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26/9/94-03

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cc: Mr. Caruso
Mr. Vlaanderen
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M E M O R A N D U M

A
To: Mrs. Steeg
Mr. Ferriter

De
From: Craig Bamberger CSB

Objet
Subject: **Energy Charter Treaty**

26 September 1994

Reference: IEA/OLC(94)241

Enclosed is a draft Note explaining the Energy Charter Treaty which I prepared with the thought that, at some point, such a paper could prove useful to the Agency's Members as well as to Secretariat staff. I would propose to keep this in draft form at least until the adoption of the treaty text and the Final Act of the Conference is assured.

On 14 September the Chairman of the European Energy Charter Conference sent to the Conference participants the proposed final text of the Energy Charter Treaty (ECT), with a request that they notify the Conference Secretariat before the end of October whether they agree to its adoption. Assuming that the text is agreed to, the participants are invited to sign the Final Act of the Conference in Lisbon on 17 December, following which the ECT will open for signature (in English, French, German, Italian, Russian and Spanish), as will a Charter Treaty Protocol on Energy Efficiency and Related Environmental Aspects. The purpose of this Note is to describe the ECT.

This presentation is organized in the following manner. After briefly telling of the origin of the ECT and giving an introductory description of it, the Note explains the treaty's principal "trade" provisions (paragraphs 3-5 of the Note) and then its principal "investment" provisions (paragraphs 6-7), excluding provisions that have significant elements of both trade and investment. Thereafter, the Note covers other substantive rights and obligations under the ECT that may affect both trade and investment (paragraphs 8-12); provisions that *further implement* the treaty's substantive obligations such as those on "sub-national" application or regulating State and privileged enterprises (paragraphs 13-16); exceptions, and special *temporary* exceptions for economies-in-transition (paragraphs 17-20); the related agreements envisaged by the ECT, *viz.*, "Protocols," "Declarations" and "Association Agreements" (paragraph 21); and finally, the ECT's institutional arrangements (paragraphs 22-24).

1. <u>Origin of the ECT</u>

The origin of the ECT is recounted as follows in the proposed Final Act of the Conference, which was distributed by the Conference Chairman along with the text of the ECT:

> "During the meeting of the European Council in Dublin in June 1990, the Prime Minister of the Netherlands suggested that economic recovery in Eastern Europe and the then Soviet Union could be catalysed and accelerated by co-operation in the energy sector. This suggestion was welcomed by the Council, which invited the Commission of the European Communities to study how best to implement such co-operation. In February 1991 the Commission proposed the concept of a European Energy Charter.
>
> Following discussion of the Commission's proposal in the EC Council of Ministers, the European Community invited the other countries of Western and Eastern Europe, the Soviet Union and the non-European members of the OECD to attend a Conference in Brussels in July 1991 to launch negotiations on the European Energy Charter. A number of other countries and

international organizations were invited to attend the Energy Charter Conference as observers.

Negotiations on the European Energy Charter were completed in 1991 and the Charter was adopted by signature of a Concluding Document at a Conference held at the Hague on 16-17 December 1991."

Some fifty-one States and the European Community have now signed the Charter document. Included are all OECD Member countries except Mexico and New Zealand.

The Charter is legally non-binding. By the time of its signature, negotiations already were under way on a "Basic Agreement" -- later called the "Energy Charter Treaty" -- to implement the objectives and principles of the Charter in a legally binding manner. As is stated in Article 4 of the ECT, "Purpose of the Treaty", it "establishes 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 Charter."

2. Introductory Description of the ECT

The ECT is unique as a multilateral sectoral treaty broadly covering trade, investment, and a range of other matters in the energy field. Many of the treaty's rights and obligations are of a "hard law" nature, enforceable in legally binding arbitration, although there also are a number of "best efforts" or other "soft law" commitments. The treaty text proper consists of seven Parts but the ECT also includes fourteen Annexes and four Conference Decisions which are incorporated by reference. In addition, it is necessary to take account of twenty-two Understandings (mostly interpretative) and seven Declarations that are contained in the Final Act.

The ECT will remain open for six months from 17 December for signature by any State or "Regional Economic Integration Organization" (such as the European Community) which has signed the Charter document. Thereafter, such States or Organisations can accede to the ECT on terms to be approved by the new Charter Conference which is to be created by the treaty. The ECT will enter into force upon deposit of the thirtieth instrument of ratification, acceptance or approval (by signatories) or of accession thereto (except that an instrument deposited by the European Community will not be counted as additional to the instruments of its members).

Article 45 of the ECT provides in paragraph (1) that each signatory will apply the treaty provisionally pending its entry into force, "to the extent that such provisional application is not inconsistent with its constitution, laws or regulations." However, paragraph (2) of that article allows a signatory to declare when signing that it "is not able to accept provisional application", in which case the signatory shall only be obliged to apply provisionally the treaty's provisions concerning institutional arrangements (as distinct from its substantive obligations), and then only insofar as that "is not inconsistent with its laws and

regulations"; a signatory so electing, and its investors, are not entitled to claim the benefits of provisional application under paragraph (1). The treaty expressly provides for provisional institutional arrangements: there are to be a "provisional Secretariat," and a "provisional Charter Conference" composed of ECT signatories, which is to be convened by the provisional Secretariat not later than 180 days after the date the treaty opens for signature.

An Understanding contained in the Final Act calls upon the provisional Secretary-General to "make immediate contact with other international bodies in order to discover the terms on which they might be willing to undertake tasks arising from the Treaty and the Charter."

PRINCIPAL TRADE PROVISIONS

3. General Description

Article 3 of the ECT announces the attitude of the ECT toward trade: "The Contracting Parties shall work to promote access to international markets on commercial terms, and generally to develop an open and competitive market, for Energy Materials and Products."

The ECT's specific trade articles extend on a legally binding basis, to trade involving Contracting Parties that are not party to the General Agreement on Tariffs and Trade (GATT), GATT provisions that are incorporated by reference into the ECT; impose "best-efforts" obligations concerning energy tariffs among the ECT's Contracting Parties and provide for the initiation of negotiations to make such tariffs binding; and adopt significant new rules for the transit of energy goods through the "Area" of a Contracting Party. These articles are described below.

