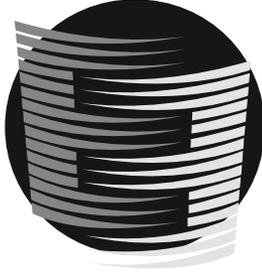


THE ENERGY CHARTER TREATY

A READER'S GUIDE



Energy Charter Secretariat



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PREFACE

This publication contains a commentary to the Energy Charter Treaty (“ECT”) and related Instruments. Signed in December 1994 and in force since April 1998, the ECT establishes a multilateral legal framework for cross-border energy co-operation. It covers energy trade, investment, and transit in a comprehensive manner. It also deals with the issue of energy efficiency and includes binding dispute resolution procedures.

The ECT aims to encourage and facilitate international energy co-operation. Its key principles of openness of energy markets and non-discrimination have the potential to stimulate foreign direct investment and cross-border trade. This will contribute towards securing energy supply of energy importing countries, and increasing capital inflows into energy exporting countries. Economies in transition need capital to develop and upgrade their energy industries.

As of 1 January 2002, the ECT comprises 46 member countries (including the European Communities). Several other countries have signed the Treaty (without having yet completed ratification procedures) or have, like various international organisations, obtained observer status. Given the fact that energy is a global issue, the Energy Charter process is dynamic and open. ECT member countries seek co-operation with non-members and encourage them to an active dialogue. The ECT therefore establishes an important international policy forum for energy-related issues.

The ECT is a complex international agreement. This survey has been written with the aim to guide interested readers (such as government officials, company representatives, business associations, trade unions, non-governmental organisations, or academics) through the Treaty text. It gives an overview of the historic development of the ECT and its principal objectives, explains the main provisions of the ECT and related Instruments, describes major recent activities, and deals with institutional matters. The intention is to contribute to a better understanding of the Treaty and to raise interest in the Energy Charter process.

The principal officer responsible for the publication is Joachim Karl. Substantive contributions were made by Tudor Constantinescu, Andras Lakatos, Alan Parfitt and Karl Petter Waern. Readers seeking additional information are kindly requested to visit the Energy Charter Secretariat’s website (<http://www.encharter.org>) or to get in contact with it. The address is as follows:

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A. THE ENERGY CHARTER PROCESS

SUMMARY

- *The ECT has its roots in a political declaration on East-West co-operation in the energy sector (the “European Energy Charter”);*
- *The ECT is a comprehensive multilateral agreement covering all aspects of energy co-operation (trade, investment, transit, energy efficiency, dispute settlement);*
- *The ECT promotes openness of energy markets and security of energy supply, while respecting the principles of sustainable development and sovereignty over natural resources;*
- *The ECT establishes an international policy forum for the discussion of all energy-related issues;*
- *The Energy Charter process is dynamic and open to co-operation with interested non-members.*

I. THE DEVELOPMENT TOWARDS THE ECT

The origins of the Charter Process date back more than one decade when the fall of the Berlin Wall and the subsequent dissolution of the Soviet Union brought fundamental change in European and world politics. This change opened new and unprecedented opportunities for economic co-operation, with the energy sector being a focal point of this new relationship.

There are several reasons why the energy sector is particularly promising for mutually beneficial co-operation: First of all, energy is the main driving force of all economies. Secondly, for many partners with a developing economy, the export and sale of energy products is, and will be, one of the most important sources of “hard” foreign currency earnings and a major source of tax revenue. To make full and efficient use of their energy resources, developing countries and transition economies need to modernise their existing facilities. This will not be possible without a massive inflow of capital, technology and know how.

Industrialised countries also have a keen interest in enhanced energy co-operation. Energy supply from the resource-rich countries helps them to meet increasing energy

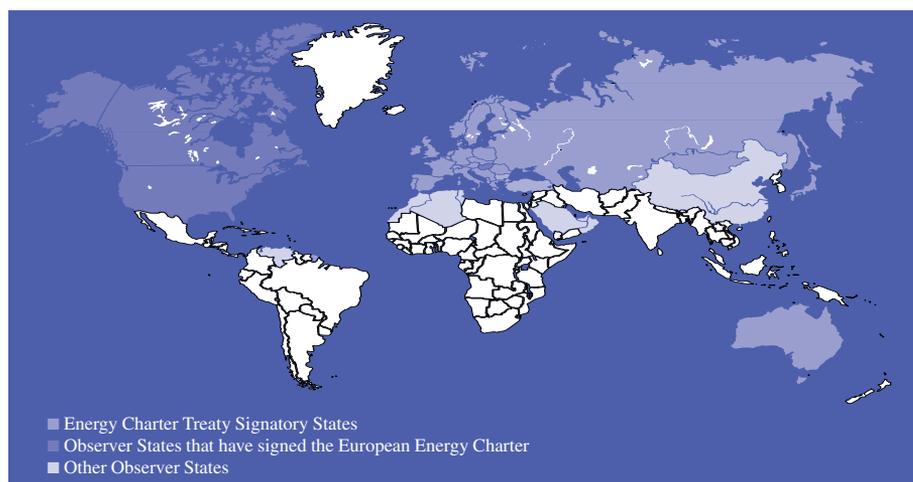
demands and results in an improved diversification of energy flows, thus reducing dependency upon one particular region.

A first important step towards the ECT was the European Energy Charter - a political declaration that was signed in The Hague in December 1991, and to which currently 54 countries adhere. It represents a political commitment to co-operation in the energy sector, based on the following objectives and principles:

- Development of open and efficient energy markets;
- Creation of conditions that will stimulate the flow of private investments and the participation of private enterprises;
- Non-discrimination among participants;
- Respect for state sovereignty over natural resources;
- Recognition of the importance of environmentally sound and energy-efficient policies.

The Energy Charter emphasised the need for the establishment of an appropriate international legal framework for energy co-operation between participants. Negotiations on the ECT started in 1992. Negotiating partners consisted of more than 50 delegations with very different backgrounds, divergent perceptions and interests. There was no previous experience with negotiations of an agreement of a similar type. Nevertheless, negotiations could be successfully concluded after a relatively short period of three years. The ECT was signed in Lisbon on 17 December 1994, and entered into force on 16 April 1998. As of 1 January 2002, 52 countries (including the European Communities) have signed the ECT, and 46 states have completed ratification procedures (see Annex 1).

TABLE: THE ENERGY CHARTER WORLD (AS OF 1 JANUARY 2002)



II. THE MAIN ELEMENTS OF THE ECT

The basic elements of the ECT ¹ are the following:

- Investment protection (e.g. by granting investors non-discriminatory treatment – national treatment and most-favoured nation treatment – compensation in case of expropriation and other losses, free transfer of capital);
- Trade in energy, energy products and energy related equipment, based on the WTO rules;
- Freedom of energy transit;
- Improvement of energy efficiency ²;
- International dispute settlement, including investor-state arbitration and inter-state arbitration;
- Improved legal transparency.

Further to these key elements, the ECT contains commitments on governmental co-operation, for instance with regard to transfer of technology, opening of financial markets, and the development of competition rules.

III. THE ROLE OF THE ECT

According to Article 2 of the ECT, the purpose of the Treaty is to establish a legal framework in order 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 Energy Charter. It is a milestone in international energy co-operation. By creating a stable, comprehensive and non-discriminatory legal foundation for cross-border energy relations, the ECT reduces political risks associated with economic activities in transition economies. It creates an economic alliance between countries with different cultural, economic and legal backgrounds, but all united in their commitment to achieve the following common goals:

- To provide open energy markets, and to secure and diversify energy supply;
- To stimulate cross-border investment and trade in the energy sector;
- To assist countries in economic transition in the development of their energy strategies and of an appropriate institutional and legal framework for energy, and in the improvement and modernisation of their energy industries.

¹ These elements will be discussed in more detail in the following chapters.

² A specific “Protocol on Energy Efficiency and Related Environmental Aspects” entered into force together with the Treaty on 16 April 1998.

The attraction of foreign investment to promote energy production in a sustainable manner, and the development of secure and diversified sources of energy imports, are pressing issues in many countries. The ECT offers an important mechanism for addressing these priority tasks through multilateral co-operation:

- Participation in the Energy Charter process is an important factor in promoting the development of a country's energy sector. By doing so, governments convey a strong political message to foreign investors that they are committed to observe the principles of openness and non-discrimination in the energy market;
- Participation in the Energy Charter process offers reciprocal benefits for countries developing their own outward investment strategies;
- In many countries a major increase in per capita energy consumption can be expected over the next decade. This in turn will entail some crucial decisions in terms of balancing consumption with energy efficiency and environmental concerns, and in terms of ensuring secure and diversified sources of energy supply to fuel growth. Participation in the Charter process offers the possibility to develop satisfactory solutions for these important issues .

The ECT has a pioneer role for treaty-based international energy co-operation. It:

- Is unique in covering all forms of international energy co-operation simultaneously, i.e. investment, trade, transit and energy efficiency;
- May create an intermediary step towards WTO membership for those ECT countries that are not yet WTO members;
- Is the first binding multilateral agreement on the promotion and protection of foreign investment, covering all important investment issues and providing high standards of protection, including a fully developed dispute settlement mechanism;
- Is the first multilateral treaty on energy transit issues and energy efficiency;
- Establishes a permanent discussion forum between members concerning all aspects of international energy co-operation.

The ECT confirms the principle of national sovereignty over energy resources (Article 18). Member countries remain free to conduct their national energy policies and exploit their natural resources, provided that they exercise their sovereign rights in accordance with their Treaty obligations. For instance, the ECT does not touch upon issues such as the structure of domestic energy markets in general, the legal structure of energy companies, or third party access. The Treaty also respects that member countries take appropriate measures for the protection of national security or other justified reasons (Article 24).

The Energy Charter process is dynamic and open towards the outside world.

Although originally conceived as a European initiative, having its roots in the European Energy Charter of 1991, the Energy Charter process has long since developed into a more global forum for energy co-operation. Russia and the five states of Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan), Australia and Japan are all founding signatories to the ECT and are active participants in the Energy Charter process. They have been joined by Mongolia in 1999.

Given the fact that energy is an issue of global dimension, ECT member countries attach great importance to co-operation with non-members. There are various forms of co-operation, reaching from informal contacts, via observership and association to full membership (see chapter on “Co-operation with Non-Members”, page 64 below).

IV. INSTITUTIONAL ARRANGEMENTS

The Treaty has established the Energy Charter Conference as its main institutional body. The Conference has the political responsibility for the implementation of the Energy Charter, the ECT and related instruments. It also decides on possible amendments to the Treaty and on the admission of new members. The Conference has created several working groups and ad-hoc committees that operate under its supervision. In 1996, the Energy Charter Secretariat has been established in Brussels, Belgium, to serve the Conference and its member states.

B. TRADE

SUMMARY

- *The ECT extends the WTO rules to trade in the energy sector between WTO and non-WTO members and to energy trade among non-WTO members (“WTO by reference” approach);*
- *The ECT trade rules cover energy materials, products (such as coal, crude oil, natural gas and electricity), and energy-related equipment;*
- *The ECT trade rules only cover trade in goods - not trade in services - and do not extend to trade-related intellectual property rights;*
- *The ECT has established procedures for the settlement of trade disputes.*

I. INTRODUCTION

One of the necessary conditions for forging open and non-discriminatory energy markets through the Energy Charter process has been to create a stable, predictable and non-discriminatory regime for energy and energy-related trade between all 52 ECT Contracting Parties (“CPs”)/signatories. Such a framework should naturally follow and be based on the rules of the multilateral trading system as embodied in the General Agreement on Tariffs and Trade (“GATT”) - when the ECT was negotiated between 1991 and 1994 - and now in the World Trade Organisation (“WTO”).

The fact that in the early 1990’s approximately half of the Charter constituency did not belong to the GATT represented a major challenge during negotiations of the ECT. A formula for dealing with energy trade between GATT and non-GATT countries and to energy trade amongst non-GATT countries was found through making the substantive GATT rules applicable to such transactions (“GATT by reference” - Article 29). As far as trade between GATT members was concerned, the GATT provisions applied exclusively, and the ECT did not derogate from these provisions.

Three years after the entry into force of the WTO Agreement, the ECT was amended in order to take account of the relevant changes in the multilateral trade rules resulting from the Uruguay Round. The amendment has taken the same approach as the original Treaty: it incorporated all those WTO rules on trade in goods that are relevant from a sectoral viewpoint (“WTO by reference”).

The ECT therefore has the effect of treating those CPs/signatories³, which are not members of the WTO, as if they were WTO members - in the framework of energy-related trade. For non-WTO CPs⁴ the applicable ECT trade regime is a major step on the way to stable, predictable and non-discriminatory trade rules and a milestone towards WTO membership. The ECT trade regime will have fulfilled its purpose once all member countries have also become members of the WTO.

II. THE MAIN PRINCIPLES OF THE ECT TRADE RULES

The legal structure of the ECT trade regime consists of two instruments: the relevant provisions of the ECT based on the GATT 1947 rules (in the version of December 1994), and the Amendment to the Trade-Related Provisions of the ECT based on the relevant WTO rules (adopted in April 1998).

The reasons for this two-tiered approach are:

- Not all trade-related issues could be resolved at the time of signature of the Treaty in December 1994 (e.g. the coverage of energy-related equipment and the legally binding regime for customs duties);
- The results of the Uruguay Round negotiations could not be incorporated into the ECT at the time of its adoption.

Some provisions of the GATT/WTO regime have not been made applicable under the ECT. This has been achieved by:

- Declaring them non-applicable or modified by Annex G (in the original Treaty) or Annex W (in the Treaty as amended by the Trade Amendment);
- Making further exceptions in the text to the generally applicable GATT/WTO related trade provisions of the ECT or in the related instruments of the Final Act. Examples are:
 - o Trade between states that were previously part of the former USSR could instead be governed by pre-existing preferential agreements between them for a limited time (Article 29 (2b)). This exception ceased to apply on 1 December 1999;

³ For the sake of easier reading, the term “CPs” is used instead of “CPs/signatories” throughout the remainder of the text.

⁴ These countries are Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Kazakhstan, the former Yugoslav Republic of Macedonia, the Russian Federation, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

- o Nuclear trade between the European Communities and some CIS countries may be governed by bilateral agreements.

Regarding customs duties on imports, there is at present only a “best-endeavours” commitment not to increase them (Article 29 (4)). However, any increase of import duties is subject to a notification obligation and consultation procedure (Article 29 (5)).

In conclusion, the trade provisions of the ECT can be characterised as follows: They

- Cover energy materials and products and energy-related equipment listed in Annexes EM I and EQ I;
- Cover trade in services partially through the rules on investment, although the provisions of the WTO-GATS as such have not been incorporated into the ECT;
- Govern energy trade relations between WTO members and non-WTO members and between non-WTO members;
- Are not a new set of rules as they are based on the WTO agreements.

III. AMENDMENT TO THE TRADE-RELATED PROVISIONS OF THE ECT

On 24 April 1998, the International Conference of the Parties to the Energy Charter adopted a new instrument, which amended the Treaty (the so-called “Trade Amendment”). It replaced the GATT provisions of the ECT with those of the WTO.

