The New Kid on the Block: The Energy Charter Treaty

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1. Introduction

On 16 April 1998, the Energy Charter Treaty entered into force. In many respects the ECT is a unique international instrument for the promotion of international co-operation in the energy sector.

One of the important functions of the ECT is to serve as an investment protection treaty for investments in the energy sector. The ECT also provides for a dispute settlement mechanism for investor-state disputes. In Article 26(4) of the ECT, the Arbitration Institute of the Stockholm Chamber of Commerce is listed as one arbitration option available to investors.

As of the end of 2017, the Arbitration Institute has handled 27 cases under the ECT, including pending cases. This case load, together with other investor-state arbitrations, has catapulted the Arbitration Institute into second place among the world's arbitration institutions dealing with investment treaty arbitrations. The largest arbitration institution of this kind is ICSID at the World Bank.

This contribution will provide a general introduction and background to the ECT (Sections 2 and 3) and also briefly address two issues which are frequently dealt with in ECT arbitrations, *viz.*, the so-called denial of benefits clause in Article 17 of the ECT (Section 4) and the fair and equitable treatment standard in Article 10(1) of the ECT (Section 5).

2. Overview of the Energy Charter Treaty

2.1 Background

In the early 1990s, various ideas were discussed on how to develop energy cooperation between Eastern and Western Europe. Russia and many of its

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neighbouring countries were rich in energy resources but in great need of investment to reconstruct their economies. At the same time, Western European countries were trying to diversify their sources of energy supplies to decrease their potential dependence on other parts of the world. There was, therefore, a recognized need to set up a commonly accepted foundation for energy cooperation between the states of the Eurasian continent. It was out of this need that the Energy Charter Process was born.[1]

The first formal step in the Energy Charter process was the adoption and signing of the European Energy Charter (the "EEC") in December 1991. The EEC is not a binding international treaty, but rather a political declaration of principles which the signatories declared themselves intent on pursuing. However, the EEC contains guidelines for the negotiation of what was later to become the Energy Charter Treaty and a set of protocols.

The ECT and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects were signed in December 1994 and entered into force in April 1998. As of today, the ECT has been ratified by approx. 50 states and the European Union.

The ECT is a multilateral treaty with binding force, limited in its scope to the energy sector. The purpose of the ECT, as stipulated in Article 2, is to *"promote long-term co-operation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter"*. It is the only binding multilateral instrument dealing with inter-governmental cooperation in the energy sector, and contains far reaching undertakings for the contracting parties. The ECT includes provisions regarding investment protection, provisions on trade, transit of energy, energy efficiency and environmental protection and dispute resolution.

2.2 Investment promotion and protection

The provisions of the ECT regarding foreign investments are considered to be the cornerstone of the treaty. The aim of the foreign investment regime is to create a *"level playing field"* for investments in the energy sector and to minimize the non-commercial risks associated with such investments. Under the ECT, a distinction is made between the pre-investment phase of making an investment and the post-investment phase relating to investments already made. While the provisions concerning the pre-investment phase primarily set up a "soft" regime of "best endeavour" obligations, the ECT creates a "hard" regime for the post-investment phase with binding obligations for the contracting states similar to the investment protection

[1] *See* e.g. Graham Coop, The Energy Charter Treaty: More than a MIT, in C. Ribeiro (ed.), Investment Arbitration and the Energy Charter Treaty, (2006) 4–9.

provisions of the North American Free Trade Agreement (NAFTA) and bilateral investment treaties (BITs).

2.3 Dispute settlement

Dispute settlement is regulated in Part V of the ECT (Articles 26–28). Article 26 of the ECT governs investment disputes between investors and contracting parties, and extends to investors a right to arbitration of such disputes. Article 27 regulates resolution of state-to-state disputes between contracting parties concerning the application or interpretation of the ECT (not limited to matters of investments). The ECT also contains special provisions for the resolution of trade disputes, a conciliation procedure for transit disputes and consultation procedures for competition and environmental disputes.

2.4 Trade

The ECT's trade provisions, based on the trading regime of the GATT and the so-called Trade Amendment to the ECT of 1998 (bringing the ECT in line with WTO rules and practices), are founded on the principles of non-discrimination, transparency and a commitment to the progressive liberalisation of international trade.

Thus, the ECT introduces the trade provisions of GATT/WTO to the energy sector. The importance of these provisions was that when the ECT entered into force in 1998, 19 of its members were not parties to the WTO.

Disputes regarding compliance with the trade provisions under Article 29 and Article 5 are to be settled in accordance with the provisions for trade dispute settlement in Annex D to the ECT. The dispute settlement mechanism set out in Annex D is modelled on the WTO dispute settlement mechanism with certain modifications.

2.5 Transit

An important part of the ECT are the rules for facilitation of the transit of energy through the participating states. The transit regime is based on freedom of transit and the principle of non-discrimination. In addition to the existing transit provisions of the ECT, the participating states commenced negotiations in 2000 on the enhancement of these rules in the form of a Transit Protocol. However, due to differences in opinion between

the Russian Federation and the European Union, the negotiation of such a protocol was never concluded.