4. The "Interim" Trade Provisions

A major element of the ECT is that it subjects the trade of Contracting Parties which are not parties to the GATT -- such as republics of the former Soviet Union -- to GATT rules, both in their relations with GATT countries and in their relations with one another. The provisions to this effect, which are set out in Article 29, are said to be "interim" ones. This is true in the sense that they will cease to be operative when all ECT Contracting Parties are full participants in either the 1947 GATT *and all of its related instruments*, or in the recent Agreement Establishing the World Trade Organization (WTO) *and all of its related instruments*.

Article 29(2) applies selected provisions of the 1947 GATT to trade involving non-GATT countries; these provisions will govern trade between any two ECT Contracting Parties where either of them is not a GATT party, or is not party to a GATT-related instrument that is relevant to such trade. There is one potential exception: trade between republics of the former Soviet Union may instead by governed by an agreement between

them, subject to prescribed notification procedures, and to cut-off provisions in case of GATT entry and in any event as of December 1999. However, the selected GATT provisions will not govern trade between ECT Contracting Parties that are either party to the 1947 GATT or "party" to "GATT 1994" (which is annexed to the WTO Agreement), and to the relevant GATT-related instruments. ECT Article 4 expressly provides that the ECT shall not derogate from the GATT, which by ECT definition includes both the 1947 GATT and "GATT 1994".

Annex G to the ECT sets out the provisions of the 1947 GATT and its related instruments that will *not* apply to trade covered by Article 29(2); any 1947 GATT provisions not listed there *will* apply. The aim of the Energy Charter Conference was to apply all of the GATT provisions that could be workable when incorporated into the ECT. Article 29(2)(a) stipulates that these provisions govern, "as applied on 1 March 1994, and practised with regard to Energy Materials and Products by parties to the GATT among themselves...."

An Understanding in the Final Act says that where a provision of the GATT or a related instrument provides for joint action by parties to the GATT, the Charter Conference will take that action. Another such Understanding indicates that the language quoted above concerning the application and practice of GATT provisions among GATT parties is not intended to refer to cases where a GATT party has disapplied the GATT toward another GATT country under GATT Article XXXV, and unilaterally applies some GATT provisions vis-à-vis the other party.

Annex G contains an explicit provision that trade in nuclear materials "may be governed" by agreements referred to in relevant Declarations in the Final Act. There is in the Final Act such a Declaration between the European Community and Russia.

The term "Energy Materials and Products" is defined in Article 1(4) by means of item references to the Harmonized System of the Customs Co-operation Council and the Combined Nomenclature of the European Communities. Annex EM, which contains these item references, covers nuclear energy, coal, natural gas, petroleum and petroleum products, electrical energy, and fuel wood and charcoal. The designation of petroleum products excludes some petrochemicals that are within the item reference for that category. Energy services and energy equipment also are excluded; however, the ECT provides that the provisional Charter Conference shall at its first meeting commence examination of the future inclusion of energy-related equipment in the ECT.

Disputes between Contracting Parties over compliance with the applicable 1947 GATT provisions are subject to final and binding arbitration under procedures set out in Annex D that were drafted using as a point of departure the then-"Dunkel text" Uruguay Round dispute settlement procedures. Where an arbitral panel concludes that a measure of a Contracting Party fails to comply with the governing ECT provisions, it may recommend that the offending Contracting Party alter or abandon the measure. The panel's report is subject to adoption by the Charter Conference, acting by a vote of three-fourths of those present and voting. Where the offending party fails to comply with the panel's ruling or recommendation, the Charter Conference may by the same vote authorize the injured party to suspend ECT trade obligations to the other party "which the injured party considers equivalent in the

circumstances." There are further provisions for the review of the level of obligations proposed to be suspended.

There are exceptions from these dispute settlement procedures both for disputes arising under the agreements between former Soviet Union republics that are referred to above, and for those arising under agreements establishing free-trade agreements or customs unions as described in Article XXIV of the GATT.

Paragraphs (3) through (5) of Article 29, which apply to all ECT Contracting Parties, establish import and export tariff notification requirements; impose a "best-efforts" obligation to limit increases in tariffs on "Energy Materials and Products"; and impose requirements for future notification and consultation with respect to such increases. Furthermore, Article 29(6) calls for negotiations to commence by 1 January 1995 on an amendment to the ECT, binding each Contracting Party not to increase energy tariffs above a level to be specified therein.

Separately, Article 30 calls for negotiation, by the later of 1 July 1995 or the entry into force of the ECT, on amendments to the ECT "in the light of the results of the Uruguay Round...."

5. The Transit Article

In most respects the ECT's trade provisions call up, replicate or resemble provisions of the 1947 GATT or the 1994 GATT. What is groundbreaking is their extension of the application of those provisions to energy trade with non-GATT countries. The unprecedented Article 7 on "Transit" is thought of as the most significant instance in the ECT of a "GATT-plus" trade provision creating *new forms* of rights and obligations.

The article deals with the movement of "Energy Materials and Products," the definition of which is discussed above. Transit refers to "carriage through the Area of a Contracting Party, or to or from port facilities in its Area for loading or unloading, of Energy Materials and Products originating in the Area of another state and destined for the Area of a third state, so long as either the other state or the third state is a Contracting Party". The term has a secondary meaning: it also covers carriage originating in and destined for the same Contracting Party, where the goods pass through another Contracting Party, unless the parties concerned have opted out of this provision by listing themselves in Annex N; two OECD countries have jointly done so. The terms "originating in" and "destined for" are undefined.

Paragraph (1) obliges each Contracting Party to "take the necessary measures to facilitate" transit "consistent with the freedom of transit" (a reference to Article V of the GATT) and on a non-discriminatory, reasonable basis. Paragraph (2) says that Contracting Parties shall encourage "relevant entities" to co-operate in developing, modernizing, operating, and interconnecting transit facilities, and in mitigating the effects of supply interruptions.

