ELGAR COMMENTARIES

COMMENTARY ON THE ENERGY CHARTER TREATY

Second Edition

Edited by
Rafael Leal-Arcas

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ARTICLE 22

STATE AND PRIVILEGED ENTERPRISES[1]

Contributions by Costantino Grasso and Tina Hunter

(1) Each Contracting Party shall ensure that any state enterprise which it maintains or establishes shall conduct its activities in relation to the sale or provision of goods and services in its Area in a manner consistent with the Contracting Party's obligations under Part III of this Treaty.

(2) No Contracting Party shall encourage or require such a state enterprise to conduct its activities in its Area in a manner inconsistent with the Contracting Party's obligations under other provisions of this Treaty.

(3) Each Contracting Party shall ensure that if it establishes or maintains an entity and entrusts the entity with regulatory, administrative or other governmental authority, such entity shall exercise that authority in a manner consistent with the Contracting Party's obligations under this Treaty.

(4) No Contracting Party shall encourage or require any entity to which it grants exclusive or special privileges to conduct its activities in its Area in a manner inconsistent with the Contracting Party's obligations under this Treaty.

(5) For the purposes of this Article, 'entity' includes any enterprise, agency or other organisation or individual.

COMMENTARY

Costantino Grasso

Article 22, which deals with state-owned and privileged enterprises,[2] sets out a basic principle under which these companies, irrespective of their national status, have to carry out their business operations in a manner consistent with the rules provided by the Energy Charter Treaty (ECT). In practice, the ECT does not prevent in any way **22.01**

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1 See Final Act of the European Energy Charter Conference, Understanding 14 with respect to Arts 22 and 23.

2 Earlier drafts of the Treaty also included articles on monopolies and state aids; these have now been deleted. In the context of the interpretative understanding, this will allow state aids to be left in place so long as they do not conflict with domestic competition law. See Lorna Brazell, 'Draft Energy Charter Treaty: Trade, Competition, Investment and Environment,' (1994) 12(3) *Journal of Energy & Natural Resources Law* 318.

Contracting Parties from maintaining or establishing state-owned companies but prevents governments from using the controlled enterprises to circumvent the rules of the treaty and ensures that in their sales and procurements those entities act in accordance with the ECT investment protection provisions.[3]

22.02 Article 22 also provides for a fundamental rule of attribution in that it implies that, where state-owned and privileged enterprises operate in a way that violates ECT rules, the responsibility is attributed directly to the state.

22.03 The issues related to Article 22 can be considered as a question of great significance. Up to the end of the 1950s, the presence of state-owned enterprises was a phenomenon that characterized mainly communist countries. In addition, the most relevant state-owned enterprises fell commonly into the category of public utilities. In a few countries, including Mexico and Italy, such enterprises were more pervasive; whereas in a few others, including the UK, those type of enterprises represented legacies of the Great Depression or the Second World War.[4] However, it is possible to identify an emerging pattern in that state-owned enterprises are currently present in a wide range of industries both in the advanced industrialized countries and in the developing nations, and they occupy a central role in many key economic areas.[5] In particular, state-owned enterprises have always played a dominant role in the energy sector due to the crucial geopolitical importance that energy resources have always had because of the asymmetric distribution of reserves, production and consumption of natural resources around the globe.[6] As a matter of fact, governments tend to create state-owned enterprises as a means of developing or maintaining industrial sectors having strategic importance, that private companies are unable to defend or where the presence of foreign-owned corporations is not considered acceptable.[7] Consequently, it is not surprising that privileged and licensed energy monopolies dominate the energy industry, in particular, the 'natural monopolies' of energy transport and distribution.[8]

22.04 A vexed question raised by Article 22 is represented by the absence of a universally accepted definition of state-owned enterprise. At the international level, no attempt to define the notion of state-owned enterprise has been successful so far. Such conceptual problems generate, in turn, practical issues related to the difficulties of assessing

3 See Sumio Kozawa, 'Depoliticization of International Dispute Settlement – A Comparison of the Dispute Settlement Provisions of the WTO and the Energy Charter Treaty,' (2002) 3(5) *Journal of World Investment* 799.