"Transit", according to the ECT, is defined as "carriage through the area of a Contracting Party, or to or from port facilities in its area for loading or unloading, of Energy Materials and Products originating in the area of another state and destined for the area of a third state, so long as either the other state or the third state is a Contracting Party."

Article 7(1) establishes the principles of freedom of transit and non-discrimination. According to this provision "each Contracting Party shall take the necessary measures to facilitate the Transit of Energy Materials and Products consistent with the principle of freedom of transit and without distinction as to the origin, destination or ownership of such Energy Materials and Products or discrimination as to pricing on the basis of such distinctions, and without imposing any unreasonable delays, restrictions or charges".

According to Article 7(3) each contracting party undertakes that its provisions relating to transport of "Energy Materials and Products" and the use of energy transport facilities shall treat such materials and products in transit in no less favourable a manner than its provisions treat such materials and products originating in or destined for its own area.

Paragraph 6 of Article 7 sets forth the important principle that, a contracting party is not entitled to interrupt or reduce the existing flow of "Energy Materials and Products" in the event of a dispute over any matter arising from the transit, except where this is specifically provided for in a contract or other agreement governing such transit, or permitted in accordance with the conciliator's decision in accordance with paragraph 7 of Article 7. Paragraph 7 sets out the possibility of appointing a special conciliator, via the Secretary-General of the ECT, in the case of a dispute regarding the transit of Energy Materials and Products. However, the appointment of a conciliator is subject to the exhaustion of all relevant contractual or other dispute resolution remedies previously agreed between the parties to the dispute, or between entities subject to their control.

2.6 Energy efficiency

Energy efficiency is regulated by the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA). PEEREA was signed together with the ECT in 1994 and entered into force in April 1998. PEEREA requires the participating states to create policies to improve the efficiency of energy use and to minimize its negative effects on the environment. The objectives of PEEREA are illustrated in the second paragraph of Article 1 of the PEEREA. These objectives include the promotion of

"energy efficiency policies consistent with sustainable development", the creation of "framework conditions which induce producers and consumers to use energy as economically, efficiently and environmentally soundly as possible, particularly through the organization of efficient energy markets and a fuller reflection of environmental costs and benefits", and the fostering of "co-operation in the field of energy efficiency".

2.7 The institutions

The governing and decision-making body for the Energy Charter Process is the Energy Charter Conference. The Conference is an inter-governmental organization established by the ECT. All States that have signed or acceded to the ECT are members of the Conference. The duties of the Energy Charter Conference are carried out by its Secretariat, which is composed of the Secretary-General and staff consisting of various experts from the energy sector.

3. Investment protection

The investment protection provisions of the ECT are found in Part III of the ECT. The aim of the provisions is to establish equal conditions for investments in the energy sector and thereby limit the non-commercial risks connected with such investments.

As mentioned above, the ECT separates two phases of investment protection and affords them different levels of protection. The provisions concerning the pre-investment phase primarily set up a "soft" regime of "best endeavour" obligations, whereas the ECT creates a "hard" regime for the post-investment phase with binding obligations for the contracting states.

The investment protection provisions of Part III of the ECT (post-investment phase) are applicable to *Investments of Investors*. "Investment" and "Investor" as referred to in the ECT are defined in Article 1.

An "Investor" is a natural person having the citizenship or nationality of, or is a permanent resident in, a contracting state in accordance with its applicable law, or a company or other organization organized in accordance with the law applicable in that contracting state.

"Investment" means every kind of asset associated with an economic activity in the energy sector which is owned or controlled directly or indirectly by an Investor and includes: (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages,

liens, and pledges; (b) 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; (c) claims to money and claims to performance pursuant to a contract having an economic value and associated with an Investment; (d) Intellectual Property; (e) Returns; (f) any right conferred by law or contract or by virtue of any licenses and permits granted pursuant to law to undertake any "Economic Activity in the Energy Sector".

"Economic Activity in the Energy Sector" means economic activity concerning the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or sale of "Energy Materials and Products" as defined in the ECT.

The scope of protection pursuant to Part III of the ECT also delineates the right to arbitration under Article 26, since the Investor's right to arbitration is limited to disputes between a "Contracting Party" and an "Investor" of another "Contracting Party" relating to an "Investment" of the "Investor" in the Area of the first "Contracting Party".

The two most central provisions with respect to standards of protection for investments are Articles 10 and 13.

Article 10 contains several standards of protection, the most important one being the so-called fair and equitable treatment standard, which will be addressed below in section 5.

Article 13 provides for protection against expropriation. Whilst expropriation clauses are the heart and soul of every investment protection treaty, in practice the fair and equitable treatment standard has become more important, in the sense that to the extent that investors are successful in investment disputes, they usually win on the basis of the fair and equitable treatment standard.

4. Denying benefits under the ECT

In several ECT arbitrations, respondent States have argued that the tribunal in question lacks jurisdiction because the respondent State is denying the benefits of the treaty to the investor, or the investment, relying on Article 17 of the ECT. This clause is often referred to as the denial of benefits clause.