In paragraph (3) each Contracting Party "undertakes" that, unless an existing international agreement provides otherwise, its "provisions" relating to the transport of

covered energy goods and to the use of fixed energy transport facilities shall treat goods that are in transit through that Contracting Party's "Area" no less favourably than goods originating in or destined for that "Area."

Paragraph (4) says that if transit via fixed facilities cannot be achieved on commercial terms, Contracting Parties "shall not place obstacles in the way of new capacity being established, except as may be provided in applicable legislation which is consistent with paragraph (1)." An Understanding to this paragraph observes that legislation on environmental protection, land use, safety or technical standards would qualify under this language.

Paragraph (4) of Article 7 is subject to the ECT's "transitional arrangements," providing for temporary exceptions that the economies-in-transition have been allowed to take from specific provisions of the ECT: such exceptions, which are listed in Annex T to the treaty, are described below in paragraph 20 of this Note. Paragraph (4) of the "Transit" article is the object of such exceptions on the part of six of the economies-in-transition.

Under paragraph (5) the transit State is not obliged to permit construction or modification of new transport facilities or to allow new or additional transit through existing ones, "which it demonstrates to the other Contracting Parties concerned would endanger the security or efficiency of its energy systems, including the security of supply." However, subject to paragraphs (6) and (7), the Contracting Parties "shall...secure established flows...."

Paragraphs (6) and (7) are the article's most operationally relevant provisions. Paragraph (6) provides that the transit State "shall not, in the event of a dispute over any matter arising from that Transit, interrupt or reduce, permit any entity subject to its control to interrupt or reduce, or require any entity subject to its jurisdiction to interrupt or reduce the existing flow" of energy goods prior to the conclusion of the dispute resolution procedures set out in paragraph (7), except where specifically allowed by a relevant agreement or permitted by a conciliator appointed under paragraph (7).

Paragraph (7), which only applies following the exhaustion of all other dispute resolution remedies previously agreed to between the concerned Contracting Parties or between the concerned entities, allows a Contracting Party to the dispute to require the Conference Secretary-General to appoint a conciliator. If within sixty days the conciliator fails to secure agreement, "he shall recommend a resolution and shall decide the interim tariffs and other terms and conditions to be observed...until the dispute is resolved." Paragraph (7)(d) states that the Contracting Parties "undertake to observe and ensure that the entities under their control or jurisdiction observe" the conciliator's decision for twelve months, unless the dispute is resolved sooner.

Paragraph (8) stipulates that nothing in the article shall derogate from international law, including existing agreements, and specifically from rules concerning submarine cables and pipelines. Paragraph (9) notes that the article is not to be interpreted to require any Contracting Party to take any measure with respect to a certain type of fixed energy transport facility that is not already in existence in that country.

PRINCIPAL INVESTMENT PROVISIONS

6. The Core Provisions

The ECT's core investment provisions are in Part III of the treaty; the corresponding dispute resolution provisions are in Part V. In many respects these resemble provisions in bilateral investment treaties, although their drafting has not been based on any single negotiating party's treaty practice.

The scope of the investment protection is shaped by the definitions in paragraphs (5) and (6) of Article 1. "Investment" is defined there as "every kind of asset, owned or controlled directly or indirectly by an Investor"; the term "refers to any investment associated with an Economic Activity in the Energy Sector" (and to investments which a host country voluntarily designates as "Charter efficiency projects"). An Understanding in the Final Act elaborates on the meaning of "control." "Economic Activity in the Energy Sector" is defined to mean "an economic activity concerning the exploration, extraction, refining, production, storage, land transport [*i.e.*, not including marine transport], transmission, distribution, trade, marketing or sale of Energy Materials and Products," but specifically excluding fuel wood, charcoal, and the distribution of heat to multiple premises.

The key Article 10 on "Promotion, Protection and Treatment of Investments" begins, in paragraph (1), with a series of general statements concerning the favourable conditions which Contracting Parties must maintain for investments by investors of other Contracting Parties. Next there is a requirement that such investments be accorded treatment no less favourable "than that required by international law, including treaty obligations." An Understanding in the Final Act indicates that the reference to "treaty obligations" excludes treaties which entered into force before 1 January 1970 and "decisions taken by international organizations, even if they are legally binding".

Then comes a provision in paragraph (1) which makes it a violation of a Contracting Party's obligations under the ECT to breach a contractual investment agreement: "Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investment of any other Contracting Party." The negotiating parties were given an opportunity to opt out of this obligation: Articles 26 and 27 allow the Contracting Parties listed in Annex IA to preclude ECT dispute settlement for breaches of the obligation. Three OECD States and one East European State are listed in Annex IA.

Paragraphs (2) and (3) provide for a "best efforts" commitment to accord the better of national treatment or most favoured nation treatment to investors of other Contracting Parties with regard to the *making* of investments, a term defined in Article 1(8) to mean "establishing new Investments, acquiring all or part of existing Investments or moving into different fields of Investment activity." The "best-efforts" commitment reflects the decision of the Conference to limit the present treaty's legally binding investment coverage to post-investment activities, deferring to a second-phase "supplementary" treaty the question of the right of establishment. Paragraph (4) expressly contemplates the second-phase treaty, negotiations toward which are to commence by 1 January 1995 with a view to concluding it

by 1 January 1998; an Understanding in the Final Act indicates that the second-phase treaty is to include provisions relating to privatization and demonopolization. A Declaration by Russia indicates a desire to revisit, in the context of the second-phase treaty negotiation, the Understanding on the meaning of "control" of investment. In the meantime, paragraphs (5), (6) and (9) of Article 10 respectively establish "best-efforts" obligations of standstill and liberalization as concerns the making of investments; envisage the possibility of voluntary undertakings by Contracting Parties of more stringent standards; and require up-to-date reporting of all measures which do not comply with the standard of the better of national or most-favoured-nation treatment.

Paragraph (7) of Article 10 establishes as a *post-investment* standard for the treatment of investment: the better of national treatment or most-favoured-nation treatment. This standard applies not only to the investments of investors of other Contracting Parties, but also to "their related activities including management, maintenance, use, enjoyment or disposal".