4 See Raymond Vernon, 'The International Aspects of State-Owned Enterprises.' (1979) 10(3) *Journal of International Business Studies* 7.

5 Ibid.

6 See Costantino Grasso, 'The Dark Side of Power: Corruption and Bribery within the Energy Industry,' in Rafael Leal-Arcas and Jan Wouters (eds), *Research Handbook on EU Energy Law and Policy* (Edward Elgar, 2017), 245.

7 See Raymond, *supra* note 4, 8.

8 See Thomas Wälde, 'Energy Charter Treaty-based Investment Arbitration: Controversial Issues,' (2004) 5 *The Journal of World Investment and Trade* 405.

whether or not a certain corporation is a state enterprise. As an example of such complexity it is possible to mention that, although the countries negotiating the Trans-Pacific Partnership agreed the percentage of government ownership ought to be the key criterion delineating a state-owned enterprise, they could then not agree on a given percentage figure.[9] The absence of a universal definition of state-owned enterprises and the differences in the way in which such companies are regulated by national legislations generate a significant level of confusion in assessing the real nature of some companies, which in turn influence the identification of the subject that has to be deemed liable for violating the established international rules.

22.05 An example of these conceptual difficulties and their practical consequences is offered by the case *Emilio Agustín Maffezini v. The Kingdom of Spain*[10] brought before the International Centre for Settlement of Investment Disputes,[11] which arose in the context of the Argentine-Spain Bilateral Investment Treaty. The Kingdom of Spain tried to rely on the structure of the Spanish public administration to argue that the involved company – SODIGA – was not to be considered as a state-owned enterprise but as a merely financial company created as a private corporation.[12] In order to support such an argument, it was invoked Article 2 of the domestic statute (Law 30/92) establishing the legal regime of public administrations in Spain. Specifically, it was pointed out that companies like SODIGA did not fall under the criteria set out by the above-mentioned national legislation.[13] However, the tribunal, applying both a structural and a functional test,[14] found that SODIGA was a state entity acting on behalf of the Kingdom of Spain. In order to reach such a conclusion, the tribunal applied both a structural and a functional test.[15] As regards the former, it was demonstrated that in Spain a variety of public entities existed that were governed by private law but occasionally exercised public functions governed by public law, and that they represented a mixed category of public entities operating under a private law regime that had always given rise to great confusion.[16] From a functional point of view, the elements on which the tribunal focused where the control of the company by the state or state entities,

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9 See Raj Bhala, 'TPP, American National Security and Chinese SOEs,' (2017) 16(4) *World Trade Review* 5.

10 See *Emilio Agustín Maffezini v. The Kingdom of Spain*, Argentine-Spain BIT, Award on the Merits, Case No ARB/97/7, 13 November 2000. https://www.italaw.com/sites/default/files/case-documents/ita0481.pdf, accessed 4 July 2018.

11 The International Centre for Settlement of Investment Disputes is the world's leading institution devoted to international investment dispute settlement. It was established in 1966 by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, which is a multilateral treaty formulated by the Executive Directors of the World Bank. See World Bank Group. *About ICSID*. https://icsid.worldbank.org/en/Pages/about/default.aspx, accessed 4 July 2018.