Article 17 of the ECT makes it possible for contracting parties to deny the benefits under Part III of the ECT. According to Article 17(1) each contracting party can narrow the scope of the granted protection, if the investor has 'no substantial business activities in the area of the [state] where it is organized', *and* if it is owned or controlled 'by citizens or

nationals of a third State'.[2] The purpose of this provision is to prohibit investors from setting up empty corporate structures with the sole purpose of obtaining the favourable investment protection available under the ECT.

Article 17 ECT raises several issues as to its interpretation, meaning and effect. These issues include the following:

i) Is Article 17 a jurisdictional defence, or a defence on the merits? This distinction is important, as jurisdictional issues can usually be challenged before the courts at the seat of arbitration, or be subjected to ICSID annulment proceedings.
ii) Does Article 17 apply to nationals of the host state?
iii) What does 'substantial business activities' mean?
iv) When will a state be deemed to have exercised its right to deny benefits pursuant to Article 17?
v) Does such a denial of benefits apply to alleged violations of the ECT that took place before the denial was exercised, or only to future violations?

So far, these questions have been answered in a consistent way by the ECT tribunals which have dealt with objections under Article 17.

1. Jurisdiction or merits?

In *Plama v. Bulgaria*,[3] the tribunal held that Article 17, even if applicable, would not affect its jurisdiction. With reference to the wording of Article 17 ('Each Contracting Party reserves the right to deny the advantages of *this Part [III]'*[4]), the tribunal found that such a provision, when interpreted in

[2] Article 17 reads:

"**Article 17: Non-Application of Part III in Certain Circumstances**
Each Contracting Party reserves the right to deny the advantages of this Part to:
(1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organised; or
(2) an Investment, if the denying Contracting Party establishes that such Investment is an Investment of an Investor of a third state with or as to which the denying Contracting Party:
  (a) does not maintain a diplomatic relationship; or
  (b) adopts or maintains measures that:
    (i) prohibit transactions with Investors of that state; or
    (ii) would be violated or circumvented if the benefits of this Part were accorded to Investors of that state or to their Investments."

[3] *Plama Consortium Ltd v. Republic of Bulgaria*, Decision on Jurisdiction (8 February 2005).

[4] Emphasis added.

good faith in accordance with its ordinary contextual meaning, only allows to deny the substantive investment protection provisions under Part III. The tribunal concluded that 'it would therefore require a gross manipulation of the language to make it refer to Article 26 in Part V of the ECT'.[5] The tribunal further noted that the question of whether the criteria of Article 17 were met could raise wide-ranging, complex, and highly controversial disputes, as in the case before it. It thus questioned how such disputes would ever be decided, in the absence of Article 26 as a remedy available to the parties.[6]

In *Amto v. Ukraine*,[7] the respondent went one step further. It argued that the question whether the state had duly exercised its rights under Article 17 was not arbitrable, and that the state was the sole judge of whether Article 17 applies. The tribunal rejected this argument, and held that the state's exercise of its 'right' to deny advantages is an aspect of the dispute submitted to arbitration by the claimant, and within the jurisdiction of the arbitral tribunal.[8]

The tribunal in the *Yukos* cases reached the same conclusion, and held that '[w]hether or not Claimant is entitled to the advantages of Part III is a question not of jurisdiction, but of the merits'.[9] Indeed, Article 17 specifies that it concerns the denial of benefits of 'this part', ie Part III of the ECT. The provision for dispute settlement under the ECT is in Part V of the treaty.

In *Petrobart v. Kyrgyzstan*, the tribunal did not expressly rule on the question whether Article 17 was a question of jurisdiction or merits. It simply held, based on the facts of the case, that the conditions for its application were not met.[10] The award was subsequently challenged by the Kyrgyz Republic, but upheld by Swedish courts. Article 17 was not invoked in the challenge proceedings.

In *Khan Resources v. Mongolia*,[11] the tribunal expressly stated that the question of the application of Article 17 was one of merits, and not jurisdiction.[12] Even so, the tribunal discussed this question in the jurisdictional decision, as the parties had agreed to treat the question of the application of Article 17 as a preliminary question. The tribunal *in Anatolie Stati v. Kazakhstan* reached the same conclusion.[13]

[5] *Plama*, Decision (n 3) para. 147.

[6] *Ibid*. para. 149.

[7] *Amto LLC v. Ukraine*, Award (26 March 2008).

[8] *Ibid*. 39.

[9] *Yukos, Hulley & Veteran Petroleum v. the Russian Federation*, Interim Award on Jurisdiction and Admissibility (30 November 2009), paras. 441, 497 and 440, respectively.

[10] *Petrobart Ltd v. Kyrgyzstan*, Award (29 March 2005) 63.

[11] *Khan Resources Inc, Khan Resources BV & Cauc Holding Co Ltd v Government of Mongolia*, Decision on Jurisdiction (25 July 2012).

[12] *Ibid*. para. 411.