However, paragraph (8) notes that the "modalities of application" of paragraph (7) in relation to grants, financial assistance or contracts for energy technology research and development, are "reserved for" the second-phase supplementary treaty; up-to-date reporting on such programmes is required by paragraph (9). In addition, a Conference Decision incorporated into the treaty allows Russia under certain circumstances to require legislative approval for the leasing of federal property; and one other State that is an economy-in-transition has listed in Annex T a transitional exception with regard to Article 10(7).

Also, paragraph (10) specifies that the treaty's standard of the better of national or most-favoured-nation treatment shall not apply to the protection of intellectual property, which shall instead be accorded the treatment specified in other applicable international agreements.

Article 10 ends with an expressed obligation for each Contracting Party to ensure that its domestic law affords effective means for the assertion of claims and the enforcement of rights.

There is an Understanding to Article 10 and certain other provisions of the treaty which acknowledges the permissibility of restraints on "programmes which provide for public loans, grants, guarantees or insurance for facilitating trade or investment abroad", on the ground that these are not "connected with Investment or related activities of Investors from other Contracting Parties" in the "Area" of the constraining party.

Article 11 establishes an obligation for the host country to "examine in good faith" requests for key personnel to enter and remain for investment-related purposes, and to permit investors of other Contracting Parties to employ key personnel of their choice.

Article 14 spells out the obligation of each Contracting Party to "guarantee," with respect to investments, the freedom of transfer without delay and in a freely convertible currency. The obligation is subject to several possible exceptions: non-discriminatory law enforcement or creditor protection measures are allowed; former Soviet Union republics may under certain circumstances agree that inter-republic transfers will be in their own currencies;

"returns" derived from an investment that are paid "in kind" (*e.g.*, crude oil pursuant to production sharing) may, under certain circumstances, be restricted in conjunction with corresponding GATT-authorized export controls; a Conference Decision avoids any doubt that the former Soviet Union republics can, in certain circumstances, apply restrictions on transfers of capital abroad by their own domestic investors; and another Decision implies that Romania, pending its transition to full convertibility, may under certain circumstances delay transfers for up to six months. Also, Annex T contains transitional arrangements for relevant transfer-related measures maintained by two States, but only with regard to the transfer of "unspent earnings" of personnel engaged from abroad.

Article 15 addresses the subrogation rights of an indemnifying party with respect to an investment.

Articles 12 and 13 deal with compensation for expropriations and for other losses such as those caused by armed conflict, state of national emergency, civil disturbance or similar event. Any expropriation (including a measure or series of measures equivalent in effect to expropriation) must be: for a purpose which is in the public interest; not discriminatory; carried out under due process of law; and accompanied by "prompt, adequate, and effective compensation" (the meaning of which is further explained). Paragraph (3) of Article 13, "Expropriation", states "for the avoidance of doubt" that the article covers "situations where a Contracting Party expropriates the assets of a company or enterprise in its Area in which an Investor of any other Contracting Party has an Investment, including through the ownership of shares."

Article 21 on "Taxation" contains in paragraph (4) provisions which apply when there is a question under Article 13 of whether a tax constitutes an expropriation or is discriminatory. In such a case the issue is to be referred to the competent tax authorities; arbitral bodies under Article 26(2)(c) or 27(2) *must* take into account any conclusions arrived at within six months by these authorities as to whether the tax is discriminatory, and *may* take into account any other conclusions on the two kinds of questions.

Article 17 allows a Contracting Party to deny the advantages of Part III to an entity owned or controlled by investors of a non-Contracting Party, and lacking substantial business activities where it is organized; or to an investment of an investor of a non-Contracting Party State with which the host State does not maintain diplomatic relations, or as to which the host State maintains prohibitory legal measures.

Article 16 regulates the relationship between the ECT and previous or subsequent treaties among ECT Contracting Parties concerning the subject matter of Parts III or V and the ECT. Its intent is to avoid derogation by any of such treaties (*e.g.*, on grounds of *lex specialis* or *lex posterior*) from provisions of the other treaties that are the more favourable to the investor or investment.

Part V is comprised of three articles, two of which establish investment dispute settlement mechanisms, and the third of which puts limits on access to one of those mechanisms. Article 26 covers disputes between a Contracting Party and an investor of a

different Contracting Party "which concern an alleged breach of an obligation of the former under Part III...." It allows an Investor a choice to submit an unresolved dispute: to the fora of the host state; in accordance with some other previously agreed procedure; or for binding arbitration, to the investor's preference among the International Centre for Settlement of Investment Disputes (ICSID), a forum established under the rules of the United Nations Commission on International Trade Law (UNCITRAL), or a proceeding of the Arbitration Institute of the Stockholm Chamber of Commerce. However, paragraph (3)(b) provides an exception which allows Contracting Parties to deny unconditional consent to ICSID, UNCITRAL or Stockholm arbitration in the situation where an investor "has previously submitted the dispute" to the domestic fora of the host state or under another previously agreed procedure; twenty-three States (including eleven OECD countries) and the European Community are listed in Annex ID as denying such consent. Paragraph (8) provides that an arbitration award concerning a measure of a sub-federal government or authority shall allow for the payment of monetary damages in lieu of another remedy.

Article 27 provides for binding State-to-State arbitration, by an ad hoc tribunal, of disputes "concerning the application or interpretation of this Treaty." Unlike Article 26 on investor dispute resolution, it is *not limited* to investment disputes arising under Part III, although the Article 27 procedures are excluded by Article 28 from application to trade-related disputes arising under Articles 5 ("Trade Related Investment Measures") or 29 ("Interim Provisions on Trade Related Matters").

Where a measure of a regional or local government is found not to be in conformity with the treaty, those Contracting Parties listed in Annex P may invoke the procedures of that annex (which have been based on WTO Agreement dispute settlement procedures), providing for Charter Conference authorization to the injured party to suspend such of its treaty obligations to the offending party "as [the Contracting Party] considers equivalent to those denied...." There are two countries listed in Annex P, both of them OECD Members.

7. The "Sovereignty" Article

Article 18, "Sovereignty Over Energy Resources," is located in Part IV entitled "Contextual" rather than in Part III, but it pertains especially to investment issues. In paragraph (1) the Contracting Parties "recognize state sovereignty and sovereign rights over energy resources" and "reaffirm that these must be exercised in accordance with and subject to the rules of international law."

