



INTERNATIONAL ARBITRATION LAW

BY EMMANUEL GAILLARD

Energy Charter Treaty: International Centre for Settlement Decision

On Feb. 8, 2005 an arbitral tribunal constituted in the case between Plama Consortium Ltd. and the Republic of Bulgaria rendered the first decision on jurisdiction in favor of the investor on the basis of the Energy Charter Treaty in an arbitration conducted under the auspices of the International Centre for the Settlement of Investment Disputes (ICSID).¹

The Energy Charter Treaty

The Energy Charter Treaty (ECT or the treaty) is the international community's most significant instrument for the promotion of cooperation in the energy sector and provides the legal basis for an open and nondiscriminatory energy market. It is also, together with North American Free Trade Agreement (NAFTA), one of the most important multilateral treaties providing for the promotion and protection of investments. The ECT was signed on Dec. 17, 1994 and entered into force on April 16, 1998. It now binds 51 states and the European communities.

One of the chief features of the ECT is the promotion and protection of investments in the energy sector. The ECT provides protection that is similar to most bilateral investment treaties, including such rights as the fair and equitable treatment, the most constant protection and security of investments, the prohibition of discriminatory measures, the most-favored-nation treatment, and the payment of prompt, adequate and effective compensation for any nationalization or expropriation.

The ECT further provides for binding international dispute settlement, in particular with respect to investment disputes. Under Article 26 of the treaty, disputes relating to the



investment of an investor can be referred to international arbitration if they are not settled amicably between the disputing parties. The investors are then given the option to choose between ICSID arbitration, the Arbitration Institute of the Stockholm Chamber of Commerce and the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL).

Besides the *Plama* case, seven other arbitrations have been initiated on the basis of the ECT. *Nykomb Synergetics Technology Ltd. v. Latvia*, an arbitration under the auspices of the Arbitration Institute of the Stockholm Chamber of Commerce, is the first—and so far only—arbitration resulting in an award on the merits, which was rendered in favor of the investor on Dec. 16, 2003. Another Stockholm Chamber of Commerce arbitration is currently pending between Petrobart Ltd. and Kyrgyzstan, and an award is expected shortly. Two other arbitrations were brought before ICSID. These are the *AES Summit Generation Ltd. v. Hungary* arbitration, which was settled amicably before any decision could be rendered, and the *Alstom Power Italia SpA v. Mongolia*, which is currently pending. The three last ECT arbitrations are brought under the UNCITRAL Arbitration Rules against the Russian Federation by investors in Yukos.

In this context, the *Plama* decision is the first to interpret the wording of the ECT relating to the protection of investments and thus provides

unprecedented insight into the interpretation of ECT provisions.

The 'Plama' Dispute

The factual background of the *Plama* case is as follows. The claimant Plama Consortium Ltd., a limited liability company registered under the laws of Cyprus, owned shares in Nova Plama AD, a Bulgarian company. The claimant filed on Dec. 24, 2002 a request for arbitration on the basis of the ECT alleging that the Bulgarian government, the national legislative and judicial authorities and other public agencies had deliberately created numerous grave problems for Nova Plama, causing material damage to the operations of the oil refinery owned by Nova Plama in Bulgaria and thus jeopardizing its investment.

On Feb. 18, 2003, after it had received the request for arbitration, Bulgaria sent to ICSID a letter whereby, in accordance with Article 17(1) of the ECT, it denied ECT protection to the claimant. Under Article 17(1), each ECT state "reserves the right to deny the advantages" of Part III of the treaty relating to "Investment Promotion and Protection" to "a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized."

Bulgaria alleged that the claimant was a mailbox company with no substantial business activities in Cyprus, and that the claimant was not owned or controlled by a national of an ECT state. On that basis, Bulgaria objected to the jurisdiction of the arbitral tribunal, claiming that its consent to arbitrate the dispute in this case was lacking. In other words, because the advantages of Part III were denied to the claimant, the ECT did not apply to the claimant and there could be no corresponding breach of Part III vis-à-vis the claimant. The claimant argued in response that Bulgaria's reliance on Article 17(1) was a defense on the merits rather than an objection to jurisdiction, which did not affect Bulgaria's offer of arbitration under Article 26 of the ECT. It argued further that a declaration

Emmanuel Gaillard is head of the international arbitration group of Shearman & Sterling and also is a professor of law at Paris XII University. **Yas Banifatemi**, an associate in the firm's Paris office arbitration group, assisted in the preparation of this article.

made under Article 17(1) had to be expressly exercised and, once exercised, had effect only for the future. Finally, the claimant argued that, in any event, the cumulative conditions for the application of Article 17(1) were not fulfilled.

The arbitral tribunal, constituted of Mr. Albert Jan van den Berg and Mr. V.V. Veeder, arbitrators, and Mr. Carl Salans, president, held in favor of the investor and decided that it had jurisdiction to hear the merits of the case. The decision puts particular emphasis on the effect of a state's consent to arbitrate its investment disputes under Article 26 of the ECT and provides guidance as to the understanding of the mechanism set forth at Article 17(1) of the ECT.