[13] *Anatolie Stati and Others v. Kazakhstan*, Award (19 December 2013), para. 716.

2. The reference to nationals of a 'third state' in Article 17

In the *Yukos* cases, Russia argued that it was entitled to deny the benefits to the investors pursuant to Article 17(1), as the investor companies were 'shell companies' owned and controlled by Russian nationals. According to Russia, the term 'third state' in Article 17(1) meant a state other than that of incorporation of the investor. Therefore, the article could be understood in a manner which would not exclude the possibility that a third state could be a contracting party or signatory (Russia being the latter). The tribunal, however, rejected this interpretation of the ECT. It held that the ECT 'clearly distinguishes between a Contracting Party (and a signatory), on the one hand, and a third State, which is a non-Contracting Party, on the other'.[14]

3. The meaning of 'substantial business activities'

The state's right to deny the benefits of Part III of the ECT only applies if the investor does not have 'substantial business activities' in the country of incorporation. This criterion was discussed by the tribunal in *Amto v Ukraine*, which held that the purpose of Article 17(1) is to exclude from the ECT's protection investors who have adopted a nationality of convenience.[15] The word 'substantial' is to be understood as 'of substance'; the decisive question is thus not the magnitude of the business activity, but its materiality.[16] In *Amto*, the claimant was found to have substantial activities in Latvia, as its investment-related activities were 'conducted from premises in Latvia, and involve[ed] the employment of a small but permanent staff.[17] In *Plama v. Bulgaria*, Plama admitted that it did not have any substantial business activities in Cyprus, so the meaning of this term was not discussed.[18]

4. Exercise of the right to deny benefits pursuant to Article 17(1)

Another threshold question under Article 17(1) ECT is whether the provision, in and of itself, provides sufficient notice to the investor that it cannot enjoy the protection of the ECT (assuming the criteria for its application are

[14] *Yukos, Hulley & Veteran Petroleum v. the Russian Federation*, Interim Award on Jurisdiction and Admissibility (n 9) paras. 544, 555, and 543, respectively.

[15] *Amto*, Award (n 7) para. 69.

[16] *Ibid*.

[17] *Ibid*.

[18] *Plama v. Bulgaria*, Decision (n 3) para. 74.

satisfied), or whether an express notification by the host state is required. In *Plama*, the tribunal referred to the wording of Article 17(1) ('reserves the right to deny'), and took the view that it required the denial of benefits to be actively exercised by the contracting state.[19] The tribunal reached this conclusion in light of Article 31(1) of the Vienna Convention on the Law of Treaties, which requires Article 17(1) to be interpreted by taking account of the object and purpose of the ECT.[20]

The same conclusion was reached in the *Yukos* cases. The tribunal found that Article 17 'reserves the right' of each contracting party to deny the advantages of Part III to a legal entity owned or controlled by a third state and which has no substantial business activity in the state where it is organized. This means that, to effect denial, the contracting party must exercise the right.[21]

The tribunal in *Khan Resources* also followed this reasoning. It found that a state must actively exercise its right under Article 17(1) ECT, which Mongolia did when it raised this objection to the tribunal's jurisdiction.[22] The timing of the objection is crucial, as discussed in the following subsection.

5. *Retrospective or prospective effect of a denial of benefits pursuant to Article 17*

In *Plama*, Bulgaria provided an express notice of denial of Plama's benefits under Article 17 to ICSID's acting Secretary General. However, since Bulgaria had not issued such notice until after Plama made its request for arbitration, and not until four years after Plama made its investment, the tribunal had to determine whether such notice applied retrospectively or only prospectively. Referring to Article 31(1) of the Vienna Convention on the Law of Treaties, stressing in particular the object and purpose of the ECT, the tribunal concluded that the exercise by a contracting party of its right under Article 17(1) should not have retrospective effect, since it would not be consistent with the purpose of the ECT 'to promote the long term co-operation in the energy field'.[23] The tribunal pointed out that such unexercised right could lure putative investors with legitimate expectations, only to have those expectations made retrospectively false

[19] *Ibid*. paras. 155–58.

[20] Article 31(1) of the Convention reads: '[A] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose'.

[21] *Yukos, Hulley & Veteran Petroleum v. the Russian Federation*, Interim Award on Jurisdiction and Admissibility (n 9) paras. 455, 512, and 455, respectively.

[22] *Khan Resources*, Decision (n 11) para. 424.