Paragraph (2) states, in language drawn from Article 222 of the Treaty of Rome, that the ECT "shall in no way prejudice the rules in Contracting Parties governing the system of property ownership of energy resources." The Final Act contains the following provision: "The representatives [of Conference participants] declared that Article 18(2) shall not be construed to allow circumvention of the application of the other provisions of this Treaty."

Paragraph (3) enumerates rights which each State "in particular" holds, such as the right to decide its geographical areas to be made available for exploration and development

of energy resources. Paragraph (4) is a "best-efforts" obligation to facilitate access to energy resources.

OTHER SUBSTANTIVE RIGHTS AND OBLIGATIONS

8. Trade Related Investment Measures

Article 5 of the ECT, which follows closely the trade related investment measures (TRIMs) provisions of the WTO TRIMs Agreement, forbids all Contracting Parties from imposing any TRIM that is inconsistent with Article III or XI of the GATT. This specifically includes *investment measures* that would require the purchase of domestic or domestic-source goods; restrict imports either directly or through restrictions on access to foreign exchange, or restrict the use of imported products; or restrict exports. Nonetheless, TRIMs can be applied as a condition of eligibility for export promotion, foreign aid, government procurement or preferential tariff or quota programmes; and preexisting TRIMs may be temporarily maintained, subject to specified notification and phase-out requirements.

ECT Article 5 rights can be adjudicated in the ECT's trade dispute resolution forum only with respect to disputes where at least one disputant is not a party to the GATT. Article 29(7), making the Annex D State-to-State trade arbitration procedures available to such disputes where at least one party to the dispute is not a party to the GATT, is subject to the exceptions referred to above for properly notified agreements among former Soviet Union republics and for free-trade areas and customs unions as described in GATT Article XXIV.

Investors are afforded limited adjudication rights with respect to Article 5 TRIMs disputes, and Article 27 expressly excludes State-to-State arbitration thereunder of such disputes unless both parties to the dispute agree otherwise. Investors' dispute resolution rights are provided for in Article 10(11), which states that the application of a TRIM to an investment of an investor of another Contracting Party "existing at the time of such application" shall be considered a breach of an obligation under Part III of the treaty. Since the Article 26 investor arbitration provisions apply to violations of Part III, the effect is to make them applicable to TRIMs on *existing* investments.

9. Competition

Article 6 obliges each Contracting Party to "work to alleviate market distortions and barriers to competition" (paragraph (1)); to "ensure that...it has and enforces such laws as are necessary and appropriate to address unilateral and concerted anti-competitive conduct...." (paragraph (2)); and to give full consideration to providing other Contracting Parties with technical assistance in respect to competition rules (paragraph (3)). An Understanding in the Final Act indicates that it is for each Contracting Party to define "unilateral" and "concerted anti-competitive conduct", which may include "exploitative abuses." Paragraph (5) contemplates consultations between Contracting Parties or their competition authorities where

one Contracting Party "considers that any specified anti-competitive conduct carried out within the Area of another Contracting Party is adversely affecting an important interest relevant to the purposes identified in" the article; in such a case the other Contracting Party "shall accord consideration" to any request that it "initiate appropriate enforcement action", and shall inform the requesting Contracting Party of its decision. Paragraph (7) excludes binding ECT arbitration with respect to disputes that may arise over the implementation or interpretation of the article, although this would not prevent the article from being cited in disputes over other provisions.

As discussed in paragraph (20) below, this article has been by far the single largest basis for claims to transitional exceptions by the economies-in-transition.

10. Transfer of Technology

Following the enunciation of a legally "soft" commitment to promote access to and transfer of energy technology on a commercial and non-discriminatory basis, paragraph (2) of Article 8 says that, to the extent necessary to give effect to the first paragraph, "the Contracting Parties shall eliminate existing and create no new obstacles for transfer of technology, in the field of Energy Materials and Products and related equipment and services...." This obligation is subject to "non-proliferation and other international obligations."

11. Access to Capital

Article 9 contains in paragraph (1) a "best-efforts" obligation of each Contracting Party to promote access to its capital market by nationals of other Contracting Parties, on the basis of the better of national or most-favoured-nation treatment, to finance trade and investment in the energy sector. Further, the Contracting Parties are to "make...available" their "facilities" under programmes providing for access to public loans, grants, guarantees or insurance for such purposes, "consistent with the objectives, constraints and criteria of such programmes...." However, nothing in the article prevents a Contracting Party from taking measures for prudential reasons or to ensure the integrity and stability of its financial system and capital markets, or prevents financial institutions from applying their own lending or underwriting practices. The article also calls on the Contracting Parties to "seek as appropriate to encourage the operations and take advantage of the expertise of relevant international financial institutions."

Annex T contains several claims to transitional arrangements with regard to the paragraph (1) "best-efforts" obligation.

12. <u>Environmental Aspects</u>

Article 19 establishes "best-efforts" commitments to environmental goals in the energy sector, and enumerates some eleven types of "softly" worded actions which Contracting Parties "shall accordingly" take. The general statement of commitments in paragraph (1) reads as follows (defined terms are identified by initial capital letters):

> "In pursuit of sustainable development and taking into account its obligations under those international agreements concerning the environment to which it is party, each Contracting Party shall strive to minimize in an economically efficient manner harmful Environmental Impacts occurring either within or outside its Area from all operations within the Energy Cycle in its Area, taking proper account of safety. In doing so each Contracting Party shall act in a Cost-Effective manner. In its policies and actions each Contracting Party shall strive to take precautionary measures to prevent or minimize environmental degradation. The Contracting Parties agree that the polluter in the Areas of Contracting Parties, should, in principle, bear the cost of pollution, including transboundary pollution, with due regard to the public interest and without distorting Investment in the Energy Cycle or international trade."

