NATIONAL INDUSTRY AND COMMERCE**

One of the prime objectives of ECT is to control and minimise political risks. Therefore all the substantive provisions of the ECT relate to that purpose. An investor in the energy sector needs to be able to predict his ability to sell his product, therefore there is a need for trade provisions in the treaty.<sup>25</sup> The trade provisions under Article 5(1) and 5(2) of the ECT stipulate that a member state must not apply any trade related investment measure (TRIM) that is inconsistent with the provisions of Article III and Article XI of GATT and in conjunction with Article 29 of the ECT, whether or not the member state is a member of the WTO.<sup>26</sup> Article 29 of the ECT incorporates the principles of GATT by reference, where all member states are bound by GATT regarding trade in energy materials and products.

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the term Contracting Party also refers to a Regional Economic Integration Organisation. Since this paper refers to the development of national industry and commerce, it will refer to the 'Contracting Party as a member state, and will be accorded the same meaning as that under Article 1(2) of the Energy charter Treaty.

<sup>23</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004), Art. 18.

<sup>24</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004), Art. 24.

<sup>25</sup> Sydney Fremantle, 'Energy Charter Treaty: Investment Promotion and Protection' in T M Waelde and K M Christie *Energy Charter Treaty: Selected Topics* (Centre for Petroleum And Mineral Law and Policy, 1995) 2.1.

<sup>26</sup> This is known as GATT by reference, and Article 29 on trade-related matters makes provisions for member states that are not party to GATT.

The trade provisions cover all energy materials and products, including petroleum products.<sup>27</sup> Initially the trade provisions only covered trade in energy materials and products, including natural gas, petroleum and petroleum products.<sup>28</sup> However, the 1998 trade amendments extended the trade rules to encompass related equipment. In the area of petroleum exploitation, this encompasses pipelines, pipes, platforms and the like, as outlined in Annex EQ of the ECT.<sup>29</sup> This enlargement of applicable goods ensures that investors have access to energy goods and the related equipment on a non-discriminatory basis.<sup>30</sup>

### *Non-discriminatory trade provisions (TRIM's) and their exceptions*

Article 5 of the ECT seeks to address trade related investment measures that create discrimination and favour, generally towards the host state. The Article 5 trade provisions are not a new set of trade provisions. Rather under Article 5 (1), the ECT trade provisions incorporate the TRIM provisions of Articles III and XI of the GATT. TRIM's refer to government measures that are enforceable under domestic law or administrative rules that are applied as a condition for the making of a foreign direct investment in the host state, or a precondition of attainment of an investment advantage, and are incompatible with the provisions of Articles III and XI of the GATT.<sup>31</sup> This includes measures such as local content requirements, trade balance requirements, foreign exchange restrictions, and domestic gas sales requirements. The scope of excluded TRIM's encompasses preferential conditions for state-owned and national companies, imposing divestment schedules, national majority requirements, local employment targets or performance requirements.<sup>32</sup>

The legal structure of the ECT trade requirements is based on two instruments. Firstly is the provision of the ECT trade regime based on the GATT 1994 rules, as implemented in Article 5 (1) of the ECT. These initial trade provisions but were modified in 1998 by the adoption of the trade Amendment to the Treaty, in order to bring the Treaty's trade provisions in line with the WTO rules and practices that are founded on the principles of

<sup>27</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004), Annex EMI.

<sup>28</sup> Energy Charter Secretariat, *The Energy Charter Treaty: A Reader's Guide* (2009), 15.

<sup>29</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004), Annex EQ.

<sup>30</sup> Energy Charter Secretariat, *The Energy Charter Treaty: A Reader's Guide* (2009), 16.

<sup>31</sup> Article III of GATT relates to National Treatment on Internal Taxation and Regulation, whilst Article XI addresses the General Elimination of Quantitative Restrictions.

<sup>32</sup> Thomas Waelde, *Investment Arbitration Under the Energy Charter Treaty: From Dispute Settlement to Treaty Implementation* (1998) Paper Presented at the Conference on Energy Arbitration, Gulf Arbitration Centre <http://www.dundee.ac.uk/cepmlp/journal/html/Vol1/vol1-10.html> at 12 September 2010, 18.

non-discrimination.<sup>33</sup> The reason for this two-tiered approach was that not all of the trade-related issues could be resolved at the time of the formation of the ECT in 1994, especially the coverage of energy related equipment and the legally binding regime for customs duties.<sup>34</sup> In addition, the results of the Uruguay round of trade negotiations could not be incorporated into the ECT at the time of its adoption in 1994. Therefore, some of the provisions of the WTO have been made inapplicable in the annexes of the ECT:<sup>35</sup>

The amended trade regimes of the ECT are an important stepping stone for member states that have not yet acceded to the WTO.<sup>36</sup> The requirement to use the WTO provisions under the GATT 97 assists member states who are not yet WTO members. Implementation of the WTO requirements of Article 5 of the ECT may create an intermediary step towards WTO membership for member states that are not WTO members. It enables these states to familiarise themselves with the practices and disciplines that WTO membership entails through the application of its rules 'by reference' to trade in energy materials, products and related equipment.<sup>37</sup> This is likely to exert an influence on the commerce of a member state, since membership to the WTO is seen as a positive sign of economic development, with WTO members more likely to be admitted into trading regimes. Therefore, the GATT trading provisions assist ECT member states in developing commerce within a state.

The GATT trade provisions in the ECT are based on the principles of national treatment and most-favoured-nation (MFN) treatment. National treatment imposes an obligation of like treatment and non-discrimination between domestic and imported goods.<sup>38</sup> This rule sets out the requirement that no law, rule of taxation pattern may adversely modify the conditions of competition between like imported and domestic products in a domestic market. This means that once the imported products have cleared customs and the applicable tariff collected, they must be treated the same as products originating from within that state.<sup>39</sup> The objective of national treatment is to 'protect the expectation of contracting parties as to the

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<sup>33</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004), 14. See also the Energy Charter Treaty Trade Related Amendments at 163-207.

<sup>34</sup> Energy Charter Secretariat, *The Energy Charter Treaty: A Reader's Guide* (2009), 13.

<sup>35</sup> See Annex G in the original ECT, and Annex X under the 1998 Trade Amendment.

<sup>36</sup> The ECT members that are not members of the WTO include Azerbaijan, Belarus, Bosnia and Herzegovina, Georgia, Kazakhstan, Tajikistan, Turkmenistan, and Uzbekistan.