[23] *Plama*, Decision (n 13) para. 162.

at a much later date. This would make it impossible for the investor to make long-term plans.[24]

The same conclusion was reached by the tribunal in the *Yukos* cases. The tribunal held that to treat denial of benefits in a retrospective fashion would be incompatible with the purpose, object, and principles of the ECT. In the tribunal's words, a 'retrospective application of a denial of rights would be inconsistent with such promotion and protection and constitute treatment at odds with those terms'.[25]

In *Khan Resources*, although Mongolia had actively exercised its right under Article 17(1) ECT, it failed to do so in due time. Indeed, such active exercise must be made preferably before the commencement of the arbitration, in order to give an adequate notice to investors. Otherwise, the investor 'would find itself in a highly unpredictable situation. This lack of certainty would impede [its] ability to evaluate whether or not to make an investment in any particular state. This would be contrary to the Treaty's object and purpose'.[26] The prospective effect of Article 17 was also followed in *Stati*.[27]

5. Fair and equitable treatment

5.1 Introduction

Whereas the first sentence of Article 10(1) of the ECT is a general statement regarding the favourable investment climate that contracting parties are required to provide qualifying investments, the second sentence of Article 10(1) explains that such favourable conditions "*shall include a commitment to accord at all times to Investments of Investors… fair and equitable treatment*". This standard of "fair and equitable treatment" is derived from international law, and has, through its frequent application by tribunals in BIT and NAFTA arbitrations, become an important principle of investment protection. Although certain elements have crystallized in arbitral practice (good faith, protection of legitimate expectations, due process, proportionality etc), the exact scope and meaning of fair and equitable treatment is not easily described in general terms. The application of the fair and equitable treatment standard is often fact-specific and requires in-depth factual assessment as well as application of standards of good-government

[24] *Ibid*. paras. 159–65.

[25] *Yukos, Hulley & Veteran Petroleum v. the Russian Federation*, Interim Award on Jurisdiction and Admissibility (n 9), paras. 458, 514, and 457, respectively.

[26] *Khan Resources*, Decision (n 11) para. 426.

[27] *Stati*, Interim Award (n 13) para. 717.

conduct. As with any flexible standard, it is a challenge for counsel and arbitrators to establish sources for good-government conduct that are relevant and suitable in the context of an individual case.

As indicated above, tribunals applying the principle of fair and equitable treatment have found it to include elements such as the protection of legitimate investor expectations with respect to the maintenance of a stable and predictable business and legal environment by the host government, the principle of transparency, the good-faith and abuse of rights principles, due process, proportionality and the prohibition on arbitrariness. References to the prohibition against arbitrariness and requirements of transparency are frequently made within the general framework of due process, which must be observed by courts and authorities of the host state.

5.2 General comments by ECT tribunals

The following section (5.3) will focus on the concepts of stability and predictability (including legitimate expectations) as being one of the most important elements of the fair and equitable treatment standard. As mentioned above, there are several other aspects which must be factored in when assessing the fair and equitable treatment standard. Predictability and stability are, however, central in this context.

Before looking at how some ECT tribunals have dealt with predictability and stability, it is worthwhile to mention a few general comments made by some ECT tribunals.

In one of the early awards – *Petrobart v. Kyrgyzstan*[28] – the tribunal did not analyse the various elements of fair and equitable treatment. Rather, the tribunal concluded that the respondent state had violated Article 10(1) in its entirety, primarily by transferring assets away from Kyrgyz Gazmunaizat (KGM) to the detriment of its creditors, which included Petrobart as the seller of gas condensate to KGM, as well as by intervening in domestic court proceedings which negatively affected Petrobart. The tribunal found "it sufficient to conclude that the measures for which the Kyrgyz Republic is responsible failed to accord Petrobart a fair and equitable treatment to which it was entitled under Article 10(1) of the Treaty".[29]

In another early case – *Amto v. Ukraine*[30] – the tribunal noted that there is considerable overlap within Article 10(1), including the fair and equitable treatment (FET) standard and the protection against unreasonable and discriminatory conduct. According to the tribunal, the result of the overlap is that "a claimant can plead that the same conduct breaches various obliga-

[28] *Petrobart*, Award (n 10).
[29] *Ibid.*, at p. 76.
[30] *Amto*, Award (n 7).

tions in Article 10(1) in circumstances where the content and relationship between the obligations is not clear."[31]

In *Al-Bahloul v. Tajikistan*,[32] the claimant, as part of his FET argument, relied on the respondent's failure to meet legitimate expectations regarding the issuance of licenses. The tribunal decided this issue based on the burden of proof. It said:

> "[…] it is the Tribunal's opinion that Claimant had a right to rely upon Respondent's commitment to issue the four further exploration licenses, but this claim based on legitimate expectations fails for lack of evidence of actual reliance thereon."[33]

In *Electrabel v. Hungary*[34] the main claim based on fair and equitable treatment related to the effect of a 2008 EU Commission decision ordering Hungary to terminate certain power purchasing agreements. The tribunal took the view that Hungary was obliged by EU law to comply with the decision, which in the opinion of the tribunal precluded liability for Hungary under the ECT based on fair and equitable treatment. The question was rather, said the tribunal, whether Hungary had irrationally or arbitrarily interpreted the decision. The tribunal concluded that this was not the case, partly because there was no practical way for Hungary to comply with its EU law obligations except to terminate the power purchase agreement. The tribunal also concluded that Hungary had not been under an obligation to challenge the decision issued by the EU Commission. With respect to the time prior to the decision, the tribunal found that Electrabel had not demonstrated that Hungary had failed to take reasonable steps to protect the investment, which was made before Hungary became a member of the EU.[35]

Such steps could, for example, have included an application for an exemption from Hungary's obligations under EU law.