12 Ibid., at para 47.

13 Ibid.

14 Ibid., at para 46.

15 Ibid., at para 46.

16 Ibid., at para 48.

and the objectives and functions for which the company was created.[17] Specifically, the tribunal found that, although some SODIGA's functions were essentially commercial in character, a number of other functions performed by the company were governmental in nature[18] (e.g., SODIGA was an entity charged with the implementation of governmental policies relating to industrial promotion).[19] As a result, the tribunal held that the responsibility for the actions carried out by SODIGA had to be attributed to the Kingdom of Spain.[20]

22.06 The definition of 'an entity of a State' is also offered in *Salini v. Morocco*, in which an ICSID Tribunal had to consider contractual and treaty claims on the basis of a bilateral investment treaty concluded between Italy and Jordan.[21] The Kingdom of Morocco alleged that the arbitral tribunal lacks *ratione personae* jurisdiction because the action was founded on acts attributed to the *Societe Nationale des Autoroutes du Maroc* (ADM), which was not a state entity.[22] The Kingdom of Morocco argued that ADM was a private legal entity, with its own assets and personality.[23] Consequently, the fact that the state exercised its rights as shareholder and licensor should not have any effect on the legal autonomy of ADM. Similarly, the nature of the public procurement contract, which automatically follows from any construction works contract within the public domain, should have no influence on ADM's nature, nor should the levying of a special tax, the benefit of which might be granted to public or private legal entities. On the contrary, the Italian companies alleged that ADM was a public legal entity, notwithstanding its incorporation as a limited liability company.[24] The composition of its assets and its Board of Directors at the time of its creation and the direct involvement of the Minister of Infrastructure in all fundamental decision-making relating to the contract established the active participation of the state. In particular, the construction contract at issue was governed by national rules known as *Cahier des Clauses Administratives Generales* (CCAG),[25] so that all the works were carried out on behalf of the state and fell under the jurisdiction of the administrative courts. This logically implied that it was a public procurement contract. Therefore,

17 Ibid., at para 50.
18 Ibid., at para 57.
19 Ibid., at para 78.
20 Ibid., at para 83.
21 See *Salini Costruttori S.P.A. and Italstrade S.P.A. v. Kingdom of Morocco*, Italy-Morocco BIT, Award on the Merits, Case No. ARB/00/4, 13 July 2001. https://www.italaw.com/sites/default/files/case-documents/ita0738.pdf, accessed 4 July 2018.
22 The Societe Nationale des Autoroutes du Maroc (ADM) was incorporated in 1989 as a limited liability company aiming at building, maintaining and operating highways and various road-works. Its business operations were carried out on behalf of the state in accordance with the Concession Agreement concluded with the Minister of Infrastructure and Professional and Executive Training. See ibid., at para 2.
23 Ibid., at para 28.
24 Ibid., at para 29.
25 Ibid.

as argued by the Italian companies, ADM was directly or indirectly financed by the Kingdom of Morocco, and the road network construction projects were accounted for by the state.[26] Thus, from the Italian perspective, being a public entity bound by a public procurement contract, all the conditions required to assimilate ADM to the state were satisfied. In order to determine the degree of control and participation of a state in a company, the ICSID Tribunal, referring to the ICSID award rendered in the above-mentioned case *Emilio Agustín Maffezini v. The Kingdom of Spain*, considered that it had to take into account the international rules governing the liability of states.[27] The assessment of the degree of state control and participation in a company was, again, based on two criteria: the first, structural, related to the structure of the company and, in particular, to its shareholders; the other, functional, related to the objectives of the company in question.[28] Therefore, in the case at issue, from a structural point of view, the tribunal considered that the Kingdom of Morocco, through the medium of the Treasury and various public entities, held at least 89 per cent of ADM.[29] Also, regarding the management of ADM, the majority stake of the Moroccan State in the company's Board of Directors translated into control *de facto* of the latter.[30] Consequently, from a structural point of view, the ICSID Tribunal affirmed that ADM was an entity controlled and managed by the Moroccan State through the medium of the Minister of Infrastructure and various public organs.[31] From a functional point of view, its Memorandum and Articles of Association made it clear that ADM's main object was to accomplish tasks that were under state control (building, managing and operating of assets falling under the province of the public utilities responding to the structural needs of the Kingdom of Morocco with regard to infrastructure and efficient communication networks).[32] In virtue of what has been set out above, the tribunal held that ADM was an entity, from a structural as well as a functional point of view, which was distinguishable from the state solely on account of its legal personality.[33] In particular, in the following passage the tribunal clarified that the model of corporate structure is irrelevant as to assess whether or not a firm can be considered a state-owned enterprise:

