Energy Charter Treaty: An Unexploited but Rich Well

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The Energy Charter Treaty ("ECT") establishes a legal framework to promote long-term cooperation in the energy sector. (Article 2 of the ECT) The ECT is a unique tool in that it is a multilateral treaty that sets out legally binding rules specifically applicable to the energy sector and covers the whole energy value chain. This article attempts to provide an overview of the ECT, which is deserving of more attention in Japan, and to inform Japanese players in the energy sector how they could possibly benefit from it.

I. Birth of the Energy Charter Process

In the early 1990s, the end of the Cold War ignited a political initiative in Europe with a view to rebuilding amicable relationships in the economy. The prospects for mutually beneficial cooperation were clearer in the energy sector where net exporters and net importers were interdependent. The interested countries and the then-European Communities started their cooperation by a political declaration that set out, without legally binding effect, the principles and objectives to be reflected in a legal framework to be subsequently established. This declaration was signed in 1991 and entitled the "European Energy Charter".

Based on the principles and objectives contained in the European Energy Charter, the negotiations on the legally binding rules opened, and eventually, materialized in the ECT, which was signed in 1994 and entered into force in 1998. The ECT remains open for accession, and its constituency currently comprises fifty-one states (as of 26 March 2013), as well as the European Union and Euratom.

The decision-making body under the ECT is the Energy Charter Conference ("Conference"), where the ECT constituency and observers discuss various issues. The Conference has some subsidiary bodies, each of which deals with one of the pillars described in the next section. The activities carried out under the ECT, including those of the subsidiary bodies of the Conference, are collectively referred to as the Energy Charter Process, although this term is not defined in the ECT.

II. Contents of the Energy Charter Treaty

The ECT has four pillars: (i) investment protection; (ii) non-discriminatory conditions for energy trade, and assurance of reliable cross-border energy transit flows; (iii) dispute settlements between the states or regional economic integration organizations who have signed and ratified the ECT ("Contracting Parties") and, in the case of investment disputes, between the investor and the host state; and (iv) the promotion of energy efficiency and the attempt to minimize the environmental impact of energy production and use.

1. Investment Protection

The ECT provides for a fully-fledged protection of investments. The ECT defines an investment as "every kind of asset, owned or controlled directly or indirectly by an Investor" (Article 1(6) of the ECT), and the definition of Investor does not require the residence or registration of main office in the host state (Article 1(7)(a) of the ECT).

The protection includes fair and equitable treatment (Article 10(1) of the ECT), national treatment and most-favoured-nation treatment (Article 10(7) of the ECT), and conditions for expropriation (Article 13). The ECT does not prohibit expropriation as such, but it requires the host government to conduct expropriation only for a purpose in the public interest, in a non-discriminatory manner, with the due process of law, and with the payment of prompt, adequate and effective compensation.

The unique feature of the ECT in terms of investment protection is that, even if a state withdraws from the ECT, the investments made in such state remain under the ECT-based protection for 20 years after the date of that state's withdrawal, provided that the investments were made on or before this date. (Article 47(3) of the ECT)

2. Trade and Transit

(1) Trade

Article 29(2)(a) of the ECT incorporates the provisions of the GATT into the trade rules under the ECT, provided that the energy trade at issue involves at least one state that is not a party to the GATT (Article 29(1) of the ECT). After the World Trade Organization ("WTO") was established, the ECT constituency adopted a set of amendments to the ECT, called the Trade Amendment, and incorporated the provisions of relevant WTO Agreements into the ECT-based trade regime.

The foregoing means that, with regard to the relationships between the ECT Contracting Parties, the GATT/WTO rules are extended to trade of energy materials and products between non-WTO members, or between WTO members and non-WTO members. The ECT's coverage of energy materials and products is comprehensive and includes, for example, crude oil, natural gas and electricity. (Article 1(4) of the ECT and Annex EM) The Trade Amendment expanded the ECT application to energy-related equipment, such as pipeline pipes, turbines, power masts, furnaces, platforms and transformers. (Article 1(4bis) of the ECT, and Annexes EQI and EQII)

The ECT also provides for a dispute settlement scheme for trade disputes (Article 29(7) and Annex D) that applies, again, only when an ECT Contracting Party who is not a WTO member is involved. This scheme is a simplified version of the WTO's Dispute Settlement Understanding, and thus, could be a useful tool for WTO members who seek to refer their disputes against non-WTO members to well-established dispute settlement procedures. As of 26 March 2013, the ECT Contracting Parties that are not WTO

Members are: Azerbaijan, Belarus, Bosnia and Herzegovina, Kazakhstan, Turkmenistan and Uzbekistan.

(2) Transit

The ECT provides for rules on transit, built upon those set out in Article V of the GATT. A particular innovation of the ECT is that it explicitly covers grid-bound energy transport. (Article 7(10)(b) of the ECT)

The ECT obliges the Contracting Parties to take necessary measures to facilitate the transit of energy materials and products consistent with the principle of freedom of transit and on a non-discriminatory basis, and without imposing any unreasonable delays, restrictions or charges. (Article 7(1)) The ECT contains a detailed definition of the word "transit" (Article 7(10)(a) of the ECT), but in effect, it would cover transportation of goods from a state, through at least one other state, to a third state or back to the origin state.