The tribunal further noted that the most important function of the fair and equitable standard is the protection of the reasonable and legitimate expectations of investors. With respect to regulatory changes, the tribunal said:

> "While the investor is promised protection against unfair changes, it is well established that the host State is entitled to maintain a reasonable degree of regulatory flexibility to respond to changing circumstances in the public interest. Consequently, the requirement of fairness must not be understood as the immutability of the legal framework, but as

[31] *Ibid.*, para. 74.

[32] *Mohammad Ammar Al-Bahloul v. The Republic of Tajikistan*, Partial Award on Jurisdiction and Liability, dated 2 September 2009.

[33] *Ibid.*, para. 210.

[34] *Electrabel S.A. v. The Republic of Hungary*, Decision on Jurisdiction, Applicable Law and Liability, dated 30 November 2012.

[35] *Ibid.*, paras. 6.66–6.77.

> implying that subsequent changes should be made fairly, consistently and predictably, taking into account the circumstances of the investment."[36]

In *Energoallians v. Moldova*[37] the facts resembled those in *Petrobart* in that the reorganization of a state owned company – Moldtranselectro – resulted in the company ceasing its activities and therefore did not receive any revenue.

The company was unable to pay its debts. The tribunal – by majority – found that the failure to take into account the company's creditors – which included the claimant – violated the fair and equitable treatment standard under Article 10(1).[38]

In *Stati et al v. Kazakhstan*[39] the parties and the tribunal agreed that the application of the fair and equitable treatment standard must take into account the specific factual circumstances of the case and that these had to be evaluated in the legal context of the ECT.[40] The tribunal stated that "treatment" in Article 10(1) indicated an evaluation of a more general nature rather than of a particular action. The tribunal then went on to evaluate a string of measures which it concluded constituted "coordinated harassment by various institutions of the Respondent", which amounted to a breach of the fair and equitable standard laid down in Article 10(1) of the ECT.[41]

In *Mamidoil v. Albania*[42] the tribunal made an initial statement with respect to the specific situation of the respondent State. Referring to the fact that Albania had just emerged from its communist regime and from a subsequent economic crisis, the tribunal said:

> "The Tribunal holds that these circumstances matter. An investor may have been entitled to rely on Albania's efforts to live up to its obligations under international treaties, but that investor was not entitled to believe that these effort would generate the same results of stability as in Great Britain, USA or Japan."[43]

As will be discussed below[44], one important element of the fair and equitable standard is the legitimate expectations of investors and the extent to

[36] *Ibid.*, para. 7.77.
[37] *Energoallians v. Moldova*, Award dated 23 October 2013.
[38] *Ibid.*, para. 356–370.
[39] *Stati*, Award (n 13).
[40] *Ibid.*, paras. 94.1–94.7.
[41] *Ibid.*, para. 1086.
[42] *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. The Republic of Albania*, Award dated 25 March 2015.
[43] *Ibid.*, para. 626.
[44] *See* section 5.3.

which the legal and regulatory framework of the host state can give rise to such expectations. This was a central issue in *Charanne v. Spain*.[45]

In discussing the regulations for the renewable energy sector which had been changed by the Spanish government, the arbitral tribunal stated, *inter alia*, that a state is entitled to maintain a reasonable degree of regulatory flexibility to respond to changing circumstances and the public interest.[46] The tribunal also took the view that the fair and equitable treatment standard does not mean that the law existing at the time when the investment is made will be frozen or will never change.[47]

5.3 Stability and predictability (including legitimate expectations)

The first sentence of Article 10(1) refers to "stable" conditions for Investors to make Investments. Stability is widely accepted as an important element of the fair and equitable treatment standard. As a matter of general principle, it could be said that "predictability" is an inherent element of stability. Stability and predictability in turn form the basis for the "legitimate expectations" of investors. The debate concerning the fair and equitable treatment standard has to a large degree focused on the concept of "legitimate expectations". Whilst no reference is made to this concept in Article 10(1), it is generally accepted that the "legitimate expectations" of investors constitute a central element of the fair and equitable treatment standard.

Arbitral jurisprudence is clear with respect the point in time which is relevant for determining the legitimate expectations of an investor, *viz.*, the point in time when the investment is made. This of course raises the question of when an investment is deemed to have been made.

The legitimate expectations of an investor is broadly speaking, typically based on the economic, legal and regulatory framework of the host state at the time of the investment. The legal framework includes legislation, treaties and case law. This includes the investment framework in general, and any framework specific to the economic sector in which the investment is made.

Legitimate expectations can also be based on statements by and conduct of representatives of the host state. Specific representations and assurances, as well as contractual undertakings, will typically play an important role in this context. Statements may be more or less explicit, and even implicit. It will depend on the circumstances of the individual case what weight is to be given to such statements.

[45] *Charanne B.V. Construction Investments S.A.R.L. v. The Kingdom of Spain*, Final Award dated 21 January 2016.