The enumerated obligations include those to: take account of environmental considerations in the policy process; promote market-oriented price formation and fuller reflection of environmental costs; encourage co-operation with other competent organizations; have particular regard to energy efficiency, renewables, cleaner fuels and pollution-reducing technologies; promote information-sharing; promote public awareness; promote and co-operate in research, development, and application; encourage technology transfer; promote transparency with regard to environmentally significant investments; promote international awareness and information exchange; and participate, "within their available resources, in the development and implementation of appropriate environmental programmes in the Contracting Parties."

Article 27(2) excludes State-to-State dispute resolution with regard to Article 19, and the ECT's dispute resolution procedures under Article 26 for investment and under Annex D for trade likewise do not apply to such disputes. As in the case of Article 6 on "Competition," the absence of ECT dispute resolution with regard to the article does not exclude the possibility that it might be cited in dispute resolution concerning other articles; however, unlike the situation with Article 6, paragraph (2) of Article 19 states that upon the request of a Contracting Party a dispute concerning the application or interpretation of the article "shall, to the extent that arrangements for the consideration of such disputes do not exist in other appropriate international fora, be reviewed by the Charter Conference."

IMPLEMENTING PROVISIONS

13. "Sub-National" Application

After recognizing the responsibility of each Contracting Party for the observance of the provisions of the treaty, paragraph (1) of Article 23 adapts the language of GATT Article XXIV(12) to oblige each Contracting Party to "take such reasonable measures as may be available to it to ensure such observance by regional and local governments and authorities within its Area." Paragraph (2) then specifies that the treaty's dispute settlement provisions -- but excluding the GATT dispute settlement provisions called up by Article 29 -- can be invoked in respect of regional or local measures affecting the Contracting Party's observance of the ECT. An Understanding in the Final Act clarifies the intention that the GATT provisions on sub-national application that are called up by Article 29 would apply to disputes over trade regulated by that article.

Noted above in paragraph 6 of this Note, in connection with the discussion of the dispute resolution procedures contained in Articles 26 and 27, are certain special provisions which apply to remedies for treaty violations by sub-national authorities.

14. State and Privileged Entities

Article 22 imposes the following four obligations on each Contracting Party:

— to assure that its state enterprises conduct their sales activities "in a manner consistent with" the Contracting Party's Part III investment obligations;

— *not* to encourage or require such an enterprise to act "in a manner inconsistent with" the Contracting Party's obligations under *other* ECT provisions;

— to ensure that any delegated "governmental authority" is exercised "in a manner consistent with" the Contracting Party's ECT obligations; and

— *not* to encourage or require any "entity" (defined to include individuals) to which it grants "exclusive or special privileges" to act "in a manner inconsistent with" the Contracting Party's ECT obligations.

As in the case of Article 23 concerning "sub-national" application, a Final Act Understanding clarifies that for the purposes of the trade regulated under Article 29, the relevant GATT provisions called up by Article 29 rather than Article 22 will apply with respect to state and privileged entities.

One State that is an economy-in-transition has claimed, in Annex T, transitional relief pertaining to its uranium trade from the obligation mentioned in the third *tiret* above.

15. Transparency

Article 20, after taking note of the transparency disciplines that exist under the GATT and its related instruments which are called up in ECT Article 29, applies to other matters covered by the ECT, a rule parallel to that in Article X(1) of the GATT. Under it, Contracting Parties are to publish promptly, subject to protections for certain confidential information, all relevant international agreements and regulations, judicial decisions and administrative rulings of general application. Paragraph (3) of the Article also requires each Contracting Party to designate "enquiry points" to which requests for information about such measures can be addressed. This requirement for "enquiry points" is the subject of Annex T transitional exceptions for ten economies-in-transition.

16. Geographical Application

Many of the rights and obligations under the ECT refer to the "Area" of a Contracting Party. This term is defined in Article 1(10) to include for a Contracting Party "the territory under its sovereignty," which is further described in that article, as well as certain additional maritime areas. Article 40 allows a Contracting Party to make the ECT binding upon it with respect to the "other territories for the international relations of which it is responsible."

EXCEPTIONS AND TRANSITIONAL ARRANGEMENTS

17. General Exceptions

Article 24 contains a number of general exceptions from the ECT for measures of Contracting Parties, except that none of them applies with respect to Articles 12 and 13 ("Compensation for Losses" and "Expatriation"), or to the Article 29 provisions regulating trade, which instead invoke the exceptions set out in the 1947 GATT. Article 24 found its inspiration in the exceptions contained in GATT Articles XX and XXI, but it addresses investment and other non-trade rights and obligations and its particulars are materially different from the GATT exceptions.

A set of three exceptions is contained in paragraph (2). These are all subject to the limitations that a measure in question must be nondiscriminatory and not a disguised restriction, and that it not unnecessarily impair benefits reasonably expected under the treaty. The first of these three exceptions, for measures necessary to protect human, animal or plant life or health, is further limited in that it does not apply to Part III on investment. The second exception, for short supply of "Energy Materials and Products" due to causes outside of the control of the Contracting Party, is subject to a condition of consistency with the principle that "all other Contracting Parties are entitled to an equitable share of the international supply...." The third exception is for measures to benefit investors who are aboriginal people or who are socially or economically disadvantaged.

Another set of three exceptions is contained in paragraph (3). This set of exceptions begins with a prefatory requirement that the Contracting Party "considers" it necessary to take the measure. And this set is subject to the limitation that a measure in question must not constitute a disguised restriction on transit. The first specific exception is for measures considered necessary for the protection of "essential security interests", including those relating to the supply of Energy Materials and Products to a military establishment or taken in time of war, armed conflict or other emergency in international relations. The second exception is for measures considered necessary with regard to nuclear non-proliferation. The third exception is for measures considered necessary for the maintenance of public order.

Finally, paragraph (4) provides that the most-favoured-nation requirements of the ECT shall not oblige any Contracting Party to extend to the *investors* of any other Contracting Party, any preferential treatment resulting from its membership in a free-trade area or customs union, or accorded by economic co-operation agreements among republics of the former Soviet Union pending the establishment of their mutual economic relations on a definitive basis. There is an important Conference Decision bearing upon this exception, discussed in paragraph 18 below.