The ECT establishes dispute settlement procedures designed specifically for transit disputes. (Article 7(7) of the ECT) Even when there is a dispute concerning transit, the Contracting Party through which the energy materials or products are transiting shall not interrupt or reduce the existing flow of such materials and products, prior to the conclusion of the ECT-based dispute settlement procedures. (Article 7(6) of the ECT) These procedures involve an appointment of a conciliator who may decide the interim tariffs and other terms and conditions to be observed until the dispute is resolved, or for 12 months, whichever is shorter. (Article 7(7)(b), (c) and (d) of the ECT) This ECT-based conciliation is less formal, and is likely to be faster, than a court proceeding or arbitration.

3. Dispute Settlements

Article 27 of the ECT provides for procedures for settlement of disputes between Contracting Parties. There, the Contracting Parties shall endeavour to settle their dispute concerning the application or interpretation of the ECT through diplomatic channels. (Article 27(1) of the ECT) In the event that the dispute is not settled within a reasonable period, either party may submit the dispute to an ad hoc arbitral tribunal. (Article 27(2) of the ECT)

The dispute settlement procedures much more often used than the abovementioned state-to-state scheme are those concerning disputes between investors and host states. These are provided for in Article 26 of the ECT. Again, the disputing parties are encouraged to settle their dispute amicably (Article 26(1) of the ECT), but if settlement is not reached within three months, the investor may submit the dispute to one of the following three fora (Article 26(2)(a) through (c) of the ECT):

(i) the courts or administrative tribunals of the respondent state;
(ii) a previously agreed dispute settlement procedure; or

(iii) international arbitration.

An example of (ii) above is a dispute settlement scheme provided by a bilateral investment treaty ("BIT"). If the investor chooses international arbitration, there are again three possible fora (Article 26(4)(a) through (c) of the ECT):

(a) the International Centre for Settlement of Investment Disputes ("ICSID");
(b) a sole arbitrator or ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law ("UNCITRAL"); or
(c) an arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce.

As of 26 March 2013, the Energy Charter Secretariat ("ECS") has detected 33 cases filed under Article 26 of the ECT. There is a rumor of one more case, but the ECS has not been able to confirm it with a reliable source. This is because there is no obligation on the disputing parties to notify their cases to the ECS. This also implies that there could be cases other than these 33 or 34.

For Japanese investors, this investor-State arbitration would be a useful tool. As of 26 March 2013, Japan has BITs or a free trade agreement ("FTA") including an investment chapter with only four of the 46 states that have ratified the ECT; namely, Mongolia, Turkey and Uzbekistan (BITs), and Switzerland (FTA). For the relationships with the other 42 states, the ECT may be the only tool with which Japanese investors might submit their disputes regarding energy investments to reliable dispute settlement procedures.

4. Energy Efficiency

Article 19(1) of the ECT states that the Contracting Parties shall strive to minimize harmful environmental impacts that arise from all operations within the energy cycle. The principles to guide the implementation of this Article are defined in the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects ("PEEREA"). (Articles 1(1) and 3 of the PEEREA) The PEEREA requires the Contracting Parties to formulate strategies and policy aims for improving energy efficiency and thereby reducing environmental impacts of the energy cycle. (Article 5 of the PEEREA) The Contracting Parties shall, to achieve such policy aims, develop, implement and regularly update energy efficiency programmes. (Article 8(1) of the PEEREA)

The PEEREA recognizes that each Contracting Party may have different circumstances in terms of proceeding with promotion of energy efficiency. As such, the Energy Charter Process does not examine to what extent the above-mentioned programmes are implemented. In the field of energy efficiency, it puts emphasis on the exchange of information or experiences among the ECT constituency, unlike the other fields.

III. Current activities and goals

As mentioned at the beginning of this article, the European Energy Charter and the ECT date back to the 1990s. However, it is clear that there have been great changes in global energy relations in the last twenty years, such as: the growth of non-OECD countries' share in global energy demand; the increased need for investments in the energy sector; and the necessity to address climate change. The Conference recognized these issues and the necessity to adapt the Energy Charter Process to them, and thus, adopted the Road Map for Modernization of the Energy Charter Process ("Road Map") in 2010.

One of the key issues highlighted in the Road Map is the necessity for expansion, outreach and consolidation of the ECT constituency. Consolidation is aimed at those states that have signed but not ratified the ECT, and the states that have not ratified the Trade Amendment. Expansion comprises efforts to facilitate observer states to work towards elevation of their status to full membership. Outreach is the introduction of the ECT to states that are neither members nor observers, with a view to including them in the Energy Charter Process.

Given the trend of involving non-European partners, the fact that the founding document of the Energy Charter Process is entitled the "European" Energy Charter and refers to the European market is perhaps no longer appropriate to current realities. This consideration led the Conference to adopt a decision, at its 23rd meeting held in November 2012 in Warsaw, to start a process that could lead to negotiations on, and the adoption of, an updated version of the European Energy Charter. This process is called the Warsaw Process.

The Warsaw Process could, in addition to eliminating the word "European", incorporate into the updated charter some new concepts or principles that did not stand out back in the 1990s. However, such a development could raise some legal implications for the ECT itself, as the ECT refers to the European Energy Charter, without mentioning any possibility of embracing an updated version thereof. The analysis on such implications is ongoing.

<Reference>

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