<sup>37</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004), 15.

<sup>38</sup> Mitsuo Matsushita, Thomas J Schoenbaum and Petros C Mavroidis, *The World Trade Organisation: Law, Practice and Policy* (2<sup>nd</sup> ed. Oxford University Press, 2006) 234.

<sup>39</sup> Mitsuo Matsushita, Thomas J Schoenbaum and Petros C Mavroidis, *The World Trade Organisation: Law, Practice and Policy* (2<sup>nd</sup> ed. Oxford University Press, 2006) 234.

competitive relationship between their products and those of the other contracting parties,... to protect current trade (and) to create the predictability needed to plan future trade'.<sup>40</sup> The most favoured national principle of the GATT applies to trade in energy, meaning that 'like' energy products and materials cannot be discriminated against on the basis of their origin (imports) or destination (exports), in terms of customs duties, charges or import and export regulations and formalities.<sup>41</sup>

Article III of the GATT interacts with GATT Article XI. Article III applies to internal taxation and regulation, while Article XI applies to quotas, import of export licences or other measures instituted or maintained on the importation or exportation of any product.<sup>42</sup> These measures have been defined as not only laws and regulations, but also non-mandatory government involvement in trade matters.<sup>43</sup> This means that the scope of Article XI is comprehensive, addressing all matters with the exception of taxation<sup>44</sup>

Traditionally, petroleum development has been seen as a possibility to develop the local and national economy, since the demand for supplies and services generated by a petroleum project, the infrastructure required and the employment potential have been considered an important boost to industrial development.<sup>45</sup> Both developing and developed countries have designed petroleum policies that utilise the development of petroleum resources to push companies into contributing to local and national development, including obligations such as preferential procurement from local industry, training of nationals, and local employment requirements.<sup>46</sup> However, the Article 5(1) and 5(2) TRIM provisions may prevent a member state from requiring investors to purchase petroleum-related equipment from local suppliers, since they may serve to restrict a member state's capacity to utilise TRIM's to develop national industry. Article 5 ostensibly prohibits governments from using TRIMS. Although largely a trade-related issue, the TRIM limitations may have an impact of licencing and concession agreements, which often contain

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<sup>40</sup> *United States – Taxes on Petroleum and Certain Imported substances*, 17 June 1987, GATT B.I.S.D. (34<sup>th</sup> Supp.) 136, para 5.2.2 (1988)

<sup>41</sup> Yulia Selivanova, *The WTO and Energy: WTO Rules and Agreements of Relevance to the Energy Sector* (2007) ICTSD Issues Paper No. 1, vii.

<sup>42</sup> Mitsuo Matsushita, Thomas J Schoenbaum and Petros C Mavroidis, *The World Trade Organisation: Law, Practice and Policy* (2<sup>nd</sup> ed. Oxford University Press, 2006) 244.

<sup>43</sup> *Japan – Trade in Semi-Conductors*, 4 May 1988, GATT B.I.S.D. (35<sup>th</sup> Supp.) at 116, paras 106-109 (1989).

<sup>44</sup> Mitsuo Matsushita, Thomas J Schoenbaum and Petros C Mavroidis, *The World Trade Organisation: Law, Practice and Policy* (2<sup>nd</sup> ed. Oxford University Press, 2006) 244.

<sup>45</sup> Thomas Waelde, 'The current Status of International Petroleum Investment: Regulating, Licencing and Contracting' in T M Waelde and K M Christie *Energy Charter Treaty: Selected Topics* (Centre for Petroleum And Mineral Law and Policy, 1995), 4.11.

<sup>46</sup> Thomas Waelde, 'The current Status of International Petroleum Investment: Regulating, Licencing and Contracting' in T M Waelde and K M Christie *Energy Charter Treaty: Selected Topics* (Centre for Petroleum And Mineral Law and Policy, 1995), 4.11-4.12.

obligations upon a foreign investor to give preference to domestic goods and services.

On the surface the TRIM's appear to prevent national favour, and therefore the development of national industry based on the development of the petroleum resources of a member state. However, there are some arguments that the TRIM provisions are neither as comprehensive nor robust as they first appear.<sup>47</sup> The provisions of Article 5 do not make mention of TRIMS that are normally associated with the petroleum industry, such as the requirements to use local services, grant local equity, or requirements for technology transfer.<sup>48</sup> Andrews-Speed and Waelde<sup>49</sup> argue that any freely negotiated contract that contains trade-related requirements would not normally be in the scope of the TRIM's that the GATT or the ECT encompasses.<sup>50</sup> This raises the question whether local content preferences that are concluded in licencing and concession agreements constitute a TRIM, and are therefore unacceptable under Article 5(2)?

This question of local content is of particular interest to Norway, who has relied on local content provisions since the 1970s and 1980s, utilising local content requirements as a way of building national industry and competence in the petroleum sector. During this period, Norway incorporated local content provisions into all petroleum licences issues to encourage and promote the development of infant local industries. These local content provisions were partly derived from the discretionary allocation of licences, which required that Norwegian subcontractors be engaged as a condition of granting the licence,<sup>51</sup> and partly from the discretionary authority granted to Norwegian government agencies to distribute rights to companies and bodies it considered would serve Norwegian interests.<sup>52</sup>

During the award of supply contracts under the local content provisions in Norway, the operator was required to inform the Ministry of Petroleum and Energy (MPE) of its recommended supplier, an the Norwegian content, and the MPE then ensured the Norwegian bidder was awarded the contract.<sup>53</sup> This preferential treatment for Norwegian suppliers of goods resulted in Norwegian

<sup>47</sup> C P Andrews-Speed and T W Wälde, *Will the energy Charter Treaty Help International Energy Investors* (CEPMLP, 1996), 17.

<sup>48</sup> C P Andrews-Speed and T W Wälde, *Will the energy Charter Treaty Help International Energy Investors* (CEPMLP, 1996), 17.

<sup>49</sup> Note that Waelde can be spelt Waelde and Wälde. For uniformity it has been kept as Waelde in the text of this paper, although the spelling of individual references is maintained in the footnotes.

<sup>50</sup> C P Andrews-Speed and T W Wälde, *Will the energy Charter Treaty Help International Energy Investors* (CEPMLP, 1996), 17.

<sup>51</sup> Ole Andreas Engen, *The Development of the Norwegian Petroleum Innovation System: A Historical Overview* (2007) TIK Working Paper on Innovation Studies No 20070605, 3.