[46] *Ibid.*, para. 500.

[47] *Ibid.*, para. 499.

The general philosophy underlying the concept of legitimate expectations is that the investor has a right to expect that the framework existing at the time of the investment will remain stable and predictable. This does not mean that the host state is prevented from amending the framework. It is beyond dispute that the host state has the right to regulate its economy and economic activities in its territory. In doing so, however, the legitimate expectations of investors must be taken into account. The difficulty here is to strike the right balance between these competing interests.

Reliance on the investment framework at the time of the investment, also raises the questions of the extent to which the investor must perform a due diligence analysis of the framework so as to ascertain the economic, legal and political risks involved.

In one of the first ECT awards dealing with the fair and equitable treatment standard – *Plama v. Bulgaria*[48] – the tribunal to a large degree relied on non-ECT awards which the parties had referred to. With respect to legitimate expectations, the tribunal noted that they include "reasonable and justifiable" expectations taken into account by the investors.[49]

In the view of the tribunal such expectations would include conditions specifically offered by the state to the investor when the investment was made and on which the investor relied.[50] The tribunal added that "the state maintains its legitimate rights to regulate and this right should also be considered when assessing the compliance with the standard of fair and equitable treatment".[51]

In its analysis of the case before it, the tribunal observed that investors are not protected against any and all changes in the legislation of the host state. The tribunal found that Bulgaria had not made any promises or other representatives to freeze its legislation on environmental law.[52]

In *Al-Bahloul v. Tajikistan*[53], the tribunal found that the investor had the right to rely on the host state's commitment to issue relevant exploration licenses, but that the investor failed to prove that he had in fact relied on his expectations when making the investment.[54]

As mentioned above, legitimate expectations can only be created at the time of the investment. In *AES v. Hungary*[55] one of the issues which the tribunal addressed was the proper interpretation of "the time of the investment". Respondent argued that the original investment was made in

[48] *Plama Consortium Limited v. Republic of Bulgaria*, Award dated 27 August 2008.
[49] *Ibid.*, para. 176.
[50] *Id.*
[51] *Plama*, Award (n 48) para. 177.
[52] *Ibid.*, para. 219.
[53] *Mohammad Ammar Al-Bahloul v. The Republic of Tajikistan*, Partial Award (n 32).
[54] *Ibid.*, para. 210.
[55] *AES Summit Generation Ltd, and AES Tisza Erömü Kft v. Republic of Hungary*, Award dated 23 September 2010.

1996 when AES had bought the shares in the locally incorporated company. AES argued that 2001 was the relevant time at which AES made investments in the power generation plant. The tribunal concluded that AES had made investments both in 1996 and in 2001 and analyzed the investors' legitimate expectations as per each point in time.[56] The dispute concerned the re-introduction in 2006 and in 2007 of administrative pricing in the energy sector after administrative prices had been abolished as of 1 January 2004. Two earlier arbitrations between the same parties had been settled by a settlement agreement in 2001, which in the view of AES set forth certain commitments by the Respondent.

With respect to the initial investment made in 1996, the tribunal noted that AES could have no legitimate expectations regarding the conduct of Hungary about which it complained in the arbitration.[57] The tribunal observed that it was clear from the privatization materials and the relevant investment agreements that Hungary would continue to set "maximum administrative prices for electricity sales indefinitely into the future."[58]

With respect to the investments made in 2001, AES relied on certain government materials and the 2001 settlement agreement.

In the view of AES, in the agreement Hungary had explicitly promised not to frustrate the purpose and intent of the agreement. The parties agreed that the clause in question was not a stabilization clause. After having analyzed the documents relied on by AES, the tribunal concluded that the investors could not legitimately have expected that an administrative pricing regime would not be introduced under any circumstances.[59]

In *Mamidoil v. Albania*[60], the claimant relied on alleged legitimate expectations based on assurances from the respondent that the claimant would be entitled to use the tank farm in question for 20 years as planned.

The tribunal, however, concluded that there were no explicit assurances by the state. The tribunal therefore examined the conduct of the state, and other circumstances, with a view to determining if legitimate expectations had been created. The majority of the tribunal noted that the investor was aware that the infrastructure of the host state, as well as the regulatory framework was inadequate. The regulatory changes undertaken subsequent to the investment were found to be guided by a long-term perspective and not by erratic considerations. Such changes included a land use plan as well as a prohibition for petroleum tankers to be discharged at the port in question.

[56] *Ibid.*, paras. 9.3.14–9.3.16.
[57] *Ibid.*, paras. 9.3.26.
[58] *Id.*
[59] *Id.*
[60] *Mamidoil*, Award (n 42).

The majority found that the investor could not have legitimately expected to operate the tank farm without obtaining the required permits to make the operation compliant with Albanian law, nor to have access to the port during the life of the contract.[61]

In *Charanne v. Spain*[62] – the first of several renewable energy cases against Spain to reach an award – the tribunal had to deal with regulatory changes concerning photovoltaic solar power plants. The claimants made their investments in 2009 against the background of the then existing regulatory framework. Changes to this framework were made in 2010. Claimants argued that these changes violated the fair and equitable treatment standard, in particular since the changes frustrated the legitimate expectations of the claimants. The changes brought about reductions in the feed-in tariffs which in the view of the claimants changed, with retroactive effect, the legal and economic regime on which they had relied when making their investments.