> The fact that a State may act through the medium of a company having its own legal personality is no longer unusual if one considers the extraordinary expansion of public authority activity. In order to perform its obligations, and at the same time take into account the sometimes diverging interests that the private economy protects, the State uses a varied spectrum of modes of organisation,

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26 Ibid.
27 Ibid., at para 31.
28 Ibid.
29 Ibid., at para 32.
30 Ibid.
31 Ibid.
32 Ibid., at para 33.
33 Ibid, at para 35.

among which are in particular semi-public companies, similar to ADM, a company mostly held by the State which, considering the size of its participation (over 80 per cent), directs and manages it.[34]

22.07 Some authors suggest to distinguish between private and state companies using the criteria provided by the General Agreement on Tariffs and Trade framework (GATT) of 1994[35] and EU competition law under which the decisive question is if a conduct displays normal 'business judgment' or the 'market investor principle,' or if it is characterized significantly by public policy concerns.[36]

22.08 Even within the EU there is not strict definition applicable to state-owned enterprises. In the opinion of the European Economic and Social Committee on 'the unexplored economic potential of EU competitiveness – reform of state-owned enterprises', it is clarified that the notion of state-owned enterprises is related to the general concepts of 'state aid and services of general economic interest'.[37]

22.09 In that regard, it is emblematic that the Report from the European Commission on the state of play in the work on the guidelines for state aid and services of general economic interest (SGEIs) of 2002 specifies that 'in the absence of Community rules in this area, Member States have wide discretionary powers when it comes to defining their SGEIs in the light of their political choices and in line with the general principles of the Treaty'.[38]

22.10 In conclusion, it is possible to affirm that, irrespective of the definition applied, the distinguishing feature of state-owned enterprises consists in the fact that they enjoy a series of privileges in their home countries that private firms cannot exercise such as direct support, preferential financing, selective enforcement of laws, or regulatory exemptions.[39]

22.11 Having said that, it is not surprising that Article 22, instead of providing a definition of 'state and privileged enterprises', has offered a general guiding principle in order to

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34 Ibid.

35 The original General Agreement on Tariffs and Trade (GATT) was signed in April 1947 in Geneva. After several rounds, the agreement was updated in 1994. The most significant change that was included in GATT 1994 was the creation of the World Trade Organization (WTO), which was established in 1994 by the Marrakesh Agreement and came into existence in 1995. See Rafael Leal-Arcas, Costantino Grasso and Juan Alemany Ríos, *Energy Security, Trade and the EU: Regional and International Perspectives* (Edward Elgar 2016) 55.

36 See Thomas Wälde, 'Energy Charter Treaty-based Investment Arbitration: Controversial Issues,' (2004) 5 *The Journal of World Investment and Trade* 406.

37 See European Economic and Social Committee, 'Opinion of the European Economic and Social Committee on The unexplored economic potential of EU competitiveness – reform of state-owned enterprises' (exploratory opinion).' OJ C 327/01, 12/11/2013, para 2.2.

38 See European Commission, 'Report from the Commission on the state of play in the work on the guidelines for state aid and services of general economic interest (SGEIs).' 2002, para 4.1. Available at http://ec.europa.eu/competition/state_aid/studies_reports/sieg_en.pdf, acccessed 4 July 2018.

39 See Bhala, *supra* note 5.

address the business interactions between state-owned enterprises and private companies, and avoid any unfairness due to the presence of such particular market players. As a matter of fact, it aims at ensuring that the Contracting States shall require state-owned enterprises to conduct their activities in a manner consistent with the Contracting State's obligations under the ECT.