<sup>52</sup> Ole Andreas Engen, *The Development of the Norwegian Petroleum Innovation System: A Historical Overview* (2007) TIK Working Paper on Innovation Studies No 20070605, 3.

<sup>53</sup> Øystein Noreng, 'Norway: Economic Diversification and the Petroleum Industry' (2004) XLVII (45) *Middle East Economic Survey* <http://www.mees.com/postedArt.s/oped/a47n45d01.htm> at 23 December 2006.

companies contracting and supplying 50-70% of goods and services during this period.<sup>54</sup> The linking of petroleum sector licencing and the development of Norwegian industries, services and skills under advantageous procurement law was been fundamental in the success of the Norwegian petroleum industry, both in a domestic sense, as well as on an international scale. This protectionist policy as a tool for economic diversification of the Norwegian industrial sector was implemented since the Norwegian government felt that market forces alone were insufficient to promote economic diversification, therefore the Norwegian government saw the need for government intervention.<sup>55</sup>

The question of whether these local content provisions that had been implemented by Norway in the 1970s and 1980s would breach the Article 5 TRIM provisions was addressed by Waelde, who noted that it is unlikely that local content provisions would not breach the requirements of the TRIM provisions under GATT and Article of the ECT.<sup>56</sup> Rather, Waelde notes that the Article 5 TRIM conditions pertain to legislative proposed TRIM condition (ie a state can't legislate TRIM's), but not to condition in a freely negotiated agreement for access to a government-owned resource.<sup>57</sup> This view is strengthened by the non-discrimination treatment provisions in Article 10 of the ECT, which are discussed in section IV below.

The issue of whether Norway's TRIM provisions would be legitimate under Article 5 of the ECT is superfluous, as a result of Norway's entry into the EEA in 1994. As a member of the EEA, Norway is required to implement the Hydrocarbon Licencing Directive (EC Directive 94/22/EC),<sup>58</sup> which required Norway to abandon its local content provisions and required open, non-discriminatory trade provisions.<sup>59</sup> Under this Directive, Norway's award of petroleum licence is required to be non-discriminatory, based on open competitive bidding, without favour to Norwegian companies.<sup>60</sup> Consequently,

<sup>54</sup> Michael Bunter, 'A New Approach to Petroleum Licencing' (2003) 1 (1) *Oil, Gas and Energy Law Intelligence* <[http://www.gasandoil.com/ogel/samples/freeArt.s/roundup\\_15.htm](http://www.gasandoil.com/ogel/samples/freeArt.s/roundup_15.htm)> at 19 September 2009.

<sup>55</sup> Øystein Noreng with Farshad Tehrani, *The Norwegian Experience of Economic Diversification in Relation to Petroleum Industry and the Relevance to Iran* (2005) the 10<sup>th</sup> Institute for International Energy Studies (IIES) Conference Tehran 4-5 December 2005, 3.

<sup>56</sup> Thomas Waelde, *Investment Arbitration Under the Energy Charter Treaty: From Dispute Settlement to Treaty Implementation* (1998) Paper Presented at the Conference on Energy Arbitration, Gulf Arbitration Centre <http://www.dundee.ac.uk/cepmlp/journal/html/Vol1/vol1-10.html> at 12 September 2010, 68.

<sup>57</sup> Thomas Waelde, *Investment Arbitration Under the Energy Charter Treaty: From Dispute Settlement to Treaty Implementation* (1998) Paper Presented at the Conference on Energy Arbitration, Gulf Arbitration Centre <http://www.dundee.ac.uk/cepmlp/journal/html/Vol1/vol1-10.html> at 12 September 2010, 68.

<sup>58</sup> *EC Directive 94/22/EC of 30 May 1994 on the Conditions for Granting and Using Authorizations for the Prospection, Exploration and Production of Hydrocarbons* (1994) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31994L0022:EN:HTML> at 24 December 2006.

<sup>59</sup> *EC Directive 94/22/EC of 30 May 1994 on the Conditions for Granting and Using Authorizations for the Prospection, Exploration and Production of Hydrocarbons* (1994) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31994L0022:EN:HTML> at 24 December 2006.

<sup>60</sup> See Article 5 of *EC Directive 94/22/EC of 30 May 1994 on the Conditions for Granting and Using Authorizations for the Prospection, Exploration and Production of Hydrocarbons* (1994) [http://eur-](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31994L0022:EN:HTML)

under the conditions of the EC Directive, Norway has not been able to favour domestic companies through conditions attached to the award of licences.

The question of whether the ECT TRIM provisions would impinge on Norway's capacity to include local content provisions in licencing would be legitimate was addressed by Thorson and Arnesen,<sup>61</sup> who noted that the required amendments under the ECT would be similarly limiting to the provisions under the EC Hydrocarbon Licensing Directive, making it very difficult to use award of licences as a means to promote national industry.<sup>62</sup> This view is in direct contrast to Waelde, who sees the TRIM provisions as not limiting general local content provisions. Furthermore, a number of exceptions to the trade provisions of Article 5 of the ECT enable a state to promote national industry.

### *TRIM Exceptions*

Important for the promotion of national industry during the development of petroleum resources, is the trade in the provision of services. These provisions, which are part of the WTO General Agreement on Trade in Services (GATS), have not been incorporated into the ECT.<sup>63</sup> During the negotiations for the 1998 Trade Amendments, the issue of non-discrimination under the GATS was considered too complex, requiring more time for reflection.<sup>64</sup> Consequently, neither the initial ECT, nor the 1998 Trade Amendments declare any GATS provisions applicable under the ECT. Since trade in services is not excluded under the TRIM provisions of Article 5 of the ECT, a member state has the capacity to apply TRIM's related to the provisions of services. This means that a member state is well within its Treaty obligations under Article 5 of the ECT to apply favourable treatment to local industries in relation to the provision of services in the petroleum sector.

In addition, there are two other TRIM exceptions under Article 5 of the ECT that encourage development of national industry and commerce when exploiting petroleum resources. Article 5(3) of the ECT allows TRIM's if they relate to the eligibility of products for export promotion, foreign aid, government procurement, preferential customs duties, or quota programs. In addition, under Article 5(4), a member state is able to temporarily maintain TRIM's if they were in effect more than 180 days before that states signature

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[lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31994L0022:EN:HTML](http://lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31994L0022:EN:HTML), at 24 December 2006.

these requirements have been incorporated into the Petroleum Activities Act 1996 (Norway) (see sections

<sup>61</sup> Mette Thorson and Finn Arnesen, 'Offshore Licensing in Norway: A Privilege for Norwegian Companies?' (1995) 13 *Journal of Energy and Natural Resources Law* 258.