Addressing legitimate expectations, the tribunal started out by noting that based on the principle of good faith under customary international law a state cannot induce an investor to make investments, thereby generating legitimate expectations, to later ignore the commitments which had generated such expectations.[63]

The tribunal then tried whether any specific commitments, directed to the claimants, had been undertaken by Spain. The tribunal found that this was not the case. In doing so, it rejected the argument by the claimants that the regulatory framework existing at the time of the investment constituted specific commitments because the provisions in question were limited to a specific and limited group of investors. The tribunal said:

> "To convert a regulatory standard into a specific commitment of the state, by the limited character of the persons who may be affected, would constitute an excessive limitation on power of states to regulate the economy in accordance with the public interest."[64]

Having thus concluded that there was no specific commitment in relation to the investors, the tribunal went on to examine whether the general legal order in force at the time of the investment could have generated legitimate expectations that the existing rules would not be modified. Referring to previously rendered awards, the tribunal found that this was not the case.[65]

In this context the tribunal noted that in order to rely on legitimate expectations, investors need to perform a due diligence analysis of the legal framework for the investment, which should include relevant case

[61] *Mamidoil*, Award (n 42) para. 735.
[62] *Charanne*, Final Award (n 45).
[63] *Ibid.*, para. 486.
[64] *Ibid.*, para. 493.
[65] *Ibid.*, paras. 499–503.

law. Had they done so, in the view of the tribunal, the claimant "could have easily foreseen possible adjustments to the regulatory framework as those introduced by the rules of 2010."[66]

Whilst the tribunal found that an investor could not – absent a specific commitment – have a legitimate expectation that the legal framework existing at the time of the investment would remain unchanged, an investor does have a legitimate expectation that when modifications are in fact made, they will not be unreasonable, disproportionate, or contrary to public interest.[67] The tribunal then went on to analyze whether the 2010 changes to the existing regulatory framework met these criteria. The tribunal found that the changes introduced were reasonable, proportionate and not in violation of the public interest. In its view the 2010 amendments did not violate Article 10(1) of the ECT.[68]

One arbitrator dissented partially. He did not agree with the majority's interpretation of legitimate expectations. In his view, legitimate expectations can be created not only by specific commitments, but also based on the legal framework at the time of the investment.[69] The special regime created for photovoltaic power generation was in his view capable of creating – and did create – such expectations.

The regime encouraged investments in the sector, was aimed at a limited number of potential investors and provided guarantees, without which the claimants would not have made the investments.[70] The dissenting arbitrator also did not agree with the majority's view that an acceptance of claimants' arguments would amount to freezing the regulatory framework. Rather, he emphasized that the state has every right to exercise its regulatory power, but added that "if in the valid exercise of that regulatory power the host state affects acquired rights or legitimate expectations, the state must compensate the damage caused".[71]

6. Concluding Remarks

The ECT has become one of the most important investment protection agreements in our modernized and globalized economy. This is well illustrated by the growing number of disputes under the ECT. It is reasonable to assume that the number of cases will continue to grow. One reason for this

[66] *Ibid.*, para. 505.
[67] *Ibid.*, paras. 513–514.
[68] *Ibid.*, paras. 527–532.
[69] *Ibid.*, dissenting opinion, para. 5.
[70] *Ibid.*, dissenting opinion, para. 7.
[71] *Ibid.*, dissenting opinion, para, 11.

is the continued and increasing importance of energy issues in general and, in particular, of renewable energy. There is, however, one crucial question looming at the horizon: the status of intra-EU arbitrations under the ECT. Suffice it to say in this context, that so far no arbitral tribunal has accepted the argument usually put forward by respondent EU Member States – often supported by the European Commission as *amicus curiae* – that arbitral tribunals lack jurisdiction over such disputes.

While the number of awards on the merits, as well as jurisdictional decisions, is constantly growing, it is still early days in terms of trying to identify and analyse what could tentatively be called ECT jurisprudence. There are several factors contributing to this state of affairs.

One such factor is the fact that there are discrepancies and inconsistencies in the practice of investment arbitration tribunals. Some decisions seem to deviate from rules and principles which are perceived as established. This should not come as a surprise. Arbitral awards based on treaties are rendered within the framework of public international law, which is a decentralized – indeed horizontal – and non-hierarchic system of law. There is no principle of binding precedent, or *stare decisis*, in public international law. In addition, the factual circumstances as well as the arguments and evidence presented by the parties vary from case to case. Against this background, it is submitted that the way forward is the gradual development of international arbitral case law, supplemented by serious scholarly analysis. This process will take time. Eventually, however, it will result in a form of ECT jurisprudence. The growing number of ECT arbitrations is an important ingredient in this development.