The main changes introduced by the Trade Amendment are the following:

1. Applicability of most of the substantive provisions of the WTO Multilateral Agreements on Trade in Goods (Annex 1A to the WTO Agreement)

The Trade Amendment follows the same mechanism concerning the applicability of trade rules as the ECT. Therefore, all rules of the WTO Multilateral Agreements on Trade in Goods apply, except those listed in Annex W of the Trade Amendment. This Annex contains two kinds of limitations:

- Annex W(A) lists WTO rules that are not applicable;
- Annex W(B) contains special rules and modifications of the WTO provisions applicable under the ECT as amended.

The following categories of WTO provisions are listed in Annex W(A) as not applicable:

- Institutional provisions - because the Charter Conference substitutes the WTO-related bodies, as provided for in Annex W(B)(9);
- Final provisions, including those on entry into force, accession, and withdrawal - because the ECT contains its own final provisions;
- Dispute settlement provisions - because the ECT provides in Article 29(9) and Annex D, as amended, for its own dispute settlement mechanism;
- All provisions on tariff bindings and tariff negotiations - because under the ECT only a “best-endeavours” regime applies to import duties. However, the Charter Conference is mandated to annually review the possibility of moving items to Annexes EM II and EQ II, which will specify those products for which bindings will apply;
- All provisions that grant special and differential treatment to developing countries, except those that permit treatment under the Generalised System of Preferences (i.e. preferential tariffs granted to developing countries on a unilateral basis);
- The Agreement on Agriculture, the Agreement on the Application of Sanitary and Phytosanitary Measures and the Agreement on Textiles and Clothing - because their content is outside the scope of the ECT;
- The GATS and the WTO Agreement on Trade-Related Intellectual Property Rights.

Under the Trade Amendment, Decisions by the WTO bodies in those areas that are applicable pursuant to Article 29(2)(a) are incorporated automatically, i.e. no further action by the Conference is needed to adopt them for the purposes of the ECT.

2. Extension of the WTO-based trade regime to Energy-Related Equipment

The trade provisions of the ECT originally only applied to trade in energy materials and products - which includes fossil fuels such as coal, natural gas, petroleum and petroleum products as well as nuclear energy, electricity, fuel wood and charcoal. The Trade Amendment extended the ECT trade rules to energy-related equipment. As a result, the ECT trade regime now covers more than 70 categories of items of energy-related equipment, such as pipeline pipes, turbines, power masts, furnaces, platforms, transformers, etc. (Annex EQ I). The listing of equipment items is based on tariff headings of the World Customs Organisation’s Harmonised System.

This is a significant enlargement of the scope of the ECT. It ensures that investors will have access to equipment of their choice on a non-discriminatory basis, both in terms of most-favoured nation treatment and national treatment.

3. Possible future legally binding tariff commitments for Energy Materials, Products, and Energy-Related Equipment

The ECT does not affect the trade regime between the ECT CPs that are likewise WTO members. It continues to be governed by their WTO obligations. However, in trade involving at least one ECT CP that is not a WTO member, the ECT CPs that are WTO members are under a “soft law” commitment not to increase their tariffs beyond a “ceiling” of their duty rates bound in the WTO (“best endeavours” clause). ECT CPs that are not yet WTO members undertook a “soft law” pledge not to raise their import and export tariffs above the applied levels.

In the negotiations of the Trade Amendment, the CPs tried to replace these “soft law” provisions of the ECT by legally binding obligations. The Trade Amendment resulted in the following compromise:

- The previous “best endeavours” clause has been maintained and, in addition, has been extended to energy-related equipment;
- A mechanism has been incorporated allowing moving items into a “basket” (Annexes EM II and EQ II) where legally binding tariff commitments would apply at a later date. In annual reviews, the Conference has to examine the possibility of such moving of items. In case of a positive conclusion, only a Conference decision by unanimous vote is required without the need to go through a formal amendment procedure. Up to now, no legally binding tariff commitments have been made.

IV. TRADE RELATED INVESTMENT MEASURES

Under the ECT and the WTO, Trade-Related Investment Measures (“TRIMs”) refer to government measures that are mandatory or enforceable under domestic law or under administrative rulings and that might be applied as a condition for the making of foreign direct investment (“FDI”) in a host country or that may be a pre-condition for obtaining an advantage (e.g. a subsidy) for an investment, and that are incompatible with the provisions of Articles III (national treatment) and XI (elimination of quantitative restrictions) of the GATT. Although there exists no exhaustive listing of TRIMs, the WTO Agreement on TRIMs contains an illustrative list of such prohibited measures.

Article 5 and Annex TRM of the ECT replicate most of the substantive provisions of the WTO Agreement on TRIMs. The ECT provisions confirm the prohibition of TRIMs that are inconsistent with Articles III or XI of the GATT. Such measures include local content requirements, trade balancing requirements, foreign exchange restrictions and domestic sales requirements.

Exceptionally, Article 5 (3) allows TRIMs if they relate to the eligibility of products for export promotion, foreign aid, government procurement, preferential customs duties or quota programmes.

As in the WTO Agreement, Article 5 (4) of the ECT allowed CPs to temporarily maintain non-conforming TRIMs that existed at least 180 days before the signature of the Treaty, subject to specific notification and phase-out requirements contained in Annex TRM. Under Annex TRM of the ECT, CPs not members of the WTO were obliged to notify existing TRIMs within 12 months after the entry into force of the ECT (i.e. by 15 April 1999) if they wished to benefit from a transitional period of three years that ended on 15 April 2001. No such notification has been made. In legal terms, this implies that no CP to the ECT may maintain or adopt new TRIMs with respect to products listed in Annexes EM I and EQ I of the ECT.

V. TRADE IN SERVICES

During the negotiations of the Trade Amendment, it was discussed whether or not to incorporate provisions of the WTO General Agreement on Trade in Services (“GATS”). It was finally considered that this issue was too complex and that it would need more time for reflection. Therefore, neither the ECT Interim Provisions on Trade-Related Matters nor the Trade Amendment declares any provisions of the GATS applicable under the ECT.

However, trade in services is not completely outside the scope of the ECT. Through the ECT provisions on investment and movement of key personnel, trade in energy services provided through commercial presence and presence of natural persons (i.e. as defined as modes of delivery 3 and 4 in the GATS) is covered by the Treaty, although the substantive provisions of the ECT concerning market access and national treatment differ from those of the GATS.⁵

⁵ As far as investment/commercial presence is concerned, a noteworthy difference between the ECT and the GATS is that the ECT does not provide for legally binding MFN treatment for the pre-establishment phase of investment. However, such treatment (and national treatment) are to be established in a so-called “Supplementary Treaty” (see below pages 22-24).

VI. THE ROLE OF THE ENERGY CHARTER SECRETARIAT

The ECT trade provisions require the Energy Charter Secretariat to act, vis-à-vis the ECT constituency, as a “surrogate” WTO Secretariat with regard to energy and energy-related trade with and between non-WTO CPs, pending their membership in the WTO.

The Secretariat has only very limited resources for this task. Therefore, up to now efforts concentrate on providing transparency and establishing appropriate notification mechanisms. For example, the Secretariat

- Collects and disseminates trade-related notifications;
- Provides technical assistance to non-WTO members for the implementation of their WTO-based ECT obligations or any other matter related to their accession to the WTO. In this context, the Secretariat has organized three major events to date: the 1999 Geneva Seminar on Notification Obligations under the WTO, the 2000 Brussels Workshop on Dispute Settlement and the 2001 Berne Training Courses on Technical Barriers to Trade (the latter in cooperation with the World Trade Institute);
- Provides technical assistance on dispute settlement procedures;
- Prepares analytical studies on trade issues as requested by the Charter Conference or the Group on Trade;
- Exchanges information with the WTO and other relevant international organisations.

A more detailed overview of the Secretariat’s activities in this regard can be found in Annex 4.

C. INVESTMENT

SUMMARY

- *The ECT promotes FDI in the energy sector by protecting foreign investors against the most important political risks in the host country (discrimination, expropriation, losses resulting from strife, transfer restrictions, breach of individual investment contracts);*
- *The ECT contains a comprehensive dispute settlement mechanism, covering both investor-state arbitration and inter-state arbitration;*
- *The ECT includes a “best-efforts” clause concerning non-discrimination in the pre-establishment phase (i.e. the making of an investment), and provides for negotiations to transform it into a legally binding obligation.*

I. INTRODUCTION

The investment chapter is a cornerstone of the ECT. Its provisions aim to promote and protect foreign investment in member countries. To this end, the Treaty grants a number of fundamental rights to foreign investors with regard to their investment in the host country. Foreign investors are protected against the most important political risks, such as discrimination, expropriation and nationalisation, breach of individual investment contracts, damages due to war and similar events, and unjustified restrictions on the transfer of funds. The dispute settlement provisions of the Treaty, covering both inter-state arbitration and investor-state dispute settlement, reinforce these investor rights.

The perceived degree of political risks in the host country considerably affects the decision of foreign companies whether to make an investment in the first place or not, and what level of return it would require. The higher the perceived risk, the higher the return that the foreign investors demand. Vice versa, the lower the perceived risk, the more capital is likely to be invested and the more potential revenue the host country will gain. By reducing the political risks that foreign investors face in the host country, the ECT seeks to boost investor confidence and to contribute to an increase in international investment flows.

The ECT's investment provisions build upon the content of bilateral investment treaties as they have developed during the last half-century. ECT negotiators felt no

need to “re-invent the wheel”, as the principles and rules embodied in these agreements are recognised universally. Nevertheless, the ECT has some added value as compared to the bilateral investment treaties. The ECT:

- Is the first multilateral agreement on the promotion and protection of foreign investment, covering all important investment issues and providing high standards of protection;
- Reflects the close inter-relationship between investment, trade and transit in the energy sector by covering not only investment issues per se, but also related areas, such as trade and transit;
- Establishes a permanent discussion forum between members on all energy-related aspects of foreign investment;
- Provides for the future establishment of the principle of non-discrimination with regard to the making of investment in a legally binding manner.

The investment provisions of the ECT respect the sovereignty of member countries in conducting their domestic investment-related policies, including in the area of energy. Member countries remain free to adopt rules and regulations for foreign energy companies investing in their territories, provided that they comply with the Treaty’s core principle of non-discrimination, and the other investment-related obligations.

II. OVERVIEW OF THE ECT’S INVESTMENT PROVISIONS

1. Definition of “Investment” and related Issues

Given the fact that the ECT is a sectoral agreement on energy, the Treaty links the definition of an “investment” to additional definitions concerning the energy sector. The following elements are relevant:

- The definition of “investment”;
- The definition of “Economic Activity in the Energy Sector”; and
- The definition of “Energy Materials and Products”.

Combining the three definitions, the scope of the ECT can be described as follows: “Investment Associated with Economic Activity in the Energy Sector covering certain Energy Materials and Products.”

a. Investment

The ECT contains a broad, non-exhaustive, “asset-based” definition of an “investment”. According to Article 1(6), “investment” means every kind of asset, owned or controlled directly or indirectly by an investor. The definition includes, inter alia:

- Tangible and intangible, moveable and immovable property;
- Shares, stocks, or other forms of equity participation in a company;
- Bonds and other debt of a company;
- Claims to money and claims to performance pursuant to a contract having an economic value associated with an investment;
- Intellectual Property;
- Returns;
- Any right conferred by law, contract or licence.

The definition also covers assets that are indirectly owned or controlled by the investor (e.g. assets owned by a holding company). The ECT contains a common Understanding (Nr. 3) concerning the interpretation of the term “control”. It covers both equity interests of the investor and the ability to exercise substantial influence over the company. Furthermore, the definition extends to any investment “associated with” an economic activity in the energy sector. The term “associated with” implies that it includes not only the establishment of an energy company as such (e.g. a refinery), but also investments indirectly linked to economic activity in the energy sector (e.g. office space associated with a refinery).

b. Economic Activity in the Energy Sector

Pursuant to Article 1 (5), “Economic Activity in the Energy Sector” means an economic activity concerning the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or sale of energy materials and products⁶. Understanding Nr. 2 relating to this provision includes an illustrative list of such activities.

c. Energy Materials and Products

Annex EM lists those “Energy Materials and Products” that are covered by the Treaty. These are nuclear energy (e.g. uranium, other radioactive chemical elements, heavy water), coal, natural gas, petroleum, petroleum products, and electrical energy.

2. General Treatment of Foreign Investors

The ECT intends to assure a basic standard of treatment for foreign investors. According to Article 10 (1), each CP shall encourage and create stable, equitable, favourable and transparent conditions for investors to make investments. Such conditions include a commitment to accord at all times to investments of investors of other

⁶ Except those included in Annex NI (in particular oils and other products of the distillation of high temperature coal tar, fuel wood, and charcoal), or concerning the distribution of heat to multiple premises.

CPs fair and equitable treatment. Investments shall enjoy the most constant protection and security. In no case shall such investment be accorded treatment less than that required by international law, including treaty obligations.

3. The Principle of Non-Discrimination

a. Treatment of Established Investments

Protection against discrimination is one of the most important components in creating a favourable investment climate. Article 10 (7) obliges host countries to accord to investments of investors of other CPs, and to their related activities including management, maintenance, use, enjoyment or disposal, treatment at least as favourable as that they accord to the investments of their own investors or of investors of other countries, i.e., the better of national treatment or most-favoured-nation (“MFN”) treatment. For example, an export license may not be granted exclusively to domestic investors or to the investors of a particular foreign country, if the other foreign investors are in similar circumstances.

CPs are not allowed to lodge individual exceptions to the principle of non-discrimination for established investments. However, there are three general cases where the principle of non-discrimination does not apply fully or where the precise manner of its application needs further clarification:

- In accordance with the practice in other international investment treaties, there are exceptions to the principle of non-discrimination concerning taxation matters (Article 21) ⁷;
- A Supplementary Treaty will deal with the modalities of the application of the principle of non-discrimination concerning grants and other financial assistance for technology R&D (Article 10(8));
- The protection of intellectual property rights shall be governed by the relevant international agreements (Article 10 (10)). Pursuant to Understanding Nr. 5, CPs recognise the necessity for adequate and effective protection of such rights according to the highest internationally accepted standards.

In addition, Decision Nr.2 concerning Article 10 (7) grants the Russian Federation the right to require from foreign investors to obtain legislative approval for the leasing of federally owned land. In doing so, Russia has to respect the principle of most-favoured nation treatment.

⁷ See also the following chapter on “Miscellaneous Provisions”, pages 38-39.

b. The Making of Investment

The legally binding obligation to grant non-discriminatory treatment applies only once an investment has been made (so-called “post-establishment phase”). While negotiating the ECT, it was intended to extend the principle of non-discrimination to the making of an investment. As a result, foreign investors would have been on equal legal footing with their domestic competitors in the host country when applying for an investment authorisation or any other kind of permission necessary for their establishment.