<sup>62</sup> Mette Thorson and Finn Arnesen, 'Offshore Licensing in Norway: A Privilege for Norwegian Companies?' (1995) 13 *Journal of Energy and Natural Resources Law* 258, 266.

<sup>63</sup> Energy Charter Secretariat, *The Energy Charter Treaty: A Reader's Guide* (2009), 15.

<sup>64</sup> Energy Charter Secretariat, *The Energy Charter Treaty: A Reader's Guide* (2009), 17. Consequently, neither the initial ECT or the 199

of the ECT, subject to the notification and phase-out provisions outlined in Annex TRM of the ECT.

#### **IV THE ARTICLE 10 INVESTMENT PROVISIONS AND PETROLEUM ACTIVITIES**

The purpose of Article 10 of the ECT is the promotion, protection and treatment of investment, seeking to accord investors non-discriminatory treatment. The treaty ensures the protection of foreign energy investments based on the principle of non-discrimination, whereby the member state is obliged to extend national treatment, or most-favoured-nation treatment (whichever is more favourable) to nationals and legal entities of all other member states who have invested in that states energy sector.<sup>65</sup>

During the drafting of the ECT, the objective of Article 10 was to introduce an Article that guaranteed non-discrimination between all member states.<sup>66</sup> Negotiations relating to petroleum were contentious since the initial drafts presented by the Norwegian party were not in line with the principles of non-discrimination, and gave maximum scope for governments to exercise sovereign rights over petroleum resources.<sup>67</sup> Furthermore, the Norwegian delegation was not in favour of the non-discrimination provisions<sup>68</sup> applying to both pre-investment and post-investment phases of investment.<sup>69</sup> Norway's position on national treatment was seen as a major obstacle in the Charter Treaty negotiations, however it was not the only member state opposed to the principle of national treatment, rather it was the country that articulated its objects openly.<sup>70</sup>

Norway, with its protectionist petroleum regime that served to encourage national industries<sup>71</sup> was successful in watering down the liberalised investment provisions.<sup>72</sup> In the final draft of the ECT, the non-discrimination provisions applied only to existing investments made by investors from

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<sup>65</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004), 14.

<sup>66</sup> Julia Dore, 'The Negotiating History of the European Energy Charter History' in T M Waelde and K M Christie *Energy Charter Treaty: Selected Topics* (Centre for Petroleum And Mineral Law and Policy, 1995), 1.6.

<sup>67</sup> Julia Dore, 'The Negotiating History of the European Energy Charter History' in T M Waelde and K M Christie *Energy Charter Treaty: Selected Topics* (Centre for Petroleum And Mineral Law and Policy, 1995), 1.5.

<sup>68</sup> This included the concepts of national treatment and most favoured nation status

<sup>69</sup> Julia Dore, 'The Negotiating History of the European Energy Charter History' in T M Waelde and K M Christie *Energy Charter Treaty: Selected Topics* (Centre for Petroleum And Mineral Law and Policy, 1995), 1.6.

<sup>70</sup> Julia Dore, 'The Negotiating History of the European Energy Charter History' in T M Waelde and K M Christie *Energy Charter Treaty: Selected Topics* (Centre for Petroleum And Mineral Law and Policy, 1995), 1.6.

<sup>71</sup> Mette Thorson and Finn Arnesen, 'Offshore Licensing in Norway: A Privilege for Norwegian Companies?' (1995) 13 *Journal of Energy and Natural Resources Law* 258, 259.

<sup>72</sup> Thomas Waelde, *Investment Arbitration Under the Energy Charter Treaty: From Dispute Settlement to Treaty Implementation* (1998) Paper Presented at the Conference on Energy Arbitration, Gulf Arbitration Centre <http://www.dundee.ac.uk/cepmlp/journal/html/Vol1/vol1-10.html> at 12 September 2010, 6.

member states, and not to potential investments (the ‘making’ of investments).<sup>73</sup> This issue was intended to be addressed in a separate Supplementary Treaty that would extend the non-discrimination treatment obligation to the pre-investment phase (the ‘Making of Investment’) phase.<sup>74</sup>

Article 10(1) notes that each member state

‘shall, in accordance with the provisions of the Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make investments in its area. Such conditions include a commitment to accord at all times to Investments of Investors of other Contracting Parties<sup>75</sup> 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.’

Under this Article, a number of concepts arise that are important when determining whether a state is able to utilise the ECT to promote national industry and commerce.

### 1. *Fair and Equitable Investment*

The fundamental objective of the ECT’s investment provisions in Article 10 is to ensure the creation of a ‘level playing field’ for energy sector investments, aiming to reduce to a minimum the non-commercial risks associated with risks in the energy sector.<sup>76</sup> The application of fair and equitable treatment has been considered in a number of arbitrations under Article 26 of the ECT, in relation to the investment provisions under Article 10. In the *Plama Merits Case*<sup>77</sup> it was found that Bulgaria’s modification of environmental law is not a violation of the fair and equitable treatment provisions. Conversely, in the *Petrobart Case*,<sup>78</sup> it was held that the government letters to the bankruptcy

<sup>73</sup> The requirements for non-discriminatory treatment for existing investments is outlined in Art. 10 (1) and

<sup>74</sup> As outlined in Art. 10 (4) of the Energy Charter Treaty.

<sup>75</sup> Note that a Contracting Party has the same meaning as Member State.

<sup>76</sup> Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004), 14.

<sup>77</sup> *Plama Consortium Ltd v Republic of Bulgaria* (2005) 44 I.L.M. 721.

<sup>78</sup> *Petrobart Limited v the Kyrgyz Republic* (2005) case No. T 5208-05.

court, and the reorganisation of the debtor's state-owned company violated the principles of fair and equitable treatment.<sup>79</sup> However, the court failed to elaborate on what it perceived as the standard of fair and equitable treatment.<sup>80</sup>

## 2. Facilitate investment transactions

The concept of the Article 10 provisions of the ECT is to create stable, equitable, favourable and transparent conditions for investors, making investments, thereby protecting foreign energy investments. This promotes foreign direct investment in the energy sector by protecting foreign investors against political risks in the host country. These investment provisions provide the cornerstone of the ECT, protecting and promoting foreign investment in member countries.