18. "Economic Integration Agreements"

Paragraph (2) of Article 25 defines "Economic Integration Agreement" ("EIA") to mean an agreement "substantially liberalizing inter alia trade and investment, by providing for the absence of elimination of substantially all discrimination between or among parties thereto...." Paragraph (1) provides that a Contracting Party need not extend to another *Contracting Party* that is not a party to the EIA, under the ECT's most-favoured-nation provisions, any preferential treatment enjoyed under the EIA among the parties to it. As in the case of Article 24, Article 25 specifies that it shall not affect the application of the GATT according to Article 29.

Annexed to the Final Act and incorporated by reference into the treaty is a Decision which provides that an investment of an *investor* of a Contracting Party which is not a party to an EIA or a member of a free-trade area or customs union shall be entitled to treatment accorded under such EIA, free-trade agreement or customs union, where the investment:

> "(a) has its registered office, central administration or principal place of business in the Area of a party to that EIA or member of that free-trade area or customs union; or
>
> (b) in case it only has its registered office in that Area, has an effective and continuous link with the economy of one of the parties to that EIA or member of that free-trade area or customs union."

In addition, in a Final Act Declaration with respect to this article, the European Community and its member States recall the provisions of Article 58 of the Treaty of Rome according national treatment as to the right of establishment to certain kinds of firms present in the Community. They state that "the application of Article 25...will only allow those derogations necessary to safeguard the preferential treatment resulting from the wider process of economic integration...."

There also is a Final Act Understanding that is relevant both to Article 25 and to Article 24, which states that derogations from most-favoured-nation treatment "are not intended to cover measures which are specific to an investor or group of investors, rather than applying generally."

19. The Taxation Article

Article 21(1) provides that except as otherwise provided therein, nothing in the ECT imposes obligations with regard to a Contracting Party's domestic tax laws (or international tax agreements). The article then deals separately with the trade, investment and expropriation provisions of the ECT. In the case of Article 13 on expropriation, it allows full applicability of that article to taxes.

As concerns trade, paragraph (2) of Article 21 allows Article 29 to apply only to domestic tax laws or provisions of international tax agreements other than those on income or capital. It likewise allows the ECT's most-favoured-nation provisions "relating to trade in goods and services" to apply to such taxation measures other than those on income or capital, except where an advantage is conferred by an international tax agreement or the measure is aimed at the effective collection of taxes in a nondiscriminatory and unarbitrary manner.

As concerns the ECT's Part III investment provisions imposing national treatment or most-favoured-nation obligations, paragraph (3) allows these to apply to domestic tax laws or provisions of international tax agreements, except that most-favoured-nation treatment need not be accorded to advantages under an international tax agreement or resulting from membership in a Regional Economic Integration Organization, and neither most-favoured-nation nor national treatment need be accorded to a measure aimed at the effective collection of taxes in a nondiscriminatory and unarbitrary manner.

20. Transitional Arrangements

Article 32 sets out arrangements under which Contracting Parties that are among the twenty-four economies-in-transition listed in Annex T will enjoy temporary exceptions from obligations under certain provisions of the ECT. The only ECT provisions as to which the transitional arrangements could be claimed are the following:

Article 6, "Competition," paragraphs (2) and (5)
Article 7, "Transit," paragraph (4)
Article 9, "Access to Capital," paragraph (1)
Article 10, "Promotion, Protection and Treatment of Investments," paragraph (7), "specific measures"
Article 14, "Transfers Related to Investments," paragraph (1)(d), "related only to transfer of unspent earnings"
Article 20, "Transparency," paragraph (3)
Article 22, "State and Privileged Enterprises," paragraph (3)

The transitional exceptions that have been claimed from specific provisions by the economies-in-transition are described in Annex T; they are all identified in the previous paragraphs of this Note describing the obligations to which they pertain. A total of 50 temporary exceptions have been claimed by nineteen of the economies-in-transition. Some half of the exceptions pertain to the "Competition" article's requirements to have competition laws and institutions to enforce them; the "Transparency" article's requirement for "official enquiry points" through which information can be obtained is the next most claimed exception. About a half dozen States took exceptions from the "Transit" article's prohibition against placing obstacles in the way of establishing new transit capacity, and from the "Access to Capital Markets" obligation to "endeavour" to promote access to such markets. Only one State claimed an exception (for its specific measures) from the Article 10(7) requirement of the better of national or most-favoured-nation treatment of existing investment; two States took exceptions (for unspent earnings only) from Article 14's transfer of payments provisions; and one State took a narrowly focused exception from Article 22(3) concerning rules imposed on the exercise of delegated governmental authority.

Paragraph (3) says that each Contracting Party claiming transitional arrangements must list in Annex T, for each such provision, "the stages toward full implementation of each, the measures to be taken and the date or, exceptionally, contingent event, by which each stage shall be completed and measure taken...." Paragraph (3) further requires that the Contracting Party "shall take the measure listed by the date indicated for the relevant provision and stage...."

According to paragraph (3), Contracting Parties that have temporarily suspended full compliance with any such provision "undertake to fully comply with the relevant obligations by 1 July 2001." Once-yearly progress reports and annual progress reviews by the Charter Conference are provided for. Any extensions of time for compliance or amendments to Annex T must be approved by the Charter Conference; a three-fourths majority of the Contracting Parties present and voting would be needed.

Paragraph (2) of the article calls on other Contracting Parties to assist the relevant economies-in-transition, in whatever form the assisting parties consider most effective, in achieving conditions which eliminate the need for transition arrangements. The Conference Secretariat is to "circulate and actively promote, relying where appropriate on arrangements existing within other international organizations, the matching of needs and offers for technical assistance...", and the Conference is to annually review such matching.

RELATED AGREEMENTS

21. Protocols, Declarations and Association Agreements

Paragraph (1) of Article 33, "Energy Charter Protocols and Declarations," provides that the Charter Conference may authorize Protocols or Declarations "in order to pursue the objectives and principles of" the Energy Charter. "Protocol" is defined in Article 1(13)(a) as a treaty, the negotiation of which is authorized and the text of which is adopted by the Charter Conference, which is entered into by Contracting Parties to "complement, supplement, extend or amplify" the ECT. Any Charter signatory may join in the negotiation of a Protocol, but it may not become a party to the Protocol without becoming a Contracting Party to the ECT. Participation in any particular Protocol is at the option of each Contracting Party; paragraph (5) assures that a Protocol shall not derogate from the ECT rights of non-participating Contracting Parties.