This very ambitious goal could not be realised within the three years of negotiations of the ECT. Negotiators therefore agreed on an intermediary solution:

- As a first step, Article 10 (2) of the ECT has established a non-legally binding “best efforts” clause for CPs to grant foreign investors non-discriminatory treatment concerning the making of their investments. In addition, pursuant to Article 10 (5), CPs shall endeavour not to introduce new restrictions for foreign investors concerning the making of an investment (“standstill”), and to progressively reduce remaining restrictions (“rollback”). Furthermore, Article 10 (6) allows CPs to make at any time a legally binding voluntary commitment to grant foreign investors non-discriminatory treatment with regard to the making of an investment (so-called “pre-establishment phase”).
- Secondly, Article 10 (4) provides for negotiations on the extension of the non-discrimination principle to the pre-establishment phase. These negotiations (on a so-called “Supplementary Treaty”) began in 1995. Although negotiators have come close to a final agreement, a number of political issues still need to be resolved. The basic structure of the draft “Supplementary Treaty” consists of two components:
 - An obligation of CPs to grant foreign investors national treatment and most favoured nation treatment concerning their establishment in the host country. According to Understanding Nr. 10 to the ECT, this includes the issues of privatisation and de-monopolisation;
 - The right of each CP to launch individual exceptions to this commitment (“top-down approach”).

The application of the principle of non-discrimination to the pre-establishment phase is of particular importance in the energy sector where often a licence or concession is required before investors can start their operations. The “Supplementary Treaty” would also have considerable significance in the context of privatisation. Foreign investors who would like to participate in tender procedures and the subsequent sale of state assets would be protected against discrimination.

The Secretariat has compiled a so-called “Blue Book”⁸, containing all exceptions to the principle of non-discrimination that member countries/signatories have reported concerning the making of a foreign investment in the energy sector. The exceptions are regularly reviewed in the ECT Investment Group, either through individual country examinations or horizontal reviews (e.g. concerning existing authorisation procedures, screening mechanisms, restrictions on land ownership, etc). The aim is to avoid the introduction of new discrimination (“standstill”) and to achieve a gradual reduction of existing ones (“rollback”).

4. Expropriation

Protection of foreign investors in case of an expropriation is a core element of investment agreements. Although the risk of politically motivated expropriations has decreased substantially during the last decade, giving way to the opposite movement of de-nationalisation and privatisation, it has not completely disappeared. In addition, there is always the possibility of an expropriation for non-political reasons (e.g. construction of a new road or building).

According to Article 13, investments may only be expropriated if certain conditions are fulfilled. The expropriation needs to be in the public interest, non-discriminatory, carried out under due process of law and accompanied by payment of prompt, adequate and effective compensation. Compensation shall amount to the fair market value of the investment at the time immediately before the expropriation, or impending expropriation, became known in such a way as to affect the value of the investment. The investor may request compensation in a freely convertible currency, and it shall include interest at a commercial rate until the date of the payment.

Furthermore, the investor has the right to prompt review of the valuation of the investment and the amount of compensation under the law of the host country by a judicial or other competent and independent authority of the host country (Article 13 (2)).

5. Compensation for losses

Article 12 deals with protection from strife. This provision is of considerable importance for foreign investors who are concerned that the host country has not yet reached a satisfactory level of political stability, resulting in the risk of internal armed conflicts or even wars with other countries.

⁸ Available on the website of the Energy Charter Secretariat (www.encharter.org).

Article 12 (1) provides that in the event of war or other armed conflict, a state of national emergency, civil disturbance or other similar event in the area of one of the parties to the Treaty, the host government shall accord to foreign investors, who suffer a loss concerning an investment made in its area, the most favourable restitution, indemnification, compensation or other settlement that it provides to any investor. An obligation to compensate foreign investors therefore only exists if the host country decides to compensate its own investors or investors of any third state (i.e. granting of national treatment/MFN treatment).

Article 12 (2) establishes an absolute obligation to compensate foreign investors in particular circumstances. Foreign investors shall receive prompt, adequate and effective restitution or compensation from the host government if they suffer a loss resulting from the requisitioning of the investment, or unwarranted destruction of the investment by the authorities or forces of the host government.

6. Transfer of payments

A considerable disincentive for foreign investors is the risk of not being able to transfer capital connected to their investment to another country. This risk exists in particular in countries with high inflation, long delays in transfer systems, widely fluctuating exchange rates, or poor foreign exchange reserves.

Article 14 (2) obliges host countries to proceed with the transfer without delay. According to Article 14 (3), transfers shall be made at the market rate of exchange in a freely convertible currency. Such transfers include the initial and additional capital, returns, payments under a contract, unspent earnings and other remuneration of personnel, proceeds from the sale or liquidation of the investment, payments arising out of the settlement of an investment dispute and compensation for losses or expropriation.

There are three specific exceptions to this obligation:

- The host government may protect the rights of creditors, ensure compliance with laws on securities and the satisfaction of judgements in proceedings, through equitable, non-discriminatory and good faith application of its laws (Article 14 (4));
- Countries belonging to the Commonwealth of Independent States (“CIS”) may, as concerns transfers among themselves, conclude agreements that transfer of payments shall be made in the currencies of such parties, provided that such agreements ensure that investors of other parties to the ECT are accorded the better of national and MFN treatment (Article 14 (5));
- Returns-in-kind may be restricted in circumstances where the GATT/WTO allows

export restrictions, except that such returns must be allowed in accordance with the provisions of any written agreement with the host state (Article 14 (6)).

In addition, Decision Nr. 3 concerning Article 14 grants CIS countries the right to apply restrictions on the movement of capital by its own investors. However, such restrictions may not impair the rights granted to foreign investors with respect to their investments. This means that, while transfer restrictions may be applied vis-à-vis a foreign subsidiary established in a CIS country, this is not allowed if the parent company of this subsidiary requests the transfer. Furthermore, in no case must such restrictions affect current transactions.

Decision Nr. 3 required CPs wishing to apply this kind of restriction to make a notification to the Charter Secretariat no later than 1 July 1995. Within this timeframe, only the Russian Federation made a notification.

7. Individual investment contracts

According to Article 10 (1), last sentence, each CP shall observe any obligations it has entered into with an investor or an investment of any other CP. This provision covers any contract that a host country has concluded with a subsidiary of the foreign investor in the host country, or a contract between the host country and the parent company of the subsidiary.

Respect of the international principle of “pacta sunt servanda” is of particular relevance in the energy sector where most major investments are made on the basis of an individual contract between the investor and the state.

Article 10 (1) has the important effect that a breach of an individual investment contract by the host country becomes a violation of the ECT. As a result, the foreign investor and its home country may invoke the dispute settlement mechanism of the Treaty. However, Article 26 (3)(c) grants CPs the right to exclude international arbitration in such cases. Four countries (Australia, Canada ⁹, Hungary, Norway) have opted for this solution; they are listed in Annex IA.

8. Key personnel

Article 11 permits foreign investors to employ key personnel of their choice, regardless of nationality, so long as such personnel has the required work and residence permits. The Treaty requires the host country, subject to its laws and regulations, to

⁹ Canada did not sign the Treaty.

examine in good faith requests by the foreign investor concerning the entry and temporary stay of employed key personnel to be engaged in activities connected with the making or development, management, maintenance, use, enjoyment or disposal of relevant investments. This includes, for instance, advice or technical services by energy experts.

9. Subrogation/Transfer of rights

Article 15 contains a so-called “subrogation clause”. It provides for the transfer of rights that foreign investors might have vis-à-vis the host country if they receive compensation from their home country under an investment insurance or guarantee. In this case, the host country shall recognise the assignment to the indemnifying party of all rights and claims with regard to the investment. It shall also acknowledge the right of the indemnifying party to exercise all such rights and enforce such claims.

10. Relation to other Agreements

Article 16 clarifies the relation of the ECT to other international investment agreements. In case of an overlap between the agreements, the provisions that are more favourable to the foreign investor shall prevail.

11. Non-Application of the Investment Provisions in certain circumstances

Article 17 gives CPs the right to deny the advantages of the investment provisions in two cases.

- Article 17 (1) covers so-called “mailbox companies” (i.e. a company that has no substantial business activities in the country where it is organised), provided that such company is owned or controlled by nationals of a third state;
- Article 17 (2) addresses indirect investments involving certain categories of third (non-member/non-signatory) countries. The provision applies if the denying CP does not maintain diplomatic relations with the third country, or adopts or maintains measures that prohibit or restrict transactions with investors of that state. (Example 1: An investment originating in member country A through third country B in host member country C. Example 2: An investment originating in third country A through member country B in host member country C. In both examples, host member country C would not maintain diplomatic relations with the third country [A,B] or would restrict business activities with that state.)

III. THE ECT INVESTMENT GROUP

Under the supervision of the Charter Conference, the ECT Investment Group is the institutional body for the discussion of all investment-related issues covered by the Treaty. Its main tasks are:

- To provide a policy forum for all investment-related matters under the Treaty;
- To conduct horizontal and country-specific reviews concerning the investment climate and the issue of market restructuring/privatisation;
- To exercise peer pressure with regard to the reduction of remaining restrictions for foreign investment in the energy sector;
- To give general recommendations or individual advice to specific members concerning their investment-related energy policies;
- To provide information on recent developments in the investment-related energy policies of member countries;
- To perform any other task assigned by the Charter Conference.

D. TRANSIT

SUMMARY

- *The ECT obliges CPs to facilitate energy transit on a non-discriminatory basis;*
- *The ECT explicitly covers grid-bound energy transport;*
- *The ECT does not oblige CPs to grant third party access;*
- *The ECT provides for a special conciliation mechanism in case of transit disputes;*
- *The ECT's existing provisions are to be supplemented, extended and modified by a legally binding Transit Protocol that is currently being negotiated;*
- *Non-legally binding model agreements (both intergovernmental agreements and agreements between host governments and private companies) are being developed as guidelines for individual energy transit projects.*

I. DEFINITION OF “TRANSIT” AND APPLICABLE RULES

The term “Transit” can be defined as covering the transport of goods from a country, through at least one other country, to a third country. In the case of transit of energy - for example, flows of oil, natural gas or electricity across national boundaries via pipelines or grids - there are two sets of rules that may apply:

- Firstly, those contained in international agreements between the states involved and in customary international law;
- And secondly, those contained in private commercial contracts between market participants, including governments and state companies.

Before the entry into force of the ECT in 1998, the international rules applicable to transit were those included in Article V of the GATT, which enshrines the principle of non-discrimination towards goods in transit. With rapidly increasing energy transit flows over recent decades, transit transactions have become more complex, in particular with regard to fees for services provided and to transit routes. It thus became apparent that, in the specific context of energy transit, Article V of the GATT could not solve all the related problems, and that more elaborate rules were needed that would ensure transit on reasonable terms.

Such rules were developed through the ECT, whose transit provisions build upon the non-discrimination principle embodied in Article V of the GATT. The aim of these provisions, included in Article 7 of the ECT, is to provide for a balance between the sovereign interests of States and the need for security and stability of transit.

The transit provisions of the Treaty confirm the principle of non-discrimination with regard to access to energy resources and markets. The important new element contained in the Treaty is its explicit coverage of grid-bound energy transport and the enforceability of its provisions. A number of countries that previously did not participate in any international transit arrangement now have, through the ECT, access to a set of multilaterally accepted rules that can be used to protect their interests.

The Treaty defines “transport facilities” through which transit takes place as follows:

- High-pressure gas transmission pipelines;
- High-voltage electricity transmission grids and lines;
- Crude oil transmission pipelines;
- Coal shipping pipelines;
- Oil product pipelines; and
- Other specific fixed energy facilities, notably port facilities.

CPs commit themselves to taking all necessary measures to facilitate transit of energy. They also undertake to promote the modernisation, development and operation of inter-regional transport facilities, as well as the development of internal and cross-border interconnection facilities. In addition, they agree to co-operate in order to mitigate the effects of interruptions in energy supply.

Under the Treaty, measures to facilitate transit are to be taken without distinction as to origin, destination or ownership of energy, or discrimination as to pricing, and without imposing any unreasonable delays, restrictions or charges. This means that countries may not refuse transit, or refuse to agree to the construction of a new pipeline or network capacity, solely on the basis of the origin, destination or ownership of the energy.

CPs must not frustrate the establishment of new capacity, if transit through existing capacity cannot be achieved on commercial terms, unless they demonstrate that such new capacity would endanger the security or efficiency of their energy systems, including the security of supply. At the same time, the ECT recognises that there may be situations where national legislation may override the provisions of the Treaty, reflecting sovereign rights of the country in areas such as environmental protection, land use, safety, or technical standards.

Under the ECT, transit countries must not interrupt or reduce existing transit flows, even if they have disputes with any other country concerning this transit. In such cases, they have the possibility to invoke a special, rapid conciliation procedure under Article 7(7) of the Treaty. Under this mechanism, an independent conciliator is appointed, who is empowered to fix interim transit tariffs for up to twelve months if the parties to the dispute fail to reach an agreement.

The ECT's transit rules need to be considered in combination with its provisions on investment protection and its extension of WTO trade rules to energy-related trade among its CPs. When taken together, this "package" of rules and obligations provides for substantially improved conditions for increased volumes of energy flows across national boundaries.

II. NEGOTIATIONS ON A "TRANSIT PROTOCOL"

Article 7 of the ECT already represents the most elaborate set of multilateral legal obligations in existence dealing specifically with energy transit flows. Nonetheless, following the Treaty's entry into force in 1998, a consensus view emerged among the Energy Charter's member governments that the Treaty's existing rules in this area needed to be further strengthened and elaborated. The following reasons led to this development:

- The dissolution of the Soviet Union transformed previous internal transport routes into international transit systems. This situation resulted in some cases in interruptions of energy transit flows. The establishment of a clearer set of energy transit rules may help to resolve these difficulties.
- The opening up of new energy production areas in, for example, the Caspian region and Central Asia has entailed a corresponding increase in importance of energy transit as an economic activity for many states.
- Energy projects involving transit are extremely capital intensive. By establishing an enhanced set of international rule on energy transit flows, governments can make an important contribution to increase investor confidence.
- Consumer markets, particularly in western countries, depend on reliable transit routes in order to secure and diversify their energy imports. At the same time, energy transit is a valuable source of income for transit states. Thus, transit is an activity that serves the mutual interest of all states involved in it.
- A common transit regime may contribute to regional stability and security.

Support for developing further the Energy Charter's role on transit issues was voiced publicly at the highest levels during the course of 1998: by the G8 Leaders at their

Birmingham Summit Meeting, the European Union's Energy Council, and the Presidents of Azerbaijan, Georgia, Kazakhstan, Turkey and Uzbekistan at their Summit in Ankara. It was widely recognised that the Energy Charter presented the most appropriate forum within which to develop these rules, given the breadth of its geographical coverage and its existing base of legal norms on transit within the ECT.

As a result, the Energy Charter Conference decided in December 1999 to launch negotiations on a Transit Protocol to the ECT. The Protocol is intended to be a legally binding document designed to strengthen the existing transit-related obligations on governments under the ECT.