The ECT establishes a series of common obligations for member states, reducing the risk to investors of investment in the energy sector. Both natural persons and commercial entities are entitled to invoke the rights arising under the Treaty, against member states.<sup>81</sup> It imposes an obligation on governments regarding the protection and treatment of foreign investment, with the rights of investors enforceable under the Investor State arbitration clause in Article 26 of the ECT. The value of the ECT is that it lowers political risk related to the undertaking and management of investments in petroleum industries in the member states. By reducing risk, investment is encouraged, thereby assisting in the development of the host state's commerce.

By establishing a stable and equitable environment, Article 10 of the ECT addressed the perceived political risks which can affect an investors decision whether or not to invest in a host country.<sup>82</sup> The higher the perceived risk in for the investor, the higher return a foreign investor demands. By reducing the political risks faced by foreign investors, the ECT seeks to boost investor confidence, thereby contributing to an increase in international investment flows. This can contribute to an improvement of a member states commerce since it promotes confidence in investors, and may encourage investors to invest in that member state.

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<sup>79</sup> S Ripinwsky and K Williams, *Case Summary: Petrobart Limited v the Kyrgyz Republic* (2005), 4.

<sup>80</sup> *Petrobart Limited v the Kyrgyz Republic* (2005) case No. T 5208-05

<sup>81</sup> Bruce Macauley, 'LNG- A Litigators Perspective in How to Protect the Investment' (2004) 8 *International Energy Law and Taxation Review* 167, 167.

<sup>82</sup> Energy Charter Secretariat, *The Energy Charter Treaty: A Reader's Guide* (2009) 19.

### 3. Principle of Non-discrimination and the ECT

One of the aims of the ECT is to 'create a climate favourable to the operations of enterprise and to the flow of investments and technologies by implementing market principles in the field of energy'.<sup>83</sup> This favourability must apply to both the host state as well as the investor, otherwise the Treaty will not meet the needs of both the host state and the investors. One of the areas in which this balance has arguably been accomplished is in the Article 10 provisions related to investment, which provides security for the investor that has invested in a member state, as well as enabling the host state to promote national industry and commerce by being able to promote national interest when negotiating an investment with an investor.

Article 10(1) articulates the requirement for a member state to accord investors fair and equitable treatment. Treatment is clearly articulated in Article 10(3) where it means treatment accorded by a member state which is no less favourable than that which it accords to its own investors or to investors of any other member state, or any third state (most favoured nation treatment), whichever is the most favourable.<sup>84</sup>

In reading Article 10(1) in conjunction with 10(3) of the ECT, it indicates that the member state should not discriminate between national and foreign investors. However, in analysing the non-discrimination provisions in Article 10 two types of investment occur, with differing requirements regarding non-discrimination. These are pre-investment obligations and post-investment obligations.

#### *Pre-investment obligations*

The pre-investment obligations are found in Articles 10(2) - 10(6) of the ECT. In the Article 10(1) provisions, member states are required to 'encourage and create' equitable and favourable conditions when other member states are 'making an investment in the member states area. however, non-discrimination is also articulated in Article 10(2) of the ECT, where member states 'shall endeavour' to accord to investors of other member states when making an investment in a investment in its Area, the treatment that is described in paragraph 3. This Article also applies to the making of investments,<sup>85</sup> which is defined in Article 1(8) of the ECT as 'establishing new investments, acquiring all or part of existing investments or moving into

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<sup>83</sup> 'Concluding Document of the Hague Conference on the European Energy Charter, December 1991', Title 1, Objectives, in Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004), 214.

<sup>84</sup> Concluding Document of the Hague Conference on the European Energy Charter, December 1991', Title 1, Objectives, in Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (2004), 214

<sup>85</sup> Article 10(2) of the ECT.

different fields of investment activity'.<sup>86</sup> This means that prior to an investment (ie the making of an investment), under Article 10(2) of the ECT the obligation is for the member state to make 'best endeavours' not to discriminate and to create stable, equitable, fair and transparent conditions, in accordance to the provisions of treatment articulated in Article 10(3).

This raises the question whether the term 'endeavour' in Article 10(2) is binding, or whether it is merely aspirational. Waelde suggests that the pre-investment component of the ECT uses soft-law terms, not imposing an immediate and direct obligation on the state to implement the non-discrimination provisions.<sup>87</sup> Furthermore, the terms 'endeavour' and 'undertake to facilitate' may be seen as merely exhortatory, where the obligation is to make best effort.<sup>88</sup> This can be interpreted as recognising that some level of government discretion is required in order for a state to achieve its policy objectives. However where a government does not make reasonable efforts to comply with the pre-investment obligations, Waelde suggest that these actions are in breach of the ECT.<sup>89</sup>

The soft law provisions in Article 10(2) are seem as a compromise between a states' discretion to admit investors and determine the terms of admission into a state, with an attempt to introduce non-discrimination investment provisions for established investments in a member state (where an investor has committed its capital and assumed the considerable political risk of the exposure). It is likely that the soft law nature of the pre-investment provisions enable a state to develop national industry and commerce by extending privileges to national companies during the pre-investment phase. This is welcomed by many petroleum-producing states, which are keen to retain sovereign rights over their petroleum resources as far as possible, in terms of who they allow to participate in petroleum activities, and under what conditions.<sup>90</sup>

The pre-investment provisions were incorporated into the ECT as a way of satisfying the concern of some states regarding the scope of the non-discrimination provisions. A number of western states, particularly Norway, were reluctant to apply non-discrimination provisions across the board in

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<sup>86</sup> Article 1(8) of the Energy Charter Treaty.

<sup>87</sup> Thomas Waelde, *Investment Arbitration Under the Energy Charter Treaty: From Dispute Settlement to Treaty Implementation* (1998) Paper Presented at the Conference on Energy Arbitration, Gulf Arbitration Centre <http://www.dundee.ac.uk/cepmlp/journal/html/Vol1/vol1-10.html> at 12 September 2010, 35.

<sup>88</sup> C P Andrews-Speed and T W Wälde, *Will the energy Charter Treaty Help International Energy Investors* (CEPMLP, 1996) 20.

<sup>89</sup> Thomas Waelde, *Investment Arbitration Under the Energy Charter Treaty: From Dispute Settlement to Treaty Implementation* (1998) Paper Presented at the Conference on Energy Arbitration, Gulf Arbitration Centre <http://www.dundee.ac.uk/cepmlp/journal/html/Vol1/vol1-10.html> at 12 September 2010, 35.