Under paragraph (6) a Protocol may assign duties to the Charter Conference and functions to the Secretariat. A Protocol also may provide that decisions to be taken thereunder, which it assigns to the Charter Conference, shall be taken in the Conference under special voting rules, which may include a rule allowing only the parties to the Protocol to vote on the matter in the Conference. Article 37(4) requires that a Protocol contain provisions to assure that any costs of the Secretariat (which by definition include the Charter Conference's costs) arising from the Protocol are borne by the parties thereto.

"Declaration" is defined in subparagraph (b) of Article 1(13) as a "legally non-binding agreement" entered into by Contracting Parties "to complement or supplement the ECT", the negotiation of which is authorized and the issuance of which is approved by the Charter Conference. As in the case of Protocols, participation by Contracting Parties in Declarations is optional.

As indicated above a Protocol on "Energy Efficiency and Related Environmental Aspects" is to open for signature along with the ECT. This Protocol contains a provision that in the event of inconsistency between its provisions and the provisions of the ECT, the provisions of the ECT shall, to the extent of the inconsistency, prevail.

Negotiations are advanced on another proposed Protocol on "Principles Governing the Peaceful Uses of Nuclear Energy and the Safety of Nuclear Installations...." However, the Working Group in which this agreement has been negotiated is now considering whether it should instead be in the form of a Declaration.

A third possible Protocol, on "Hydrocarbons, " is further from completion, negotiations having been suspended some time ago.

An Understanding in the Final Act calls on the provisional Charter Conference to decide "at the earliest possible date how best to give effect" to the Charter's goal of negotiating Protocols in areas of co-operation identified in the Part III of the Charter.

Provision also is made in Article 43 for the negotiation of "Association Agreements" with States, Regional Economic Integration Organizations, or international organizations, "to pursue the objectives and principles of the Charter and the provisions of this Treaty or of one or more Protocols." The term "Association Agreement" is undefined, and paragraph (2) merely says that "[t]he relationship with and the rights enjoyed and obligations incurred" thereunder will depend on the particular circumstances and will be spelled out in the agreement.

INSTITUTIONAL ARRANGEMENTS

22. The Charter Conference

Article 34 provides that the Contracting Parties will meet "periodically" in "the Charter Conference." The functions of the Conference, enumerated in fourteen subparagraphs of paragraph (3), include not only specific duties such as approving the programme of work and budget and taking decisions concerning the Secretariat, but also some fairly broad general powers such as to "facilitate the implementation of the principles of the Charter and of the provisions of this Treaty and the Protocols," to "facilitate...the co-ordination of appropriate general measures to carry out the principles of the Charter," and to "encourage co-operative efforts aimed at facilitating and promoting market oriented reforms and modernization of energy sectors" in the economies-in-transition.

Unanimity of the Contracting Parties present and voting is necessary for certain specified Charter Conference decisions, including most treaty amendments, accessions to the ECT by States or Regional Economic Integration Organizations which have not signed the Charter by the ECT's closing date for signature, and changes to almost all Annexes. Article 36 expressly contemplates that other decisions will if possible be taken by consensus, but it sets out voting rules in case that is infeasible. The budget is to be approved by Contracting Parties whose assessed contributions represent a three-fourths majority of the total assessed contributions. And in the absence of a contrary specification in the ECT, decisions are to be taken under the treaty by a three-fourths majority of Contracting Parties present and voting. This last requirement, applies, *inter alia*, to amendments to the ECT's Article 34 and 35 provisions concerning the Charter Conference and Secretariat or to Annex T containing transitional exceptions, and to ECT accessions by those who were signatories to the Charter on the closing date for ECT signature.

Paragraph (4) contains the following guidance:

> "In the performance of its duties, the Charter Conference, through the Secretariat, shall co-operate with and make as full a use as possible, consistently with economy and efficiency, of the services and programmes of other institutions and organizations with established competence in matters related to the objectives of this Treaty."

Paragraph (7) directs that in 1999 and at intervals of not more than five years thereafter, the Charter Conference is to "thoroughly review the functions provided for in this Treaty" and "may amend or abolish" its own functions "and...discharge the Secretariat." Article 36(3) allows such decisions to be taken by an absolute three-fourths majority of the Contracting Parties.

23. The Secretariat

Article 35 provides for a Secretariat responsible to the Charter Conference, whose Secretary-General is to be appointed by it (initially for a maximum term of five years), and whose staff shall be "the minimum consistent with efficient operation." The Secretariat is empowered to enter into administrative and contractual arrangements.

The treaty imposes substantial responsibilities upon the Secretariat, many of which will have to be discharged by the provisional Secretariat from the very outset. These include, in addition to starting-up activities, administrative duties such as receiving notifications, keeping records, distributing information, appointing transit conciliators and trade dispute panelists, helping match technical assistance offsets and needs, or arranging for Charter Conference meetings, the first of which is to be held by mid-June. The Secretariat also will have to support new treaty negotiations, by itself a demanding task. Negotiation of the "second-phase" investment treaty is scheduled to commence *by 1 January*, as is the negotiation of an ECT amendment to bind Contracting Parties' energy tariffs; consideration of treaty coverage of trade in energy-related electrical and other equipment is supposed to begin at the first Charter Conference meeting (*i.e.*, by mid-June); a more general trade negotiation is expected to start before the ECT enters into force; and there is the possibility of Protocol or Declaration negotiations.

24. Funding

The costs of the Charter Conference and Secretariat are to be assessed annually on the basis of an adjusted version of the UN's "Regular Budget Scale of Assessment." Voluntary contributions also can be accepted, but they do not operate to reduce the annual assessments.

During provisional application the signatories (and any State or Regional Economic Integration Organizations that accede to the treaty) are required to contribute to the costs of the provisional Charter Conference and Secretaries as if the treaty was in force.