Among the key features under discussion in the present draft of the Transit Protocol are the following obligations:

- To ensure that energy flows in transit are not interrupted;
- To ensure that access to available capacity for transit shipments is granted on a transparent and non-discriminatory basis, and that negotiations on access to such available capacity are conducted in good faith - although it should be underlined that this provision does not entail an obligation to provide mandatory third party access to pipeline systems, either in the CIS region or elsewhere in the Energy Charter's constituency;
- To ensure that tariffs charged for energy in transit are objective, reasonable and non-discriminatory; and
- To ensure that due consideration is given to the energy supply needs of transit countries themselves.

The Protocol would expand upon the existing provisions of Article 7 of the ECT. This implies that nothing in the Protocol would deviate from, or contradict, any of the existing obligations under the Treaty.

In parallel with the development of this new legal instrument, in the form of a Protocol, the Energy Charter's member states are also giving consideration to the development of non-legally binding instruments relating to energy transit, designed to provide member governments and energy companies with guidelines on best practices to follow in relation to negotiations on individual projects involving transit.

Specifically, CPs are in the process of drawing up Intergovernmental and Host Government Model Agreements for projects involving cross-border oil and gas transit. Companies and governments would not be legally obliged to use these models, but their aim is to provide a balanced set of recommendations, supported by

the political authority of the Charter Conference, that can be used, if individual governments and companies so wish, as a starting-point for commercial negotiations on particular projects.

When taken together, the transit-related provisions of the ECT and the Protocol itself, once adopted, will constitute the Energy Charter's "transit regime". Full implementation of the Charter's transit regime should help significantly to improve the energy security of producer states, consumer states, and transit countries.

E. MISCELLANEOUS PROVISIONS

SUMMARY

- *The ECT promotes access to and transfer of energy technology;*
- *The ECT acknowledges the importance of competition and open capital markets;*
- *The ECT confirms the principle of national sovereignty over natural energy resources;*
- *The ECT includes obligations of CPs concerning environmental protection when exploring, exploiting and using their energy resources;*
- *The ECT establishes the principle of transparency concerning energy-related legislation of CPs;*
- *The ECT does, in principle, not deal with taxation matters. However, the ECT protects foreign investors against confiscatory taxes;*
- *The ECT obliges CPs to ensure that their state enterprises respect the provisions of the Treaty;*
- *The ECT confirms that CPs are responsible for the observance of the Treaty by their sub-national authorities;*
- *The ECT includes general exceptions (e.g. concerning the protection of life and health, essential security interests, or concerning emergency energy shortage situations);*
- *The ECT contains an MFN exception concerning regional economic integration.*

I. COMPETITION RULES

Up to now, competition issues have usually been dealt with in the context of free trade or customs union agreements. There have been suggestions, firstly within the Uruguay Round and then in the WTO, to develop truly multilateral competition rules. This has proven to be difficult.

Several ECT CPs have until now only very limited experience with competition rules. The ECT (Article 6) aims at creating modern and compatible competition legislation in all ECT CPs.

Article 6 (1) states that CPs should work to alleviate market distortions and barriers to competition. They also have to enforce laws as are necessary and appropriate to address unilateral and concerted anti-competitive conduct (Article 6 (2)). In order to familiarise those CPs with only limited experience in the area of competition rules with such regulations, elements of co-operation have been introduced into Article 6 (3). They require experienced CPs to provide other CPs, within available resources, with technical assistance on the development and implementation of competition rules. Article 6 (5) has introduced a special information and consultation procedure concerning disputes on competition issues ¹⁰.

Since the competition provisions of the ECT are a novelty for several CPs, Article 32 allowed countries with economies in transition to temporarily suspend full compliance with them. Article 32 ceased to apply on 1 July 2001.

II. TRANSFER OF TECHNOLOGY

The transfer of technology is of considerable importance in the context of international energy cooperation. The exploration and exploitation of energy resources are capital intensive and may prove to be technically difficult. They may also be potentially environmentally harmful. In all these respects, state-of-the-art technology may be the best possible means to make use of energy resources in a cost-efficient, technologically sound and environmentally friendly manner.

According to Article 8 (1), CPs agree to promote access to and transfer of energy technology on a commercial and non-discriminatory basis. However, this obligation is subject to the existing laws of each CP, including its rules on the protection of intellectual property rights. CPs are neither obliged to amend their respective existing legislation, nor does Article 8 impose a mandatory technology transfer. Article 8 can therefore be characterised as a “best efforts” clause concerning the encouragement of technology transfer.

Pursuant to Article 8 (2), CPs shall eliminate existing and create no new obstacles to the transfer of technology, to the extent that this is necessary to give effect to paragraph (1) and subject to non-proliferation and other international obligations.

¹⁰ For details see chapter on “Dispute Resolution”, page 58.

III. ACCESS TO CAPITAL

An important element of the promotion of cross-border trade and investment is the right of foreign traders and investors to have access to the capital markets of the host country. Foreign investors in particular might be more interested in a loan provided by banks located in the host country than in the home country, because this avoids the risks of transfer restrictions and exchange rate fluctuations. However, there may be cases where the host country's financial market is too weak or too small to guarantee foreign companies unlimited access.

According to Article 9 (1), CPs acknowledge the importance of open capital markets in encouraging the flow of capital to finance energy trade and investment. Therefore, each CP shall endeavour to promote conditions for access to its capital market by companies and nationals of other CPs for the purpose of such financing on a non-discriminatory basis. The provision does not amount to a legally binding obligation because the capital markets are generally in the hands of private investors.

Article 9 (2) deals with financing activities by home countries of energy traders and investors. The provision confirms that a CP may adopt or maintain programmes relating to the promotion of trade or investment abroad (e.g. public loans, grants, insurance, guarantees). Such programmes shall apply to energy trade and investment with/in other CPs. Pursuant to Article 9 (3), CPs shall, in implementing these programmes, seek to cooperate with international financial institutions.

IV. SOVEREIGNTY OVER ENERGY RESOURCES

Energy issues are closely related to national sovereignty. Article 18 (1) confirms the principle of state sovereignty over natural resources. This sovereignty must be exercised in accordance with and subject to the rules of international law. Apart from this obligation, CPs remain free to conduct their national policies, including in the area of energy. Pursuant to Article 18 (2), CPs also retain their sovereign right to determine the system of property ownership of energy resources.

Article 18 (3) contains an illustrative list of sovereign rights that are not affected by the Treaty. Each state continues to have the right

- To decide the geographical areas to be made available for exploration and development of its energy resources;
- To decide on the optimization of their recovery and the rate at which they may be depleted or otherwise exploited;

- To specify and enjoy any taxes, royalties or other financial payments payable by virtue of such exploration and exploitation;
- To regulate the environmental and safety aspects of such exploration, development and reclamation; and
- To participate in such exploration and exploitation, inter alia, through direct participation by the government or through state enterprises.

Article 18 (4) deals with the issue of authorisations, concessions and licences in connection with access to energy resources. Given the fact that in many countries a considerable part of economic activities in the energy sector is subject to such requirements, it is very important for foreign investors that they can compete with domestic companies on equal legal footing when applying for a permit. Article 18 (4) pursues this objective by stipulating that each CP shall undertake to facilitate access, inter alia, by allocating such authorisations, etc, in a non-discriminatory manner on the basis of published criteria.

V. ENVIRONMENTAL ASPECTS

The energy sector has a high potential to pollute the environment. Therefore, Article 19 (1) commits CPs to strive to minimize in an economically efficient manner harmful environment impacts inside or outside their area from all domestic operations within the energy cycle, taking into account obligations existing under other international agreements and in pursuit of sustainable development. In doing so, CPs

- Shall act in a cost-effective manner;
- Shall strive to take precautionary measures, and
- Agree that, in principle, the “polluter pays” principle should apply.

Article 19 (1) also requires CPs to take various concrete actions. They relate to, inter alia, the promotion of market-oriented price reform and a fuller reflection of environmental costs and benefits, the encouragement of international co-operation, the improvement of energy efficiency¹¹, information sharing on environmentally sound and economically efficient energy policies, promotion of environmental impact assessment activities and monitoring, promotion of public awareness on relevant environmental programmes, and R & D of energy efficient and environmentally sound technologies, including the transfer of technology.

¹¹ See also the chapter on “Energy Efficiency”, page 43.

Article 19 does not directly impose environmental obligations on foreign investors operating in their host countries. This approach reflects the principle that environmental protection is primarily a matter of national policy. It is the host country's domestic legal order that sets environmental standards for national and foreign companies operating in its territory. International environmental agreements may be applicable by their integration into the domestic laws and regulations.

Disputes arising from the application or interpretation of the environmental related provisions of Art 19 of the Treaty are to be dealt with by the Charter Conference only if arrangements for the consideration of such disputes do not exist in other appropriate international fora ¹².

VI. TRANSPARENCY

An important precondition for successful economic energy cooperation is the availability of information about the applicable legal rules in individual countries. Transparency of rules and regulations continues to be a major problem in several transition countries. Article 20 introduces various transparency obligations of CPs:

Article 20 (1) confirms the application of the transparency rules existing under the GATT/WTO with regard to trade. Article 20 (2) extends these rules insofar as CPs shall promptly publish any laws, regulations, judicial decisions and administrative rulings of general application, as well as applicable international agreements, which affect other matters covered by the Treaty. However, this obligation does not require a CP to publish confidential information. Furthermore, pursuant to Article 20 (3) each CP shall designate one or more enquiry points to which requests for information about the legal framework may be addressed.

VII. TAXATION

The issue of taxation has great significance both for the private economic agents in the energy sector and the involved states. While foreign companies have a keen interest that they are not fiscally discriminated, host countries may wish to retain some discretion concerning their tax treatment. In an international context, the issue is primarily and most commonly dealt with in bilateral agreements on the avoidance of double taxation.

¹² See also the chapter on "Dispute Settlement", page 58.

The ECT confirms the priority of the latter agreements and seeks to avoid a potential conflict with them. Accordingly, Article 21 excludes taxation matters, in principle, from the scope of application of the agreement. However, this carve-out of taxation issues does not affect the application of the principle of non-discrimination as included in agreements on the avoidance of double taxation existing among ECT CPs.

Article 21 does not entirely exclude taxation matters:

According to Article 21 (2),(3), the principle of non-discrimination in transit and investment matters shall apply to taxation measures other than those on income and capital. This means that this principle remains, in general, applicable with regard to indirect taxes in these two areas. However, even there the principle of non-discrimination shall not apply concerning

- Advantages accorded by a CP in an agreement on the avoidance of double taxation;
- Any taxation measure aimed at ensuring the effective collection of taxes.

Pursuant to Article 21 (4), the ECT covers taxation matters in trade with the exception of income or capital taxes.

According to Article 21 (5), the provision on expropriation (Article 13) applies to taxes. A foreign investor may therefore claim that a tax measure has expropriatory effects. However, the investor is not allowed to submit the case immediately to arbitration, but has first to contact the competent tax authorities. The tax authorities of the two countries concerned shall strive to resolve the issue within six months. If the issue cannot be settled within this period, the foreign investor and/or his home country may invoke the dispute settlement mechanisms under Articles 26, 27. The tribunal may take into account any conclusions arrived at by the tax authorities regarding whether or not the tax amounts to an expropriation.

VIII. STATE AND PRIVILEGED ENTERPRISES

In many ECT member countries, state enterprises continue to play a major role in the energy sector. They often have a dominant or even monopolistic position in their home countries. When negotiating the ECT, it was important to deal with this issue. The solution adopted in the Treaty is to establish various obligations of CPs with regard to the conduct of their state enterprises. By contrast, the ECT does not create direct obligations of these companies themselves.

Pursuant to Article 22 (1), each CP has to ensure that its state enterprises respect the investment-related Treaty provisions when they sell or otherwise provide goods and services. In particular, Article 22 (1) prohibits discrimination of foreign investors in this respect. This ensures, for example, the provision by state enterprises of natural gas or electricity to foreign investors at prices no higher than those charged to domestic companies.

According to Article 22 (2), no CP shall encourage or require its state enterprises to conduct its activities in its area in a manner inconsistent with any other obligation of that CP under the Treaty. For instance, this would apply to state enterprises that operate transit pipelines. As an example, Article 22 (2) prohibits that a CP encourages or requires such an enterprise to charge higher transit fees from foreign pipeline users than from domestic users for a comparable internal transport. By contrast, Article 22 (2) would not apply if the state enterprise itself charges higher fees (i.e. without being encouraged or obliged by the CP).

Pursuant to Article 22 (3), each CP has to ensure that enterprises, agencies or other organisations that it establishes and entrusts with regulatory, administrative or other governmental authority, exercise such authority consistent with the CP's Treaty obligations. As in the case of Article 22 (1), the provision primarily aims to prohibit discrimination against foreign energy companies (e.g. as regards the application of official tariff rates, or the adoption of energy-related regulations and administrative decrees).

Finally, Article 22 (4) prohibits CPs to encourage or require any enterprise, agency or other organisation to which it grants exclusive or special privileges to conduct its activities in its area contrary to its Treaty obligations. This would, for instance, cover private enterprises to which a CP has granted a monopoly position by law.

IX. OBSERVANCE BY SUB-NATIONAL AUTHORITIES

Several of the ECT CPs are organised as federal states. It therefore became necessary to deal with the issue of observance of the Treaty's obligations by sub-national units. Article 23 (1) confirms that each CP is fully responsible for the observance of the Treaty and shall take such reasonable measures as may be available to it to ensure such observance by its regional and local governments and authorities. The Treaty respects the internal organisational structure of a CP, as it does not impose concrete obligations on how observance shall be ensured. In particular, a CP is not obliged to take measures that are not available in its internal legal order or are even contrary to it.

Article 23 (2) clarifies that the dispute settlement mechanisms included in Parts II, IV and V of the Treaty apply for measures taken by sub-national authorities.

X. EXCEPTIONS

The ECT contains a number of exceptions to the Treaty obligations. One can distinguish general exceptions and transitional arrangements:

1. General exceptions

Article 24 (2) allows measures (1) necessary to protect human, animal or plant life or health, (2) in emergency energy shortage situations, and (3) to benefit investors who are indigenous or socially or economically disadvantaged persons. However, these measures must not constitute a disguised restriction on economic activity in the energy sector or an arbitrary or unjustifiable discrimination. The measures shall be duly motivated and not impair benefits reasonably expected under the Treaty to an extent greater than is strictly necessary to the stated end.

The general exceptions also cover measures related to essential security interests, or the non-proliferation of nuclear weapons, and the maintenance of public order (Article 24 (3)).

Article 24 (4) establishes an MFN exception for members of a free trade area or customs union, and for parties to an economic co-operation agreement between CIS countries, pending the establishment of the latter's mutual economic relations on a definitive basis.

Pursuant to Article 24 (1), none of these exceptions apply to Article 12 (compensation for losses), Article 13 (expropriation) and Article 29 (interim provisions on trade-related matters).

2. Transitional arrangements

Until 30 June 2001, there existed a number of transitional arrangements for countries in transition. According to Article 32, they had the right to ask for the suspension of certain Treaty obligations. These transitional arrangements recognised that certain countries need time to adapt to the requirements of a market economy. The bulk of these measures referred to competition laws and transparency obligations. With regard to investment, Article 32 allowed, inter alia, for the suspension from Article 10 (7) - principle of non-discrimination - and Article 14 (1d) - transfer of unspent earnings.