<sup>90</sup> Thomas Waelde, *Investment Arbitration Under the Energy Charter Treaty: From Dispute Settlement to Treaty Implementation* (1998) Paper Presented at the Conference on Energy Arbitration, Gulf Arbitration Centre <http://www.dundee.ac.uk/cepmlp/journal/html/Vol1/vol1-10.html> at 12 September 2010, 29.

relation to investments. Consequently, the Articles regarding the non-discrimination in investment were the most difficult to conclude, with Norway articulating its dissatisfaction in the provisions of the Treaty regarding investment and national industry, resulting in the best endeavours clauses in Articles 10(1) and 10(2). The soft law provisions of the pre-investment phase were implemented as a compromise between government and industry, enabling governments to continue to negotiate favourable conditions for national industry, whilst protecting investors once an investment has been made in the host state.<sup>91</sup> They reflect continued wariness of western countries, in particular Norway, about free and discriminatory access to foreign investment in all sectors.<sup>92</sup>

A resolution to this stalemate between governments and industry was to decision to provide for further negotiations about the pre-investment regime. In addition to the 'best endeavours' clause in Article 10(2), Article 10(4) provides for negotiations on a legally binding instrument (the so-called "Supplementary Treaty") for the pre-investment phase. The supplementary treaty was to extend the investment obligations to ensure that non-discrimination treatment applied to the pre-investment phase (the 'making of an investment').

The Energy Charter Secretariat sees the conclusion of the Supplementary treaty as vital in completing the non-discrimination provision of the treaty, allowing investors from member countries to be on equal legal footing with their domestic competitors in the host country when applying for the granting of a licence/concession.<sup>93</sup> Negotiations on this Supplementary Treaty started in 1996, and have not been concluded to date. In autumn 2002, member states decided to put negotiations on hold pending the outcome of discussions in the WTO on a multilateral framework for foreign direct investment. Consequently, at present the soft law provisions remain, enabling a member state to negotiate favourable conditions for national industry under the member state's licencing and concession provisions.

In order to retain control over the variations in non-discrimination under Articles 10(1) and 10(2), Article 10(5) requires a member state when making investments, to limit to a minimum the treatment exceptions, ensuring no new restrictions can be entered after the conclusion of the agreement, and liberalisation measures, which once introduced.<sup>94</sup> This is known as standstill

<sup>91</sup> Saamir Elshihabi, 'The difficulty Behind Securing Sector-Specific Investment Establishment Rights: The Case of the Energy Charter Treaty' (2001) 35 *International Law* 137, 145.

<sup>92</sup> Thomas Waelde, *Investment Arbitration Under the Energy Charter Treaty: From Dispute Settlement to Treaty Implementation* (1998) Paper Presented at the Conference on Energy Arbitration, Gulf Arbitration Centre <http://www.dundee.ac.uk/cepmlp/journal/html/Vol1/vol1-10.html> at 12 September 2010, 20.

<sup>93</sup> Energy Charter Secretariat, *Supplementary Treaty* (2009) <http://www.encharter.org/index.php?id=33> at 13 September 2010.

<sup>94</sup> Article 10(5) (a) of the Energy Charter Treaty.

provisions, where the pre-investment discretion is at a standstill and no new discriminatory practices are introduced.<sup>95</sup> Furthermore, the ECT makes provisions for a member state to make a voluntary declaration at any time its intention not to introduce any new exceptions regarding the making of investments in its area under Article 10 (6).<sup>96</sup> However once that declaration has been made, the commitment is binding under Article 10(1) and 10(2). The ECT also has 'rollback' provisions under Article 10(5) (b), where the member state endeavours to progressively remove existing restrictions affecting investors in the making of an investment.

Once a restriction relating to the making of an investment is implemented, the ECT requires a member state to submit to the Energy Charter Secretariat a report summarising all of the exceptions to the non-discrimination provisions.<sup>97</sup> These restrictions are collated and published in a register of such non-conforming measures, the so-called 'Blue Book'.<sup>98</sup> Progress towards the removal of the discriminatory measures recorded in the Blue Book is regularly reviewed by the Energy Charter Conference and its Investment Group,<sup>99</sup> in an attempt to decrease the number of restrictions in the pre-investment phase.

The existing non-conforming measures that are recorded in the 'Blue Book' comprise four main categories: land and real estate restrictions; privatisation; measures regarding registration and screening, and reciprocity requirements.<sup>100</sup> Of the four categories, measures regarding registration and screening comprises almost half of all exceptions,<sup>101</sup> and is dominated by exceptions relating to concessions and licences (18 in total). Exceptions to licencing and concession agreements represents 21% of all pre-investment exceptions, demonstrating that discrimination in licencing and concession agreements, presumably to provide national benefit, remains prevalent.

#### *Post investment obligations and exceptions to the principle of non-discrimination in investments*

Once an investment has been made in a host state by another member state, the ECT imposes the national treatment non-discrimination requirements under Article 10(1), the so called 'hard law' provisions. The protection of an investment against discrimination is important, since it

<sup>95</sup> Rainer Geiger, 'Towards a Multilateral Agreement on Investment' (1998) 31 *Cornell International Law Journal* 467, 470.

<sup>96</sup> Under Article 10(6) (a) of the Energy Charter Treaty.

<sup>97</sup> Article 10(9) of the Energy Charter Treaty..

<sup>98</sup> Energy Charter Secretariat, *Blue Book* (2009) <http://www.encharter.org/index.php?id=33> at 13 September 2010.

<sup>99</sup> Energy Charter Secretariat, *Blue Book* (2009) <http://www.encharter.org/index.php?id=33> at 13 September 2010.

<sup>100</sup> Energy Charter Secretariat, *Blue Book* (2009) <http://www.encharter.org/index.php?id=33> at 13 September 2010.

<sup>101</sup> This category comprises 41 of the 86 exceptions recorded in the Blue Book. See Energy Charter Secretariat, *Blue Book* (2009) <http://www.encharter.org/index.php?id=33> at 13 September 2010, 9.

creates a favourable investment climate by encouraging direct foreign investment in the petroleum activities of a host state. Article 10(7) of the ECT obliges the member state to accord investors from other member states that have made an investment the better of national treatment or MFN treatment in their investments for energy and related activities. This includes the management, use, enjoyment or disposal of the investment. However it must be realised that the national treatment and MFN requirements are comparative standards, in that they apply in like situations.<sup>102</sup> Therefore the special circumstances of each investment are taken into account. This means that a member country is not expected to extend programs to promote small and medium sized enterprises or regional development to big multinational enterprises that do not meet the criteria of these programs.<sup>103</sup> This enables a state to tailor programs to foster national industries and build its economy.