22.12 The fact that Article 22 serves the purpose of setting a general guiding principle to avoid any unfair business operation carried out through state-owned enterprises emerges clearly also from the alternative proposals for its drafting as submitted to the European Energy Charter Secretariat during the ECT preparatory works. For instance, in the Note from the European Energy Charter Secretariat of 18 September 1992 it was proposed to include the following text: 'Each Contracting Party undertakes that if it grants to any entity exclusive or special privileges, in the field of energy, such entity shall conduct its activities in a manner consistent with this Agreement.'[40] Another proposal, which was included in the same document, suggested the following alternative text: 'Any Contracting Party shall be free to participate in energy activities through direct participation by the Government or through government-controlled investors. Such Investors may be granted exclusive or special privileges in this respect. In such cases, they shall conduct these activities in a manner consistent with this Agreement.'[41]

22.13 In reality, Article 22 reiterates the general international law rules on state responsibility, which are customary in nature[42] but have been codified in 2001[43] by the International Law Commission (ILC) established by the United Nations General Assembly.[44] As a matter of fact, the subject of state responsibility has always been regarded as a major area of interest in the development of international law. In 2001, at its 53rd session, the Commission adopted the final version of the text, consisting of 59 Articles.[45] Then, by resolution 56/83 of 12 December 2001, the General Assembly took note of the

40 European Energy Charter Conference Secretariat, *Note from the Secretariat*, 40/92, BA-18, 18 September 1992, p. 38. https://energycharter.org/fileadmin/DocumentsMedia/ECT_Drafts/9_-_BA_18__18.091992_.pdf, acccessed 4 July 2018.

41 Ibid., p. 39.

42 In international law, customary law can be defined as a law created by a usual or habitual course of action or a long-established practice occurring among states where such a repetition of the conduct is accompanied by the shared conviction that it constitutes the fulfilment of a duty or the exercise of a right. See Hans Kelsen, *Principles of International Law*, 2nd edition (Holt, Rinehart and Winston, 1966), p. 440.

43 International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts, GA res. 56/83 (12 December 2001), Annex.

44 The International Law Commission was established in 1947 by the General Assembly of the United Nations to undertake the mandate of the Assembly, under Art 13 (1) (a) of the Charter of the United Nations to 'initiate studies and make recommendations for the purpose of ... encouraging the progressive development of international law and its codification'. See United Nations. International Law Commission. <http://legal.un.org/ilc/>.

45 See International Law Commission, 'Responsibility of States for Internationally Wrongful Acts.' 2001. http://legal.un.org/ilc/texts/instruments/english/draft_articles/9_6_2001.pdf, acccessed 4 July 2018.

Articles, the text of which was annexed to the resolution, and commended them to the attention of governments.

22.14 In particular, the ILC's document establishes the fundamental postulates defining the basic features of state responsibility for internationally wrongful acts by identifying a set of criteria under which it is possible to attribute a certain conduct to a state. Specifically, the provisions of Chapter II of Part One specify the scope of this concept, both from a subjective and a functional point of view.[46] Those criteria include inter alia: Article 4, under which the conduct of any state organ (person or entity) shall be considered as an act of that state under international law whatever position it holds in the organization of the state; Article 5, which provides that the conduct of a person or entity which is not an organ of the state but is empowered by the law of that state to exercise elements of the governmental authority shall be considered an act of the state under international law; and Article 8, under which the conduct of a person shall be considered an act of a state under international law if the person is in fact acting on the instructions of, or under the direction or control of, that state in carrying out the conduct.[47]

22.15 The rationale behind the above-mentioned provisions is to prevent a state from invoking domestic law as a defence against the violation of an international obligation in relation to contracts or other acts undertaken by state entities.[48] The same principle is provided under Article 27 of the Vienna Convention on the Law of Treaties,[49] which is entitled 'Internal Law and Observance of Treaties' and specifies that: 'A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.'[50]

22.16 Therefore, the provision of Article 22 aims at resolving the vexed issue of attribution, which is the assessment as to whether the conduct of a state-owned enterprise towards a foreign investor can be attributed to the state with the effect that the state is responsible for that conduct as if it were its own.[51] In other words, it consists in determining

46 See James Crawford, *Introductory Note to the Articles on Responsibility of States for Internationally Wrongful Acts*. United Nations Audiovisual Library of International Law, 2001, p. 4. <http://legal.un.org/avl/ha/rsiwa/rsiwa.html>.