XI. ECONOMIC INTEGRATION AGREEMENTS

Article 25 contains a separate MFN exception for members of an economic integration agreement (EIA). This provision covers organisations (e.g. the European Union) that show a higher degree of internal economic and political integration than a customs or trade union. Such organisations grant special benefits amongst themselves on a mutual basis. The ECT - like Article V GATS - recognises that such practice constitutes a valid exception to MFN treatment.

Accordingly, Article 25 provides that an IEA member is not obliged to extend, by means of the MFN principle, any preferential treatment applicable between EIA members, to non-EIA members. In contrast to Article 24 (4a), Article 25 is not limited to preferential treatment of investors, but refers to treatment under the whole range of the Treaty.

Article 25 (2) defines an “economic integration agreement” as an agreement substantially liberalizing, inter alia, trade and investment, by providing for the absence or elimination of substantially all discrimination between or among parties thereto through the elimination of existing discriminatory measures and/or the prohibition of new or more discriminatory measures.

F. ENERGY EFFICIENCY

SUMMARY

- *The ECT requires that CPs strive to minimise in an economically efficient manner harmful environmental impacts resulting from energy-related activities in their territories;*
- *The Protocol on Energy Efficiency and Related Environmental Aspects (“PEEREA”) promotes the principles of “full-cost”, “cost effectiveness” and “sustainable development”;*
- *The PEEREA provides guidance and includes commitments concerning the development and implementation of energy efficiency programmes;*
- *The PEEREA provides for a multilateral discussion and cooperation forum on energy efficiency issues.*

I. THE ORIGINS OF THE CONCEPT OF ENERGY EFFICIENCY

The concept of energy efficiency started to develop and gain importance in the aftermath of the first oil crisis in the early 1970s. In this period, energy efficiency became a distinct area of energy policy for most governments of industrialised countries.

In formulating their approach to energy policy, governments initially tended to give priority to issues regarding energy security or support in balancing supply and demand. Following the adjustment of the energy prices after the two oil crises, however, environmental concerns and industrial competitiveness became driving forces of the energy conservation policies in western countries. It was at this point that energy efficiency programmes came to the forefront, both in terms of their cost-effectiveness and capacity to diminish adverse environmental impacts.

In less industrialised countries and in countries with a large amount of domestic energy resources, the impact of the oil crises was less strongly perceived. Governments in these countries did therefore not consider the creation of a “culture” of energy efficiency to be a priority. As a result, even now, energy intensity - i.e. the ratio of total primary energy supply to GDP - in many of these countries is higher than in western countries.

Today, for countries in transition towards a market economy, developing countries or industrialised countries concerned about changes in the world's climate systems, the concept of energy efficiency has gained great importance. Instruments developed to improve energy efficiency are associated with and support actions oriented towards a cleaner environment, restructuring of economies and a higher standard of living. The contribution of improvements of energy efficiency to the security of supply is also an aspect not to be neglected, especially in view of the volatility shown by energy prices in recent years.

This is the context in which the Energy Charter process agreed on the energy efficiency provisions of the ECT and on the PEEREA. The Treaty requires that each CP strive to minimise, in an economically efficient manner, harmful environmental impacts resulting from all operations within the energy cycle in its area. Basic principles with strong influence on the energy efficient behaviour in an economy, such as regards price formation, liberal trading relations, public awareness and international co-operation, are already anchored within the Treaty. Further, the PEEREA expressly recognises the need to take into account particular national or regional circumstances in developing and implementing policies and programmes relating to energy efficiency.

II. THE PEEREA

The Protocol was negotiated, opened for signature and entered into force at the same time as the Treaty - on 16 April 1998. It represents a clear expression by all participating governments of the necessity and the value of a binding document to focus efforts to tap the potential of energy efficiency as a concrete policy approach. The PEEREA also provides a mechanism for international co-operation and exchange of experience and ideas between countries with economies in transition and countries with twenty years or more experience in the area of energy efficiency.

The Protocol promotes the principles of “full-cost”, “cost-effectiveness”, and “sustainable development” as the appropriate platform for the development of energy efficiency policies and greater international and institutional co-operation. The PEEREA also reinforces the policy framework that will support greater energy efficiency: the introduction of market mechanisms, price formation reflecting real energy and environmental costs, cost-effective energy policies, transparency of regulatory frameworks, dissemination and transfer of technologies, and promotion of investments.

The PEEREA is structured in five parts, namely scope and objectives, basic policy principles, international co-operation, legal arrangements and final provisions. In

particular, the Protocol:

- Defines policy principles for the promotion of energy efficiency;
- Provides a framework for the development of co-operative and co-ordinated action;
- Provides guidance on the development of energy efficiency programmes; and
- Indicates areas of possible co-operation.

The PEEREA requires CPs to encourage: implementation of innovative approaches for financing energy efficiency, introduction of fiscal and financial incentives for the diffusion of energy efficient technologies, commercial trade and cooperation in the area of energy efficient and environmental sound technologies and action of the private sector.

The Protocol includes specific commitments that are essential in improving energy efficiency and reducing harmful environmental impacts. It expressly stipulates that governments shall:

- Formulate policy aims and strategies (Article 5);
- Establish policies (Article 3.2);
- Develop, implement, and update programmes (Article 8.1);
- Create the necessary legal (Article 3.2), regulatory (Article 3.2) and institutional (Article 8.3) environment; and
- Cooperate/assist internationally (Article 3.1).

It is of vital importance for all countries, notably for transition and developing countries, to implement the principles and commitments laid out in the Protocol. Without application of principles through which market signals encourage participants in the economy to behave in a manner that is conscious to energy concerns, government-funded activities and programmes will not reach their objectives. Scarce resources may be wasted, as energy efficiency will not improve.

III. IMPLEMENTATION OF THE PEEREA

The Protocol supports energy efficiency by creating a legal framework to achieve increased energy efficiency and to reduce the negative impact on the common environment. Since the PEEREA became operational in April 1998, all participating countries aiming at higher levels of energy efficiency have been provided with a legal instrument supporting the development and implementation of national legislation, policies and programmes. It is the first time that all well-known principles of energy efficiency have been incorporated into a multilateral agreement between so many countries.

The Protocol forms a solid foundation for concentrated and co-ordinated action in implementing the jointly agreed obligations due to a number of factors:

- Firstly, Countries in the process of economic reform are, in general, at a crucial point in the process of restructuring their economies. With energy consumption down and economics taking off on a new, market oriented basis, sustainable development is based on policies of cost-effective supply and demand of energy;
- Secondly, Instruments developed to improve energy efficiency are associated with and support actions oriented towards a cleaner environment. After Kyoto, the emphasis on energy efficiency as a major tool in achieving the obligations has assumed greater importance;
- Thirdly, Governments have to play an important role in creating instruments for improving energy efficiency in parallel with market mechanisms being in place;
- Fourthly, Recent experience of the countries in the process of economic reform indicates that in the absence of appropriate legislation and domestic programmes, the results of technical and financial assistance provided by international organisations are limited;
- Finally, Globalisation brings more competition and fewer opportunities for protectionism of domestic industries that need to adapt to high standards of efficiency in order to be able to survive.

It is in the context of general market reforms and the circumstances described above that the Protocol can play an important role in addressing aspects of energy efficiency that are of major importance in the process of developing and restructuring the economy and improving the standard of living.

In accordance with the provisions of the Protocol, important aspects to be considered in developing and implementing cost-effective energy efficiency policies include:

1. Developing energy efficiency strategies and legislation as well as monitoring their implementation

It is one of the basic commitments that countries should develop such strategies, laws and regulations as appropriate for the improvement of energy efficiency. At the same time, the Protocol calls for member countries to co-operate and assist each other in this respect, making effective use of the work and expertise developed worldwide. Therefore, the definition of standards designed to improve the efficiency of energy using equipment, and efforts to harmonise them internationally are also considered important requirements of the PEEREA.

The experience of some countries with economies in transition indicates that the efforts to develop legislation are not fully rewarded without ensuring adequate enforcement mechanisms and institutions. It is therefore important to develop/adapt institutions in such a way as to ensure proper implementation of the existing policies, strategies and legislation. The role of governments, municipalities, utilities, equipment manufacturers and non-governmental organisations in this regard needs to be carefully defined and understood in practice. The Protocol specifically requires the establishment of specialised energy efficiency bodies at appropriate levels that are sufficiently funded and staffed to initiate and implement policies.

2. Encouraging the introduction of market oriented prices, mechanisms and programmes

Pricing is the foremost incentive for energy efficiency. The level and structure of energy prices can induce cost-effective programmes on energy efficiency that are the starting points from which to define national strategies on energy efficiency.

Under the PEEREA, countries are required to formulate strategies and policy aims to improve energy efficiency and thereby reduce environmental impact of the energy cycle as appropriate in relation to their own specific energy conditions. In order to achieve the above-mentioned policy aims, the countries are required to develop, implement and regularly update energy efficiency programmes that are best suited to their circumstances.

In transition economies and developing countries, there is a historic opportunity to couple the foreseen economic growth with a low rate of increase in energy consumption and emissions. Recognizing the challenges connected with the introduction of energy efficiency, time is ripe to implement cost-effective policies for the supply and demand of energy.

Energy efficiency should also be integrated as an underlying principle shaping general development and restructuring policies. Sectoral policies, such as housing, industrial, transport and infrastructure policies should integrate energy efficiency issues. The efficient use of energy needs to be seen as the norm in the operation of all sectors.

3. Adopting policies that encourage the development of appropriate regulations and standards, financial measures and incentives

For countries in the process of economic reform, the government should play an active role in the economy in the period before market forces take effect. Striking the right

balance between governmental intervention and the introduction of market mechanisms is therefore very important in the transition process. In the course of this development, the PEEREA can offer a legal basis for the establishment of specific regulations and programmes on energy efficiency.

The setting up of financing mechanisms for energy efficiency is one of the key provisions of the Protocol. It explicitly requests third party financing, access to private capital markets and the use of fiscal and financial incentives to energy users. Input has to come from industry and the private sector as governmental resources are limited. At the same time, international banks may support a limited number of actions. This may in turn expose domestic commercial banks to the potential value of energy efficiency investments, to the operation of special investment instruments and to the specific risk factors per sector that are involved. By creating domestic financing mechanisms for energy efficiency, the chance of energy efficiency investments being properly considered in the multitude of restructuring/development projects is likely to improve.

Efficient use of energy is also important due to the need to address problems such as low purchasing power and employment. Often, despite the high level of education and strong theoretical skills, transition economies and developing countries suffer from limited experience in undertaking energy efficiency projects in a market economy environment. Lack of funds and financing mechanisms make the situation even more difficult. Co-operation and strong commitment at political level, for which the PEEREA offers a unique legal basis, is thus very important.

4. Introducing energy efficient technologies and encouraging cogeneration

This is another issue of great importance covered by the PEEREA, and also by the Treaty. CPs are requested to promote the efficient use of energy and environmentally sound technologies, services and management practices throughout the energy cycle.

The use of efficient and environmentally sound technologies, including cogeneration, is important for the enhancement of economic efficiency and the reduction of local and global harmful environmental impacts. Due to its high level of efficiency and its major contribution to reducing emission levels, cogeneration should be adequately reflected in legal and regulatory provisions in the new framework of liberalised markets. Fiscal and financial incentives play a major role in facilitating their implementation. Investments on the supply or demand side should then be assessed for their comparative effectiveness. At the same time, technologies need to be accompanied by service

and management programmes, on both the production and consumption side. In promoting these technologies, public or governmental agencies should firstly understand and subsequently create awareness of the role of grants and demonstrative projects. Otherwise, such initiatives could lead to a continuous form of subsidisation, providing incorrect signals on the market performance of various technologies.

5. Intensifying international co-operation

Numerous international organisations and programmes are already focusing their activities on regions characterised by high-energy intensity. Their aim is to support legislative and institutional development and to encourage the transfer of technology. Seminars, training courses, awareness campaigns, studies and demonstrative projects have been developed in these countries. Despite these actions and the numerous internal measures taken by the countries concerned, the results recorded so far towards lower energy intensity and qualitative improvements in the condition of the environment are not yet satisfactory.

Building a new type of platform for international co-operation is also an objective - as is the mechanism by which the PEEREA aims to bring countries to a similar operational level in the area of energy efficiency. It is for this reason that the Protocol contains a relevant but not exhaustive list of areas where direct co-operation between countries is encouraged. The PEEREA specifically requires countries to improve co-operation in order to make efficient use of their expertise and programmes. Harmonisation of efforts is therefore a direct and very constructive consequence of the Protocol. This harmonisation should cover, among other issues: pricing mechanisms, financial incentives, information and institutional arrangements, transfer of technologies and cogeneration. The Secretariat is seeking to enhance international co-operation on energy efficiency by broadening the number of participants in this dialogue.

IV. RECENT DEVELOPMENTS

After the PEEREA became operational, the Energy Charter Conference developed procedures to facilitate the monitoring of its implementation and to support countries in implementing its provisions and identifying areas of co-operation. At the same time, a Working Group on Energy Efficiency and related Environmental Aspects was established. The Working Group meets regularly to address priorities, review progress and discuss possible plans for action.

The Working Group has developed its activities into two areas:

- Reviewing progress in implementing the PEEREA and in improving energy efficiency;
- Developing activities that support dialogue between member countries and facilitate the implementation of the Protocol.

The review process relies on two complementary activities: regular reviews and in-depth energy efficiency reviews:

- Regular reviews serve the purpose of monitoring the implementation of PEEREA. They are based on an agreed format (comprising both quantitative and qualitative information);
- In-depth energy efficiency reviews are completed on a peer basis, following a mission to the host country, including representatives of several countries. Such in-depth reviews result in recommendations to the host government that are endorsed by the Charter Conference. So far, Bulgaria, Hungary, Lithuania, Poland, the Slovak Republic and Romania have hosted such reviews. Several other countries have expressed their interest in becoming a host.

Activities supporting dialogue and facilitating implementation of the PEEREA include: a brochure offering Advice on Developing an Energy Efficiency Strategy, a Manual on Financing Mechanisms, a report on Fiscal and Taxation Policies for improving Energy Efficiency and a report on Effects of Market Liberalisation on Energy Efficiency. There is ongoing work on the issues of energy efficiency institutions and third party financing mechanisms.

Under these circumstances, the PEEREA establishes a forum for the exchange of ideas and policies, successes and failures in the area of energy efficiency and supports governments in establishing new targets and programmes. The Protocol is expected to play an important role in governments' efforts to lower energy intensity. This will support the international competitive position of countries, while efficient energy use will, at the same time, improve the standard of living and the quality of the regional and global environment.