In the post-investment regime, the provisions of the ECT dealing with treatment and protection of actual investments have real substance.<sup>104</sup> This is a significant advance on existing Bilateral Investment Treaties (BIT's) representing the first real attempt to create an international competition law in the energy sector.<sup>105</sup> As such, the ECT achieves 'robust and enforceable rules and procedures which represent an advance on even the most advanced Bilateral Investment Treaty'.<sup>106</sup> These provisions offer a guarantee to foreign investors from member states that existing investments will be accorded fair and equitable treatment under national treatment, or MFN treatment, whichever is the more favourable. This reduces the political risk for investors, and provides assurances for investors in transition economies. This encourages investment in the member state, therefore providing economic benefits.

The hard law provisions of the ECT were demonstrated in the investor-state arbitration between Nykomb Synergetics and The Republic of Latvia under the Article 26 Arbitration provisions of the ECT.<sup>107</sup> The decision in *Nykomb Synergetics v The Republic of Latvia* was the first case to focus on unreasonable or discriminatory measures, and involved a breach of the

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<sup>102</sup> Rainer Geiger, 'Towards a Multilateral Agreement on Investment' (1998) 31 *Cornell International Law Journal* 467, 470.

<sup>103</sup> Rainer Geiger, 'Towards a Multilateral Agreement on Investment' (1998) 31 *Cornell International Law Journal* 467, 470.

<sup>104</sup> C P Andrews-Speed and T W Wälde, *Will the energy Charter Treaty Help International Energy Investors* (CEPMLP, 1996), 11.

<sup>105</sup> Andrew E L Tucker, 'The Energy Charter Treaty and 'Compulsory' International State/Investor Arbitration' (1998) 11 *Leiden Journal of International Law* 513, 518.

<sup>106</sup> C P Andrews-Speed and T W Wälde, *Will the energy Charter Treaty Help International Energy Investors* (CEPMLP, 1996), 21.

<sup>107</sup> *Nykomb Synergetics Technology Holding AB v Republic of Latvia* (2003) ICSID Case no. ARB/03/24.

antidiscrimination measures by a Latvian –owned enterprise.<sup>108</sup> Although the tribunal accepted that under the Treaty ‘like should be compared to like’, and that the burden of proof to prove that no discrimination has taken place falls on the member state, the Arbitral Tribunal found that Nykomb Synergetics had been subject to a discriminatory measure in violation of the provisions of Article 10(1).<sup>109</sup>

The outcome of *Nykomb Synergetics v The Republic of Latvia* demonstrated to investors and states alike that the investment provisions of the ECT, combined with the investor-state arbitration mechanism, creates a significant range of rights and remedies against discriminatory practices, including injurious state measures.<sup>110</sup> This case provided assurance to investors from a member state that investments made in another member state will be accorded non-discrimination rights, thus reinforcing that the ECT significantly reduces political risk. This not only assists an investor, but also a member state, since the reduction in political risk creates favourable investment conditions in that state, thereby encouraging investments which promotes national commerce.

Whilst Article 10(7) is a hard law provision requiring member states to accord investments of investors from other member states the more favourable of national treatment or MFN, there are a number of exceptions to the hard law provisions.

Firstly, Intellectual Property is specifically excluded under Article 10(10) of the ECT. This is because there is often conflict between the need to protect intellectual property and the need to encourage competition.<sup>111</sup> A benefit of attracting foreign investment is to get access to the technology which the investors possess. The value of that technology is how it applies to the exploitation of petroleum in the host state, rather than the technology in its purest form.<sup>112</sup> This has been particularly important in many of the eastern European states which lagged behind western countries during the Cold War, although developed economies such as Norway have taken advantage of technology in order to optimise the extraction of petroleum from its fields on the Norwegian Continental Shelf. Article 10 (10) enables the treatment of intellectual property to be specified in the corresponding provisions of the

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<sup>108</sup> Nykomb Synergetics Technology Holding AB v Republic of Latvia (2003)ICSID Case no. ARB/03/24.

<sup>109</sup> Nykomb Synergetics Technology Holding AB v Republic of Latvia (2003)ICSID Case no. ARB/03/24. at para 34.

<sup>110</sup> Andrew E L Tucker, ‘The Energy Charter Treaty and ‘Compulsory’ International State/Investor Arbitration’ (1998) 11 *Leiden Journal of International Law* 513, 525.

<sup>111</sup> Sydney Fremantle ‘Energy Charter Treaty: Investment Promotion and Protection’ in T M Waelde and K M Christie *Energy Charter Treaty: Selected Topics* (Centre for Petroleum And Mineral Law and Policy, 1995), 2.4.

<sup>112</sup> Sydney Fremantle ‘Energy Charter Treaty: Investment Promotion and Protection’ in T M Waelde and K M Christie *Energy Charter Treaty: Selected Topics* (Centre for Petroleum And Mineral Law and Policy, 1995), 2.1.

applicable international agreements for the protection of Intellectual Property rights to which the respective member states are parties. This provides states with the capacity to build national competence in areas related to technological advances related to petroleum extraction.

Another exception to the non-discrimination provisions is government programs for research and development that are effected through grants or loans to private companies to carry out research and development. Under Article 10(8) of the ECT, where the member state provides grants or other financial assistance, or enters into contracts for technology research and development, the non-discrimination provisions do not apply. Rather, this is reserved for consideration in the Supplementary Treaty, which is yet to be concluded.

The combination of the Article 10(10) intellectual property exception under Article 10(10) and the grant provisions under 10(8) of the ECT, enable a state to promote national competence relating to petroleum activities in some areas, especially the development on intellectual property related to technology under grant programs. Together, these provisions mean that the member state is able to promote national technology and research in the exploitation of petroleum resources. However, the member state is required to inform the Charter Secretariat of the modalities it applies to the grants or financial assistance it extends.<sup>113</sup>

## V ARTICLE 22, STATE ENTITIES AND STATE RESPONSIBILITY

The petroleum sector is dominated by government-owned or government controlled companies, which sometimes not only participate in petroleum activities. Currently, over 80% of world oil is controlled by State-owned oil companies.<sup>114</sup> The provisions regarding State owned and privileged enterprises are articulated in Article 22 of the ECT.<sup>115</sup> It requires state parties to ensure that their state-owned enterprises, including 'privileged entities' conduct their operations in a manner consistent with the provisions of the treaty, particularly in relation to investment.<sup>116</sup> In addition, the member state is not permitted to encourage a state enterprise to conduct its activities in a manner inconsistent with the member state's obligations under the ECT<sup>117</sup>

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<sup>113</sup> Art. 10 (8) of the Energy Charter Treaty.