Consent to Arbitrate

• *Consent to arbitrate investment disputes under Article 26.* In discussing whether the parties had consented to submit their dispute to ICSID arbitration, the *Plama* tribunal laid strong emphasis on the protection regime established by the ECT and, in particular, by its arbitration clause contained at Article 26, which provides for a contracting party's unconditional consent to investor-state arbitration:

[...] Article 26 ECT provides to a covered investor an almost unprecedented remedy for its claim against a host state. The ECT has been described, together with NAFTA, as 'the major multilateral treaty pioneering the extensive use of legal methods characteristic of the fledging regulation of the global economy,' of which 'perhaps the most important aspect of the ECT's investment regime is the provision for compulsory arbitration against governments at the option of foreign investors...;' and these same distinguished commentators concluded: 'With a paradigm shift away from mere protection by the home state of investors and traders to the legal architecture of a liberal global economy, goes a coordinated use of trade and investment law methods to achieve the same objective: a global level playing field for activities in competitive markets.' By any standards, Article 26 is a very important feature of the ECT which is itself a very significant treaty for investors, making another step in their transition from objects to subjects of international law. (para. 141)

The unprecedented remedy provided by Article 26 was further underlined by the tribunal as it observed that the application of the ECT on a provisional basis extends to its Article 26: "Article 45(1) ECT provides that each signatory agrees to apply the treaty provisionally pending its entry into force for such signatory; and in accordance with Article 25 of the Vienna Convention, it follows that Article 26 ECT

provisionally applied from the date of a state's signature, unless that state declared itself exempt from provisional application under Article 45(2)(a) ECT. (Bulgaria made no such declaration)." (para. 140).

The tribunal held on this basis that it had jurisdiction to hear the case under Article 26.

The Mechanism of Article 17

Turning to Bulgaria's objection based on Article 17(1), the tribunal interpreted the language of that provision both textually and in light of the structure of the ECT, the arbitration clause of Article 26 being contained in Part V of the treaty whereas the denial of advantages applies to obligations contained in Part III:

In the Tribunal's view, the Respondent's jurisdictional case here turns on the effect of Article 17(1) and 26 ECT, interpreted under Article 31(1) of the Vienna Convention. The express terms of Article 17 refer to a denial of the advantages 'of this Part,' thereby referring to the substantive advantages conferred upon an investor by Part III of the ECT. The language is unambiguous; but it is confirmed by the title to Article 17: 'Non-application of Part III in Certain Circumstances' (emphasis supplied). All authentic texts in the other five languages are to the same effect. From these terms, interpreted in good faith in accordance with their ordinary contextual meaning, the denial applies only to advantages under Part III. It would therefore require a gross manipulation of the language to make it refer to Article 26 in Part V of the ECT. (para. 147).

The tribunal concluded that both the language and the object and purpose of the ECT require "Article 26 to be unaffected by the operation of Article 17(1)" (para. 148). Indeed, according to the tribunal, the object and purpose of the ECT is not for Article 17(1) to "operate as a denial of all benefits to a covered investor under the treaty but is expressly limited to a denial of the advantages of Part III of the ECT." (para. 149).

Another issue was whether the denial of benefits under Article 17(1) operates automatically and requires no further action from the host state as argued by the respondent, or whether it requires the right to deny to be exercised through positive action taken by the host state as argued by the claimant. The tribunal adopted the latter approach and established that Article 17(1) sets forth a reservation of rights mechanism which, to be effective, must be exercised: "In the Tribunal's view, the existence of a 'right' is distinct from the exercise of that right. [...] a Contracting Party has a right under Article 17(1) ECT to

deny a covered investor the advantages under Part III; but it is not required to exercise that right; and it may never do so. The language of Article 17(1) is unambiguous [...]. The Tribunal has also considered whether the requirement for the right's exercise is inconsistent with the ECT's object and purpose. The exercise would necessarily be associated with publicity or other notice so as to become reasonably available to investors and their advisers. [...] By itself, Article 17(1) ECT is at best only half a notice; without further reasonable notice of its exercise by the host state, its terms tell the investor little; and for all practical purposes, something more is needed." (paras. 155 and 157).

Once established that the host state must manifest its intention to deny the benefits of the ECT to a covered investor, such exercise of the right to deny cannot be retroactive and operates only prospectively. The tribunal's interpretation once again relies on both the language of Article 17(1) and the treaty's object and purpose: "The covered investor enjoys the advantages of Part III unless the host state exercises its right under Article 17(1) ECT; and a putative covered investor has legitimate expectations of such advantages until that right's exercised. A putative investor therefore requires reasonable notice before making any investment in the host state whether or not that host state has exercised its right under Article 17(1) ECT. [...] In the Tribunal's view, therefore, the object and purpose of the ECT suggest that the right's exercise should not have retrospective effect." (paras. 161-162).

Based on these principles, the tribunal held that Bulgaria's exercise of its right under Article 17(1) only deprived the claimant of the advantages of Part III prospectively from the date of the declaration onwards. It thus proceeded to hear the merits of the case, reserving issues pertaining to Article 17(1), if necessary, to that phase.

The decision rendered by the *Plama* tribunal on jurisdictional issues and the interpretation it has provided of chief provisions of the ECT such as the arbitration agreement contained at Article 26 is likely to greatly contribute to the body of arbitral decisions as to effect of a state's consent to arbitrate its investment disputes and the manner in which such consent operates under investment protection treaties.

1. The author represented the claimant in this arbitration. The decision is available on the ICSID Web site at www.worldbank.org/icsid/cases/awards.htm.