G. DISPUTE RESOLUTION

SUMMARY

- *The ECT includes various dispute settlement mechanisms, covering disputes in the area of trade, investment, transit, competition and environment;*
- *The ECT's provisions concerning trade disputes are based on the WTO rules, while bilateral investment treaties are a model for the resolution of investment disputes;*
- *The ECT contains novel dispute resolution systems concerning transit (conciliation), competition (information and consultation), and environment (review by Charter Conference).*

I. INTRODUCTION

The ECT contains a fully-fledged system of international dispute resolution. These provisions were developed because at the time when the Treaty was negotiated, some CPs - in particular countries in transition - did not yet have a sufficiently developed domestic juridical system. There was - and still is - concern about the neutrality, professional competence and efficiency of domestic courts in these countries, and the respect of the rule of law. By providing an alternative means of dispute resolution before international tribunals, the ECT contributes to increasing confidence of investors and traders, and promoting investment and trade flows between members. This is of particular relevance in the energy sector, due to the fact that disputes may often be very complex and involve huge amounts of money.

The ECT includes several international dispute resolution mechanisms, each of them being designed to address a particular subject matter of the Treaty. The two basic forms of binding dispute settlement are the following:

- State-state arbitration for basically all disputes arising under the ECT (Article 27), except competition and environment (Articles 6 (7), 27 (2));
- Investor-state arbitration for investment disputes (Article 26).

Special provisions have been developed for the resolution of inter-state disputes in the area of trade (Article 29, Annex D) and transit (Article 7). They derogate from the

otherwise applicable general provisions on state-to-state dispute settlement. As far as competition (Article 6) and environment (Article 19) are concerned, the ECT does not establish binding arbitration procedures, but provides for “softer” and less formal dispute resolution mechanisms.

ECT negotiators did not want to “re-invent the wheel”. Therefore, as far as trade and investment disputes are concerned, the ECT provisions are based on the model of the WTO arbitration rules (for trade) and bilateral investment treaties (for investment). By contrast, the ECT dispute resolution rules concerning transit, competition and environment are new features, giving the Treaty a pioneer role in these areas.

In each case, the objective of international dispute settlement is not to favour foreigners but to ensure an independent and neutral judicial forum. Overall, the ECT offers a dispute settlement system that is unique in the international arena both for the broad scope of covered issues (investment, trade, transit, competition and environmental protection) and the number of countries having subscribed to it.

II. INVESTMENT DISPUTES

Articles 26 and 27 of the Treaty cover investments disputes. Article 26 deals with disputes between an investor and a host country and Article 27 covers disputes between States.

1. Investor-to-State disputes

Based on the model of bilateral investment agreements, Article 26 grants foreign investors the right to sue the host country in case of “an alleged breach of an obligation of the host State under Part III of the Treaty”, i.e. the provisions relating to investment promotion and protection. By contrast, Article 26 does not apply to other disputes in which a foreign investor might be involved. For instance, if a country fails to promote the conditions for access of foreign investors to its capital markets, such investors would not have access to dispute resolution under the Treaty, because the relevant provision (Article 9) does not fall under Part III of the ECT.

The ECT dispute settlement mechanism has been invoked for the first time in April 2001, when a European investor sued a European country before the ICSID because of an alleged breach of Article 13 (expropriation). The case was finally settled out of court in December 2001.

a. Prior consultations

According to Article 26(1), disputes shall be settled, if possible, amicably. Both sides have a period of three months for consultations.

b. Option between domestic and international dispute settlement

If consultations/negotiations fail, the foreign investor has three options where to submit the dispute for resolution (Article 26 (2)):

- To the domestic courts or administrative tribunals of the host state to the dispute;
- To any applicable, previously agreed dispute settlement procedure, e.g. an arrangement under bilateral investment treaties;
- To international arbitration.

c. Options between different international arbitration fora

If foreign investors choose to submit a dispute to international arbitration, they have the choice between basically three alternative arbitration procedures (Article 26 (4)):

- The International Centre for the Settlement of Investment Disputes, Washington, D.C., established by the ICSID Convention of 1965. This option is available if both the home state of the investor and the host state are parties to the ICSID Convention. Alternatively, the foreign investor may invoke the ICSID Additional Facility Rules for the Administration of Proceedings by the Centre. These arbitration rules are applicable where only either the home state of the investor or the host state - but not both - is a party to the ICSID Convention;
- A sole arbitrator or an ad hoc arbitration tribunal established under the UNCITRAL Arbitration Rules; or
- The Arbitration Institute of the Stockholm Chamber of Commerce.

There exist detailed procedural rules for all these arbitration proceedings, including the establishment of tribunals, selection of arbitrators, hearings and costs.

d. State consent to international arbitration

According to Article 26 (3)(a), each CP gives its unconditional consent to the submission of a dispute to international arbitration. However, there exist two exceptions to this rule:

- Article 26 (3)(b) permits CPs listed in Annex ID to decline giving their unconditional consent to the submission of a dispute to international arbitration where the investor has previously submitted the dispute to another dispute resolution forum.

- Article 26 (3)(c) provides that CPs listed in Annex IA do not give their unconditional consent to international arbitration in respect of disputes of alleged breaches of the obligation in the last sentence of Article 10(1). The latter provision concerns the observance of obligations under an individual investment contract between a CP and an investor or investment of any other CP.

The original Annex ID lists 24 states¹³ and Annex IA 4 states (Australia, Canada¹⁴, Hungary, Norway). These are relatively far-reaching exceptions, but they need to be seen in the overall context of broad acceptance of the full scope of the investor-state dispute resolution.

e. Applicable law and finality of awards

Regardless of which of the three above-mentioned basic options for international arbitration is chosen, the dispute shall be decided in accordance with the provisions of the Treaty and the rules and principles of international law (Article 26 (6)). The award is binding and final and may include interest (Article 26 (8)).

Where disputes arise out of an act by a sub-national entity of the host country, Article 26 (8) further stipulates that the award may authorise the host state to pay monetary damages in lieu of any other remedy. This provision ensures that the central government, in cases where it lacks the authority to ensure compliance by a sub-national entity, may discharge its obligation to comply with the award by a pecuniary payment.

f. Enforcement of arbitral awards

Pursuant to Article 26 (5)(b), an investor-state arbitration shall, at the request of any party to the dispute, be held in a state that is a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”). This Convention requires state parties to recognise and enforce within their courts arbitral awards rendered in foreign states. Many of the parties to the “New York Convention” have declared that they will enforce an arbitral award only if it is rendered in a state that is also a party to the Convention. Thus, this provision permits the investor to ensure that such states are obliged to enforce the award.

¹³ These countries are: Australia, Azerbaijan, Bulgaria, Canada, Croatia, Cyprus, the Czech Republic, European Communities, Finland, Greece, Hungary, Ireland, Italy, Japan, Kazakhstan, Norway, Poland, Portugal, Romania, the Russian Federation, Slovenia, Spain, Sweden, United States. From these countries, Canada and the United States did not sign the Treaty.

¹⁴ Canada did not sign the ECT.

Article 26 (5)(b) also provides that claims are considered to arise out of commercial relationship or transaction. This ensures enforceability under the New York Convention - which is applicable only to such kind of disputes.

It should be noted that the ICSID Convention already requires that its parties recognise and enforce ICSID arbitral awards. Therefore, if this option is chosen, the ICSID awards will generally be enforceable in a large number of states even if the New York Convention is, for some reason, inapplicable.

2. State-to-State disputes

In addition to investor-state dispute settlement, Article 27 of the ECT provides for inter-state arbitration. Once again, this reflects the practice of bilateral investment agreements.

In comparison with investor-to-state disputes under Article 26, the scope of inter-state disputes is wide. It is, in principle, not limited to investment disputes but applies to the application and interpretation of the Treaty as a whole - with very limited exceptions. However, for various kinds of inter-state dispute resolution (e.g. trade disputes), the ECT contains specific rules that derogate from the general provision of Article 27 (see below).

Unlike the investor-to-state disputes, the parties to state-to-state disputes, after exhausting attempts to settle them amicably, do not have a variety of alternative means. According to Article 27 (2), disputes have to be submitted to an ad hoc tribunal, subject to certain exceptions. For such disputes, the UNCITRAL rules shall apply, unless there is an agreement to the contrary between the CPs.

Pursuant to Articles 27 (2), and 28, international arbitration is not available in the following cases:

- Application or interpretation of competition and environmental issues (Articles 6 and 19);
- Observance of obligations under an individual investment contract against states listed in Annex IA;
- Application or interpretation of trade-related matters (Article 29) or trade-related investment matters (Article 5) unless both parties to the dispute agree otherwise.

The tribunal shall decide the dispute in accordance with the Treaty and applicable rules and principles of international law. The arbitral award shall be final and binding. Unless the parties to the dispute agree otherwise, the tribunal shall sit in The Hague, and use the premises and facilities of the Permanent Court of Arbitration.

III. TRADE DISPUTES

In respect of trade-related disputes, Article 29 (7) of the Treaty provides for a dispute resolution mechanism (Annex D) that is based on the GATT/WTO panel model. It applies only in cases where at least one of the disputing parties is not a member of the WTO. The ECT fulfils a unique role in this respect, because it makes a GATT/WTO-like dispute settlement system available although not all parties to the dispute are GATT/WTO members.

Disputes of an intra-GATT/WTO nature are to be resolved in the appropriate WTO fora. This approach avoids a possible parallelism of dispute settlement procedures concerning the same dispute (“forum shopping”).

As a general rule, dispute settlement under Article 29 (7) is a substitute for state-to-state arbitration under Article 27 and investor-to-state arbitration under Article 26. Nevertheless, according to Article 28 CPs have the right to submit a trade-related dispute (including a dispute on trade-related investment matters (TRIMs)) to arbitration under Article 27, provided that they both agree. Article 29 does likewise not exclude that foreign investors bring actions relating to TRIMs under Article 26 (see Articles 5 and 10(11)). The different dispute resolution mechanisms reflect different international approaches to the adjudication of disputes on investment and trade.

The ECT trade dispute resolution mechanism is lighter, less detailed and simpler than that developed in the WTO. Accepting the trade regime of the Treaty may therefore be an important interim step for non-WTO-ECT members towards membership in the WTO.

There are two main differences between the ECT approach and the WTO system:

- When a panel concludes that the disputed measure does not comply with the Treaty, it may recommend that the offending party alter or abandon it. The panel’s report is subject to adoption by the Charter Conference acting by a vote of 3/4 of those present and voting, provided that at least a simple majority of all CPs to the Treaty supports the decision. This is different from the WTO procedures where panel reports are automatically adopted unless disapproved by consensus. Therefore, the Treaty retains an element of political decision-making that could serve as an additional incentive for mutually acceptable out-of-court resolutions of trade-related disputes.
- There is no appellate body under the ECT rules.

The Charter Conference has to adopt a roster of panellists. It shall contain persons

named for this purpose and persons who have served as panellists on GATT or WTO dispute settlement panels. ECT panels shall take into account panel interpretations of the WTO Agreement.

It is important to recall that the Treaty is not a “WTO mirror” and that it does not apply to all trade disputes. In particular, it does not apply to any dispute that arises under an agreement as described in Article XXIV of the GATT (relating to free trade area or customs union) or under an agreement among States that were constituent parts of the former Soviet Union (Article 29 (2b)).

IV. TRANSIT DISPUTES

An effective mechanism for the resolution of transit disputes is particularly important, given the economic significance of energy transit and the fragility of transit security, especially, but not exclusively, in CIS countries.

Article 7 (7) gives CPs the possibility to invoke a conciliation mechanism concerning transit disputes. As compared to “normal” dispute settlement procedures under Article 27, conciliation might have the advantage of being faster and less formal. A CP being party to the dispute may notify the dispute to the Secretary-General of the Secretariat who shall consult with the interested parties and appoint a conciliator within 30 days. If the conciliator fails to secure an agreement within ninety days, he/she shall recommend a resolution or a procedure to achieve such resolution, and shall decide the interim tariffs and other terms and conditions to be observed until the dispute is resolved. Paragraph (7)(d) provides that the CPs “undertake to observe and ensure that the entities under their control or jurisdiction observe” any interim decision of the conciliator for twelve months, unless the dispute is resolved earlier. The conciliation procedures may only be invoked after exhaustion of all other dispute resolution remedies previously agreed between the CPs or entities concerned.

Article 7(6) provides that the transit state shall not, in the event of a dispute over “any matter arising from that transit”, interrupt or reduce, or permit or require any entity to interrupt or reduce, the existing flow of energy materials and products prior to the conclusion of the conciliation mechanism set out in paragraph (7). There are only two exceptions to this prohibition: where this is specifically permitted in the original contract or agreement or allowed by the conciliator appointed to seek to resolve the dispute.

The Charter Conference has established ad hoc Rules concerning the conduct of conciliation and the compensation of the conciliator.

V. COMPETITION DISPUTES

Article 6 (5) deals with the settlement of competition disputes. One important example concerns disputes concerning state subsidies for energy companies.

Article 6 (5) reflects the fact that the ECT does not establish a common competition regime between CPs¹⁵. Rather, the ECT confirms the applicability of their domestic competition rules. Consequently, Article 6 (5) establishes “only” a mutual information and consultation mechanism in respect of the interpretation and application of national competition laws.

If a CP considers that any specified anti-competitive conduct carried out in the territory of another CP is adversely affecting an important interest concerning the alleviation of market distortions and barriers to competition, it may notify the other CP and request that the latter’s competition authorities initiate appropriate enforcement action. The notified CP, or, as the case may be, its competition authorities may consult with the competition authorities of the notifying CP and shall accord full consideration to the request of the latter in deciding whether or not to initiate enforcement action with respect to the alleged anti-competitive conduct. The notified CP shall inform the notifying CP of the decision. In addition, CPs have the possibility to resolve the dispute through diplomatic channels. Pursuant to Article 6 (7), no other means of dispute settlement are permitted.

VI. ENVIRONMENTAL DISPUTES

Article 19 contains various obligations of CPs with regard to the protection of the environment¹⁶. According to Article 19 (2), the Charter Conference shall, at the request of one or more CPs, review disputes concerning the application or interpretation of these obligations, aiming at a solution. The Charter Conference therefore acts as a consultative body that may make recommendations to the parties in dispute on how to settle the case. However, this possibility only exists if arrangements for the consideration of such disputes are not available in other appropriate international fora.

¹⁵ See also above the chapter on “Miscellaneous Provisions”, pages 34-35.

¹⁶ See above the chapter on “Miscellaneous Provisions”, pages 37-38.

H. ECT INSTITUTIONAL PROVISIONS, CHARTER INSTRUMENTS, AND THE ECT AS PART OF INTERNATIONAL LAW

SUMMARY

- *The ECT has set up the Charter Conference as the highest institutional body. There exist various working groups acting as subsidiary bodies;*
- *The Charter Conference is assisted by the Energy Charter Secretariat;*
- *The ECT includes a number of additional Instruments (annexes, decisions, declarations, understandings);*
- *The ECT is an agreement in the meaning of the Vienna Convention on the Law of Treaties.*

I. INSTITUTIONAL ARRANGEMENTS

Part VII of the ECT deals with the structure of the Treaty and its institutions.

1. The Charter Conference and its subsidiary bodies

Article 34 of the ECT sets up the Charter Conference as the main institutional body where the CPs regularly meet. Among the powers and functions given to the Charter Conference are to:

- Carry out the duties assigned to it by the Treaty and its Protocols;
- Keep under review and facilitate the implementation of the principles of the Charter and the provisions of the Treaty;
- Consider and approve the annual accounts and budget of the Secretariat;
- Encourage cooperative efforts aimed at facilitating and promoting market-oriented reforms and the modernization of energy sectors in transition economies;
- Authorize and approve amendments to the Treaty, negotiations of accession and association agreements, and the negotiations of new Declarations and Protocols related to the Treaty;
- Appoint the Secretary General.