<sup>114</sup> Article 22(1) of the Energy Charter Treaty

<sup>115</sup> Article 10 (1) of the ECT. Part III of the treaty (Art. 10- 17) pertains to *Investment Promotion and Protection*.

<sup>116</sup> See in particular Art. 22 (1) of the Energy Charter Treaty.

<sup>117</sup> Article. 10 (2) of the Energy Charter Treaty.

Article 22 applies to state entities and other entities that are given special privileges. This means that where a state entity has governmental authority, it must act in accordance with the provisions of the Treaty.<sup>118</sup> If the state entity is involved in the provisions of goods and services, then that entity must act in accordance with the national treatment provisions of Article 10.<sup>119</sup> This means that the government cannot bypass its treaty obligations by devolving its responsibilities to State and privileged enterprises.<sup>120</sup>

### ***State Responsibility and Article 22***

Eminent academic Waelde notes that in general, international law is inadequate to deal with the complex issues arising out of the wrongful acts of non-state actors in the area of international economic law.<sup>121</sup> In order to address the wrongful acts of a state, the rules of attribution in international law are laid out in the ILC Draft Articles on State Responsibility.<sup>122</sup> However, Article 22 of the ECT creates an obligation for the state to be responsible for the conduct of its state enterprises and entities in energy transactions. Waelde notes that by making the state responsible for regulating and supervising the activities of state and privileged enterprises, the ECT solves the problems inherent in the attribution-based approach to international responsibility under international law.<sup>123</sup>

The ECT forces a member state to be liable for its failure to ensure that the state enterprises or entities comply with the trade and investment provisions of the treaty. The member state is held directly responsible for the failure of a state enterprise to comply with the provisions of the ECT. This provides added assurance to investors making an energy investment in a member state, since there are no attribution requirements for the state's wrongful acts. Rather, where the member state has breached the provisions of the ECT, an investor has access to dispute resolution measures in investments with State and privileged enterprises.<sup>124</sup>

<sup>118</sup> Articles 22(2), 22(3) and 22(4) of the Energy Charter Treaty

<sup>119</sup> Sydney Fremantle 'Energy Charter Treaty: Investment Promotion and Protection' in T M Waelde and K M Christie *Energy Charter Treaty: Selected Topics* (Centre for Petroleum And Mineral Law and Policy, 1995), 2.8.

<sup>120</sup> Thomas Waelde, *Investment Arbitration Under the Energy Charter Treaty: From Dispute Settlement to Treaty Implementation* (1998) Paper Presented at the Conference on Energy Arbitration, Gulf Arbitration Centre <http://www.dundee.ac.uk/cepmlp/journal/html/Vol1/vol1-10.html> at 12 September 2010, 39.

<sup>121</sup> Thomas Waelde and Patricia Wouters, 'State Responsibility and the Energy Charter Treaty: The rules Regarding State Enterprises, Entities, and Subnational Authorities' (1997) 2 *Hofstra Law and Policy symposium* 117, 130.

<sup>122</sup> In particular see Art 3-10. International Law Commission, *Draft Articles on Responsibility of States for Internationally Wrongful Acts* (2001).

<sup>123</sup> Waelde and Wouters, 128.

<sup>124</sup> This remedy is available under the Energy Charter Treaty, Art. 26.

## VI CONCLUSION

The aim of the Energy Charter treaty has been the liberalisation of the energy market, and in particular the liberalisation of the European oil and gas market after the break up of the former Soviet Union. However, what commenced as a Eurocentric attempt to gain access to oil and gas resources has developed into an expanding treaty arrangement with real teeth to enforce non-discrimination provisions through the investor state arbitration provisions in Article 26.

The trade regime under Article 5 ensures that TRIM's are not implemented to the detriment of member states. This is achieved by enforcing the TRIM provisions of Articles III and XI of GATT. Furthermore, the implementation of GATT provisions assist ECT states who are not members of the WTO, thereby assisting the State's ascension into the WTO. These measures control and minimise political risk for an investor, thereby making a state more favourable trading partner, which in turn promotes national industry and commerce

The provisions of Article 5 of the ECT do not encompass the GATS, enabling a state to promote national services related to petroleum activities. Furthermore, the allowance of some TRIMs related to government procurement and foreign aid may assist in the development of national industry.

The current pre and post investment regime under Article 10 of the ECT represents a solid framework for developing a state's national industry and commerce as they exploit their petroleum resources. The pre-investment provisions encourage negotiations between the member state and investors from another member state, enabling a member state to negotiate conditions of a licencing regime that promote national industry as part of the conditions of the licencing agreement. Furthermore, the intellectual property and grants for technology exceptions to investment enable a state to develop national competencies in these areas. This is particularly useful for states where the development of technologies can assist in the exploitation of petroleum resources.

The post-investment phase provides economic stability for investors, even in member states that have been politically unstable, since the investment provisions in Article 10, coupled with the arbitration provisions provides an investor with a remedy if they are subject to discriminatory practices from a host state. This encourages investment in the host state, therefore promoting the national economy and commerce in that state.

The Article 22 requirements of state responsibility for state and privileged enterprises, thereby relieving investors of the need to prove attribution when

a state engages in a wrongful act, also assists a state to develop its national commerce. By extending the non-discrimination provisions to incorporate state-owned enterprises, which control over 80% of the world's petroleum resources, the ECT provides investors with the assurance that their investments will not be arbitrarily dealt with. The decision in *Nykomb v the Republic of Latvia* supports this view. This means that investors are assured that their investments will be protected, even if they are subject to discriminatory measures by state-owned enterprises. This is likely to encourage investment in a member state, thereby promoting national commerce.

Therefore, it can be said that as a state embarks on exploiting its petroleum resources, Articles 5, 10 and 22 of the Energy Charter Treaty can assist a state to develop its national industry and commerce.

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