Furthermore, the Charter Conference has taken on specific tasks, such as developing additional elements for the several dispute resolution mechanisms in the ECT, or establishing procedures for the implementation of the PEEREA.

The Charter Conference combines the roles of a negotiation forum for the development of new instruments mandated under the ECT, and an oversight body. It also considers matters relating to the implementation of the Treaty, such as progress towards ratification, requests for accession, review of transitional arrangements for countries in transition, review of exceptions to national treatment, improvement of transparency, etc.

The Charter Conference has established a number of subsidiary bodies to assist it in its work. There are three subsidiary bodies that deal with the main areas of the Treaty:

- Energy Efficiency Group;
- Investment Group; and
- Trade Group;

In addition, there are two bodies with no regular schedule:

- Budget Committee;
- Legal Advisory Committee.

Finally, a special working group has been established for the negotiations on a Transit Protocol.

2. The Charter Secretariat

According to Article 35, a Secretariat assists the Charter Conference in carrying out its duties. The Secretariat is located in Brussels, Belgium. Given the broad scope of the ECT, it is small by international standards. This reflects the original intention of the negotiators that the Charter Conference and the Secretariat should not duplicate the work of other international organisations. As of 1 January 2002, the Secretariat employs 29 persons, coming from 18 different countries. The objective is to have a balanced representation of member states.

The main tasks of the Secretariat are the following:

- To prepare the meetings of the Charter Conference and its auxiliary bodies;
- To monitor and review the obligations of member countries under the ECT;
- To give advice on all matters related to the Treaty; and
- To establish and develop contacts with interested non-members.

3. Voting Rights

Article 36 of the ECT sets up a differentiated structure of voting rights, depending on the subject matter on which a vote is taken. As a general rule, decisions provided for

in the Treaty shall be taken by a three-fourths majority of the CPs present and voting at the meeting of the Charter Conference. However, no decision shall be valid unless it has the support of a simple majority of the CPs. In each case, CPs shall make every effort to reach agreement by consensus.

There are a number of issues for which unanimity is required. These include political decisions of a fundamental character, such as amendments and accessions to the ECT, as well as the conclusion of association agreements. The same applies for changes to the Annexes of the Treaty or the approval of the Secretary General's nominations of panellists for trade disputes.

Decisions on budgetary matters shall be taken by a qualified majority of CPs whose assessed contributions represent, in combination, at least three-fourths of the total assessed contributions. Decisions concerning amendments of the functions of the Charter Conference or the Secretariat require a three-fourths majority of the CPs.

4. Funding Principles

Pursuant to Article 37, each CP shall contribute to the annual budget of the Organisation according to its capacity to pay. Annex B contains a formula for the allocation of the Charter costs. Accordingly, contributions payable by CPs shall be determined by the Secretariat annually on the basis of their percentage contributions required under the latest available United Nations Regular Budget Scale of Assessment. The contributions shall be adjusted as necessary to ensure that the total of all CPs' contributions is 100 per cent.

II. ADDITIONAL CHARTER INSTRUMENTS

In addition to its main provisions, the ECT includes a number of Annexes, Decisions, Declarations and Understandings. All these instruments are recorded in the Final Act of the European Energy Charter Conference - the multilateral conference that undertook the negotiations and adopted the text of the Treaty. According to Article 48, Annexes and Decisions are integral parts of the Treaty. Understandings and Declarations are not a formal part of the Treaty but, as the Charter Conference made it clear, are part of the overall political package when setting the conditions for accession.

1. Annexes

The original Treaty includes fourteen Annexes. They relate to a variety of issues, such as the definition of covered energy materials and products, or transitional arrangements for countries in transition. Some Annexes have a temporary nature and will disappear over time. A complete list of the existing Annexes is attached in Annex 2.

2. Decisions

In addition to the Annexes, there are five Decisions with respect to the ECT. Three of these Decisions cover “country-specific issues (in respect of Norway, Romania, and the Russian Federation). Two Decisions relate to specific Articles and are important in understanding the provisions on currency controls (Decision No. 3 with respect to Article 14), regional economic integration organisations, customs unions and free trade areas (Decision No.5 concerning Articles 24 (4)(a) and 25).

3. Understandings

In order to gain a complete picture of the Treaty package, it is necessary to also look into the twenty-two Understandings agreed by negotiators and recorded in Part IV of the Final Act. They provide guidance for the interpretation of various Treaty provisions. For example, the Understandings confirm that the ECT does not include an obligation to introduce mandatory third party access (Understanding Nr. 1), or clarify what constitutes an economic activity in the energy sector (Understanding No. 2).

4. Declarations

Finally, there are Declarations of the Charter Conference, states or groups of states, recording individual views and positions about certain aspects of the Treaty. According to Article 1 (13)(b) of the ECT, “declaration” means a non-binding instrument. They appear in the Final Act (Part V and VI). There are also a few Declarations that have been made outside the Final Act. They include the *Chairman’s Statement at the Adoption Session on 17 December 1994* and the *Joint Memorandum of the Delegations of the Russian Federation and the European Communities on Nuclear Trade*, made at the signature ceremony in Lisbon on 17 December 1994. Pursuant to Article 33 (1), the Charter Conference may at any time authorise the negotiation of a number of Energy Charter Protocols or Declarations in order to pursue the objectives and principles of the Charter.

III. THE ECT AS PART OF INTERNATIONAL LAW

The ECT is an international agreement in the meaning of the Vienna Convention on the Law of Treaties 1969. It establishes rights and obligations of CPs in a legally binding manner.

In contrast to most international treaties, Article 45 expressly provides for its provisional application prior to ratification by a CP, provided that such application is not inconsistent with its internal legal order. However, according to Article 45 (2), any signatory has the right, when signing the agreement, to declare that it is not able to accept provisional application. As of 1 January 2002, such declarations had been made by Australia, Iceland, Japan, and Norway. Even in the case of exclusion of provisional application, the institutional provisions of the ECT (e.g. on participation in the Charter Conference, voting rights, budget) shall remain applicable, provided that this is not inconsistent with the laws and regulations of the respective signatory.

According to Article 45 (2)(b), a signatory that does not apply the ECT provisionally - and investors of this signatory - may not claim the benefits of provisional application by other signatories (principle of reciprocity).

Pursuant to Article 46, no reservations¹⁷ may be made to this Treaty. According to Article 47, each CP has the right to withdraw from the agreement at any time after five years from the date on which the ECT has entered into force for this CP. Such withdrawal shall become effective one year after the date of the receipt of the notification of withdrawal by the Depositary. However, the Treaty protects existing investments of foreign investors in the territory of the withdrawing CP for an additional period of twenty years.

¹⁷ International law distinguishes between “reservations” and “exceptions”. While a reservation has the effect that the other CPs may withhold the same advantage from the CP making the reservation, an exception does not allow the other CPs to take such reciprocal measures.

I. CO-OPERATION WITH NON-MEMBER COUNTRIES, FORMS OF PARTICIPATION

SUMMARY

- *The Energy Charter Process is dynamic and open to non-members;*
- *There are several forms of cooperation, ranging from informal contacts (e.g. seminars, workshops) to formal links (observership, association, accession);*
- *Current outreach activities involve Mediterranean countries, China, ECO, and APEC.*

I. THE ENERGY CHARTER'S POLICIES VIS-À-VIS NON-MEMBERS

Given the fact that energy is an issue of global dimension, ECT member countries attach great importance to co-operation with non-members. Accordingly, the Charter Conference concluded in December 1999 that “further efforts to expand the Treaty’s and the Protocol’s geographical coverage would be in the long-term interest of global energy security”. It agreed that the Charter process should be open to any state or regional economic organisation that expresses interest in the work.

The dynamism and openness towards non-members is demonstrated by the fact that a considerable number of countries have obtained observer status in the Energy Charter Process (see below). In addition, the Charter Process pursues specific outreach activities with a focus on the following countries/regions:

1. Mediterranean countries

In 1995, the Euro-Mediterranean Partnership between the European Union and twelve Mediterranean countries/regions¹⁸ was launched. One of its goals is the association of these states with the ECT. Among them, two (Malta, Turkey) are already CPs, and another three (Algeria, Morocco and Tunisia) have obtained observer status. In particular, Morocco and Tunisia show interest in a still closer involvement in the Charter process. In order to increase the knowledge of the Charter process among

¹⁸ Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, the Palestinian Authority, Syria, Tunisia and Turkey.

Euro-Mediterranean Partnership countries, the ECT and related documents have been translated into the Arabic language as a part of the MEDA programme, which is financed by the European Commission.

2. Economic Co-operation Organisation

Out of the ten ECO member countries¹⁹, seven are also CPs of the ECT²⁰. In February 2000, the ECO Regional Planning Council concluded to pursue its efforts in establishing cooperation with international organisations that are active in the energy sector, including the Energy Charter Conference. A joint ECO-ECS workshop on the ECT was held in Turkey in January 2001. In particular, participants from Iran and Pakistan expressed interest in future co-operation.

3. APEC

APEC is another important potential partner in the Energy Charter process. At the 21st meeting of the APEC Energy Working Group in Kuala Lumpur on 18-19 May 2001, the Energy Charter Secretariat informed participants about the Energy Charter process, its goals and objectives, and the current work priorities. At its 22nd meeting in Port Moresby, Papua New Guinea, on 27-28 September 2001, the APEC Energy Working Group affirmed its interest in developing a dialogue with the Energy Charter process on topics of mutual interest.

4. China

Against the background of its ever-growing importance in global energy matters, the Charter Process seeks cooperation with the People's Republic of China. First contacts between the Chinese authorities and the Energy Charter Secretariat date back to 1997, and lead to the organisation of a first "Seminar on the ECT and its Relation to China" in June 1998. Another important event was the translation of the ECT into Chinese in 2000. A second symposium on the ECT, jointly organised by the Chinese State Development Planning Commission and the Energy Charter Secretariat, was held in July 2001 in Beijing. Following this event, the People's Republic of China obtained observer status in the Charter process on 17 December 2001.

¹⁹ Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyzstan, Pakistan, Tajikistan, Turkey, Turkmenistan, Uzbekistan.

²⁰ ECT-Non members are Afghanistan, Iran and Pakistan.

II. FORMS OF PARTICIPATION IN THE ENERGY CHARTER PROCESS

The ECT offers various forms of participation in the Charter process. This flexibility of the Treaty has the advantage that it allows for a tailor-made involvement of non-members, taking into account their particular situation and their individual wishes.

1. Membership

With the entry into force of the Treaty/Protocol on 16 April 1998 after the 30th ratification by signatories, the Charter Conference comprises the CPs, i.e. the states and regional economic integration organisations that have ratified or acceded to the Treaty/Protocol and for which it has entered into force (Article 1 (2)). As of 1 January 2002, 46 states (including the European Union) belong to this category.

Signatories - i.e. states that have not yet completed the ratification procedures - also participate in the discussions of the Conference and all established bodies. As of 1 January 2002, signatories were Australia, Belarus, Iceland, Japan, Norway and the Russian Federation.

Accession to the Treaty/Protocol means acquiring membership as a CP (Article 41). Under international law it has the same status as ratification. The basic conditions for accession are:

- The acceptance of:
 - The principles and obligations embodied in the Energy Charter, the ECT and related instruments;
 - All decisions of the Charter Conference in effect at the time of deposit of the instrument of accession to the Treaty/Protocol; and
- The provision of exhaustive information about the legislative situation and other conditions for making business in the energy sector of the acceding state.

As of 1 January 2002, two countries have acceded to the Treaty/Protocol: The former Yugoslav Republic of Macedonia and Mongolia. The Federal Republic of Yugoslavia has initiated its accession process.

Detailed information about the various steps to follow during accession procedures is included in Annex 3.

2. Observership

Observership is a “light” form of participation in the Charter process. It offers interested non-members the possibility to become more familiar with the ECT, to establish

informal contacts with member countries and other observers, and to participate in the international forum for energy dialogue established by the Treaty. Observers do not have any obligations under the ECT; in particular they do not have to contribute to the budget of the Organisation. Observership may be - but need not be - a transitional phase towards full membership.

One can distinguish two categories of observers:

- The “minimal” form of observership is participation in the Charter Process without any formal commitments. In this case, the Charter Conference may invite the observer country to be represented at meetings of the Charter Conference or of its subsidiary bodies without a right to vote.

As of 1 January 2002, such observer states include some Southern Mediterranean countries (Algeria, Morocco, Tunisia), major oil producing countries from the Middle East (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates), the People’s Republic of China and Venezuela. International organisations with observer status are the: Baltic Sea Regional Energy Cooperation (BASREC), Black Sea Economic Cooperation (BSEC), CIS Electric Power Council, European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), International Atomic Energy Agency (IAEA), International Energy Agency (IEA), Organisation for Economic Cooperation and Development (OECD), UN-ECE and the World Bank.

- Second, there is the possibility to obtain a more advanced form of observership. This requires that the observer country sign the European Energy Charter. By signing the Charter, the observer country expresses its political will to support the principles and goals of the Declaration. By contrast, adherence to the Charter does not imply any legally binding commitments by the observer country. Such obligations would only be established by joining the ECT itself.

Observer countries falling into this category may attend meeting of the Charter Conference without a right to vote. They may likewise be invited to attend meetings of the Conference’s subsidiary bodies without a right to vote. Moreover, such observer countries may participate in the negotiations of new Charter Instruments. As of 1 January 2002, observers with this status were Canada, the Federal Republic of Yugoslavia and the United States.

The formal requirements for becoming an observer are simple and straightforward: Any country interested in becoming an observer may submit a written request to the Charter Secretariat. The Secretariat forwards the request to the Charter Conference

that takes the final decision. The main criterion for the Conference decision is whether the granting of observership status would be in the mutual interest. This is normally the case for requests from transition economies, energy producing countries and energy transit countries.

3. Association agreements

Article 43 provides that the Charter Conference may authorize the negotiation of association agreements in order to pursue the objectives and principles of the Energy Charter and the provisions of the Treaty/Protocol. The concept of an association agreement allows participation in the Charter process that falls somewhere between the status of full membership and observership. As of 1 January 2002, no such association agreement exists.

ANNEX 1

STATUS OF RATIFICATION OF THE ECT (AS OF 1 JANUARY 2002)

I. CHARTER SIGNATORIES THAT HAVE DEPOSITED INSTRUMENTS OF RATIFICATION/ACCESSION OF THE TREATY WITH THE DEPOSITARY

1. on 12.07.1995 : GEORGIA
2. on 16.10.1995 : SLOVAKIA
3. on 15.01.1996 : LATVIA
4. on 12.03.1996 : UZBEKISTAN
5. on 17.06.1996 : CZECH REPUBLIC
6. on 22.06.1996 : MOLDOVA
7. on 06.08.1996 : KAZAKHSTAN
8. on 19.09.1996 : SWITZERLAND
9. on 15.11.1996 : BULGARIA
10. on 25.06.1997 : TAJIKISTAN
11. on 07.07.1997 : KYRGYZSTAN
12. on 17.07.1997 : TURKMENISTAN
13. on 12.08.1997 : ROMANIA
14. on 04.09.1997 : GREECE
15. on 10.09.1997 : SLOVENIA
16. on 27.11.1997 : LUXEMBOURG
17. on 09.12.1997 : CROATIA
18. on 12.12.1997 : LIECHTENSTEIN
19. on 16.12.1997 : AUSTRIA
20. on 16.12.1997 : DENMARK
21. on 16.12.1997 : FINLAND
22. on 16.12.1997 : GERMANY
23. on 16.12.1997 : ITALY
24. on 16.12.1997 : NETHERLANDS
25. on 16.12.1997 : PORTUGAL
26. on 16.12.1997 : SPAIN
27. on 16.12.1997 : SWEDEN
28. on 16.12.1997 : UNITED KINGDOM
29. on 16.12.1997 : EUROPEAN COMMUNITIES
30. on 23.12.1997 : AZERBAIJAN

- 31. on 16.01.1998 : CYPRUS
- 32. on 19.01.1998 : ARMENIA
- 33. on 12.02.1998 : ALBANIA
- 34. on 27.03.1998 : THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA
- 35. on 08.04.1998: HUNGARY
- 36. on 04.05.1998: ESTONIA
- 37. on 08.05.1998: BELGIUM
- 38. on 14.09.1998: LITHUANIA
- 39. on 29.10.1998: UKRAINE
- 40. on 15.04.1999: IRELAND
- 41. on 28.09.1999: FRANCE
- 42. on 19.11.1999: MONGOLIA
- 43. on 05.04.2001: TURKEY
- 44. on 24.04.2001: POLAND
- 45. on 17.05.2001: BOSNIA AND HERZEGOVINA
- 46. on 10.07.2001: MALTA

II. CHARTER SIGNATORIES THAT HAVE NOT YET DEPOSITED INSTRUMENTS OF RATIFICATION/ACCESSION OF THE TREATY WITH THE DEPOSITARY

- 47. AUSTRALIA
- 48. BELARUS*
- 49. ICELAND
- 50. JAPAN
- 51. NORWAY
- 52. RUSSIAN FEDERATION*

* apply the Treaty provisionally

III. CHARTER SIGNATORIES THAT HAVE NOT (YET) SIGNED THE ENERGY CHARTER TREATY

- 53. CANADA
- 54. REPUBLIC OF YUGOSLAVIA ²¹
- 55. UNITED STATES OF AMERICA

²¹ Process of Accession to the Treaty has started.

ANNEX 2

OVERVIEW OF THE ANNEXES TO THE ECT

The original Treaty includes fourteen Annexes. They relate to:

- Definition of covered energy materials and products (Annexes EM and NI);
- Special arrangements for notification and phase-out of trade-related investment measures (Annex TRM);
- Lists of CPs that have accepted “voluntary commitments” in respect of investment or limited their acceptance of certain aspects of the Treaty (Annexes VC, N, ID, IA and PA);
- Special dispute resolution provisions for disputes involving sub-national entities (Annex P);
- The scope of the interim trade regime for trade involving non-WTO members (non-application of certain GATT and related instruments/WTO provisions) and the relevant dispute settlement mechanism (Annexes G and D). Annex G has been replaced by Annex W for the purpose of the ECT Trade Amendment 1998. The latter has also modified Annex D.
- Trade agreements between states that were constituent parts of the former Soviet Union (Annex TFU);
- Cost allocation formula in respect of the Conference (Annex B);
- Transitional arrangements for 24 countries in transition in respect of certain obligations in the Treaty to allow these States to bring their laws and practices into conformity with the Treaty (Annex T).

The Amendment to the Trade-Related Provisions of the ECT adopted by the Charter Conference on 16 April 1998 added six new Annexes to the Treaty. The situation concerning these Annexes may be described as follows (as of 1 January 2002):

ANNEX EM I AND EQ I

These Annexes list those items for which the trade provisions of the ECT apply. Annex EM I replaces Annex EM in the original Treaty text.

ANNEX EM II AND EQ II

These Annexes do currently not contain any items. They relate to future binding customs duty commitments for those items that may be included later.

ANNEX TRM

This Annex contained the dates for notifications and eliminations of possible TRIMs. No such notification has been made, and since the transitional periods have lapsed, this Annex is no longer applicable.

ANNEX TFU

States that were constituent parts of the former Union of Soviet Socialist Republics have made no notifications within the set time limits. Therefore, the relevant exceptions granted with regard to their internal trade relations did not materialise. This Annex and the relevant provisions of the Treaty ceased to apply on 1 December 1999.

ANNEXES G (ANNEX W, AS ESTABLISHED BY THE TRADE AMENDMENT) AND D

Article 29 of the ECT - which makes the GATT 1947 (or the WTO) provisions applicable under the Treaty - will cease to apply when CPs to the ECT have become WTO members. Currently, the following ECT CPs are not members of the WTO: Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Kazakhstan, the former Yugoslav Republic of Macedonia, the Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

ANNEX PA

This Annex was applicable only to Poland. However, Poland has completed its ratification procedures. As a result, this Annex has ceased to apply.

ANNEX T

The ultimate deadline for termination of all transitional suspensions was 1 July 2001. Therefore, Annex T has ceased to apply.

ANNEX 3

PROCEDURAL REQUIREMENTS FOR ACCESSION TO THE ECT

Any State/Regional Economic Integration Organisation (“REIO”) wishing to accede to the Treaty/Protocol has to undertake the following procedures:

1. The State/REIO has to present its application to the Charter Conference/Secretariat. The application is distributed to all CPs for their individual opinions, to be subsequently expressed in the collective decisions by the Conference.

2. If agreed by the CPs, the Charter Conference invites such State/REIO to sign the European Energy Charter, and to initiate the accession process. The signature of the Charter is a basic condition for accession to the Treaty/Protocol.

3. The Charter Conference then invites the Government of the Netherlands, as Depositary of the Charter, to make appropriate arrangements for assisting such State/REIO in the signature process.

4. After signature of the Charter, the Government of the Netherlands notifies the Secretariat accordingly. From that date on, the State/REIO becomes an observer to the Charter Conference, may attend its meetings and be invited by the Conference to attend meetings of subsidiary bodies in the capacity of an observer.

5. Following signature of the Charter, the Secretary-General submits a letter to the Government of the State/representative of the REIO specifying the requirements and general conditions relating to the accession procedures. Subsequently, the Secretariat submits to the Government of that State/representative of the REIO a set of basic documents that are essential for the initiation of the accession process, and requests the State/REIO to submit to the Secretariat a proposal for a schedule of consultations. The basic condition for accession is the acceptance of the obligations contained in the Treaty/Protocol and of all decisions of the provisional Charter Conference and the Charter Conference in effect at the time of the deposit of the instrument of accession to the Treaty/Protocol. The elaboration of additional supportive documents is required based on clearly specified guidelines.

6. As a part of the consultation process, the State/REIO is requested to elaborate three reports on the basis of the more detailed guidelines approved by the Charter Conference at its 1999 December meeting:

- a) Report on Harmonisation of Laws and Regulations with the Provisions of the Treaty providing the description and analysis of the legislative situation concerning Articles 3-15, 18-23, 26, 27 and 29 of the Treaty;
- b) Report on Investment Climate and Exceptions to National Treatment, addressing general investment policy issues, energy supply and demand, market structure by sub-sectors, future development and investment needs in each of the energy sub-sectors, issues of privatisation and monopolies, general legislation relevant to investment, exceptions to national treatment and plans for further liberalisation, etc.;
- c) Report on Energy Efficiency, describing energy efficiency and environmental policies and addressing all relevant issues contained in Articles 3-9 of the Protocol.

7. Based on the analysis of the Reports, and the input provided during the consultative process, the Secretariat prepares a comprehensive report for the Charter Conference. Provided that the basic accession requirements are met, the Conference invites the State/REIO to accede subject to specific accession terms and conditions.

- a) The basic condition for accession to the ECT involves the acceptance of the obligations contained in the following documents:
 - i) The ECT, including the Annexes to the Treaty set out in Annex 1 and the Decisions set out in Annex 2 to the Final Act of the European Energy Charter Conference signed at Lisbon on 17 December 1994, which, according to Article 48 of the Treaty, form an integral part of the Treaty;
 - ii) The Final Act of the European Energy Charter Conference of 17 December 1994, except section VII, taking due note of the Chairman's Statement at that time, which appears in Annex I to Document CONF 115 of 6 January 1995;
 - iii) The Amendment to Trade-Related Provisions of the ECT, including the Decisions in connection with the adoption of this Amendment set out in Annex 2 to the Final Act of the International Conference adopted in Brussels on 24 April 1998;
 - iv) The Final Act of the International Conference and Decision by the Conference in respect of the Amendment to the Trade-Related Provisions of the ECT of 24 April 1998;
 - v) All Decisions and Conclusions of the Provisional Energy Charter Conference and the Energy Charter Conference that shall be in force at the time of the deposit of the instrument of accession.

- b) The basic condition for accession to the Protocol involves the acceptance of the obligations contained in the following documents:
- i) The Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects;
 - ii) Section VII of the Final Act of the European Energy Charter Conference of 17 December 1994;
 - iii) All Decisions and Conclusions of the Provisional Energy Charter Conference and Energy Charter Conference relating to the Protocol that shall be in force at the time of the deposit of the instrument of accession.
- c) Other conditions required to be fulfilled at the time of deposit of accession instruments may, inter alia, include submission of:
- i) A report summarising all laws, regulations or other measures relevant to exceptions from the better of most favoured nation or national treatment as regards the making of investments in its area and programmes under which a State/REIO provides grants or other financial assistance, or enters into contracts, for energy technology research and development;
 - ii) A list of all tariff rates and other charges levied on Energy Materials and Products and Energy-Related Equipment at the time of their importation or exportation as applicable on the date of accession;
 - iii) The designation of one or more enquiry points to which requests for information about laws, regulations, judicial decisions and administrative rulings may be addressed.
- d) Additional requirements might specify that a State/REIO shall:
- Not make any declaration that might diminish its determination to achieve the objectives of the Treaty and carry it out;
 - Apply the Trade Amendment on a provisional basis with all rights and obligations contained therein, pending the entry into force of the Trade Amendment;
 - Follow certain procedures with respect to the deposit of its ratification instruments.

8. The invitation by the Charter Conference informing that a State/REIO may accede to the Treaty/Protocol is officially announced through a letter by the Secretary-General to the Government of the State/representative of the REIO concerned. The decision by the Conference, stating all terms and conditions that need to be fulfilled

by the State/REIO and that are integral parts of the internal ratification process, is attached to this letter.

9. In response to the letter of the Secretary-General, the Government of the State/representative of the REIO concerned submits a letter to the Secretary-General:

- a) Reconfirming its intention to accede to the Treaty/Protocol;
- b) Accepting the terms and conditions stated in the decision of the Charter Conference.

10. The final stage of the accession process involves national ratification of the Treaty/Protocol/Trade Amendment.

11. Once ratification is completed, the instrument of accession to the Treaty/Protocol and the instrument of ratification of the Trade Amendment shall be deposited with the Government of the Portuguese Republic (Depositary). Upon deposit of its instruments of accession and ratification with the Depositary, a State/REIO submits simultaneously all necessary information, or documents included in a Charter Conference decision, to the Secretariat.

12. The Treaty shall enter into force for a State/REIO on the ninetieth day after the date of deposit of its instrument of accession to the Treaty.

13. The Trade Amendment shall enter into force for a State/REIO on the ninetieth day after the date of deposit of at least three-fourths of the CPs to the Treaty of their instruments of ratification, acceptance or approval if the Amendment is not in force or on the ninetieth day after the date of deposit of its instrument of ratification, acceptance or approval if the Amendment has entered into force.

14. The Protocol shall enter into force for a State/REIO on the thirtieth day after the date of deposit of its instrument of accession to the Protocol once such a State/REIO has become a CP to the Treaty.

ANNEX 4

TASKS OF THE ECT SECRETARIAT IN THE TRADE AREA

The main tasks of the Secretariat in the trade area can be summarised as follows:

- **Notification procedures**

Transparency is a key principle of the multilateral trading system. Notifications are necessary to enable CPs monitoring their trade partners' obligations under the ECT. By abiding by their WTO-based notification obligations under the ECT, non-WTO CPs develop their capacities and prepare themselves for future WTO membership. Notifications to the Energy Charter Secretariat are in the public domain and may be accessed at <http://www.encharter.org>. The ECT notifications may also help to provide traders and investors with useful information and thereby contribute to a more transparent and predictable trade environment.

The notification requirements are based on the relevant provisions of the WTO. Notification formats are those of the WTO and review procedures mirror the relevant WTO practice while avoiding duplication of work. Notification requirements concern specific measures, procedures, applicable laws, rules, and administrative rulings of general application, international treaties and the competent authorities on a variety of issues.

- **Monitoring/review of measures triggered by notifications**

Notifications or non-compliance with notification obligations may result in further investigations, e.g. concerning balance of payments measures or consultations on technical barriers to trade. Interested CPs, concerned with a particular aspect of trade implementation, may drive many of these activities.

- **Information on customs duties and other charges**

The Secretariat collects notifications and disseminates information on customs duties and other charges of any kind imposed on, or in connection with, importation or exportation of Energy Materials and Products and Energy-Related Equipment and on any changes to such duties or charges of any kind.

- **Annual review on moving items to a legally binding tariff commitment**

Such a review is based on background documentation containing compilation of applied and bound tariff rates of any kind with respect to Energy Materials and Products and Energy-Related Equipment, as well as of rates contained in official offers submitted by non-WTO CPs in the context of WTO accession and requiring listing in Annexes BR or BRQ.

If there is agreement on moving an item to a legally binding tariff commitment, a tariff record will be drawn up in accordance with Annex W(B)(4) and (5) reflecting the commitments under Article 29(6) and (7). It will be continuously updated with respect to those CPs that are listed in Annexes BR or BRQ.

- **Dispute settlement procedures**

Interim Rules of Procedure for trade disputes have been elaborated in accordance with Annex D (3)(a) of the ECT. In addition, the Charter Conference adopted a list of panelists in accordance with Annex D (7).

The trade-related dispute settlement provisions of Annex D are similar, but not identical with those under the WTO Understanding on Dispute Settlement (DSU). Accordingly, the Secretariat will provide:

- The parties to the dispute, upon request, with technical assistance and practical advice on the functioning of the dispute settlement procedure and on applicable rules;
- The panels with practical assistance, including selection of the panelists, the communication of dispute settlement cases, the compilation of the factual material, and the drafting of the panel's findings or the final report.

- **Information exchange and co-operation with WTO and other institutions**

The Secretariat maintains regular contacts with the WTO Secretariat concerning information on interpretation or modifications/amendments of all WTO rules applicable under the ECT, and other relevant institutions (e.g. UNCTAD, OECD, IEA, the European Commission).

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