47 See International Law Commission, *supra* note 45.

48 See Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press, 2012), p. 220.

49 The convention was adopted due to the fundamental role that treaties had assumed in the history of international relations as well as their ever-increasing importance as a source of international law. It represents one of the major international law reform of the last century. See Keith Kenneth, 'Bilateralism and Community in Treaty Law and Practice,' in Ulrich Fastenrath et al. (eds), *From Bilateralism to Community Interest* (Oxford University Press, 2011), p. 754.

50 See United Nation Treaty Collection, 'Vienna Convention on the Law of Treaties (with annex). Concluded at Vienna on 23 May 1969.' Article 27. <https://treaties.un.org/doc/publication/unts/volume%201155/volume-1155-i-18232-english.pdf> acccessed 4 July 2018.

51 See Wälde, *supra* note 8.

to which subject – the state-owned enterprise or the government – the responsibility should be attributed where the firm carries out its business operations in a manner inconsistent with the ECT. Article 22 makes it clear that the obligation of ensuring that state enterprises carry out their business activities in a manner consistent with the ECT represents a duty of the state. This conclusion is also backed by the principles of customary international law as codified by the International Law Commission's Draft Articles on State Responsibility.

22.17 This solution has been consistently used also within other international contexts. For instance, Chapter Fifteen of the North American Free Trade Agreement (NAFTA),[52] which is entitled 'Competition Policy, Monopolies and State Enterprises,' provides that: 'Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any privately owned monopoly that it designates and any government monopoly that it maintains or designates acts in a manner that is not inconsistent with the Party's obligations.'[53] Such a provision, resembling the one adopted by Article 22, has been construed in another decision taken by the ICSID in the following way:

> The particular provisions of chapter 15 themselves distinguish in their operation between the Party on the one side and the monopoly or enterprise on the other. It is the Party which is to ensure that the monopolies or enterprises meet the Party's obligations stated in the prescribed circumstances. The obligations remain those of the State Party; they are not placed on the monopoly or enterprise.[54]

22.18 The analysis of two cases that have dealt with Article 22 ECT can help understand how the issues raised by this article have been addressed in practice.

22.19 In *Nykomb Synergetics Technology Holding AB v. The Republic of Latvia*,[55] the transaction between Nykomb and Latvenergo (a Latvian State Joint-Stock Company) took

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52 The North American Free Trade Agreement (NAFTA) came into effect on 1 January 1994 among three contracting parties: Canada, Mexico and the US. It represents a trading bloc that now links 450 million people, producing USD 17 trillion worth of goods and services. See Leal-Arcas, Rafael, Grasso, Costantino and Alemany Rios, Juan. *Energy Security, Trade and the EU: Regional and International Perspectives* (Edward Elgar 2016) 92.

53 See the NAFTA, Art 1502(3)(a).

54 See *United Parcel Service of America v. Government of Canada*, NAFTA/UNICTRAL, Award on the Merits, Case No. UNCT/02/1, 11 June 2007, p. 31. https://www.italaw.com/sites/default/files/case-documents/ita0885.pdf, accessed 4 July 2018.

55 On 24 March 1997 Nykomb Synergetics Technology Holding AB, a Sweden company, entered into an agreement with the State Joint-Stock Company Latvenergo, which was originally organized as a state enterprise under Latvian law in 1991, and was in 1993 transformed into a joint stock company under Latvian law. The Republic of Latvia owned 100 per cent of the shares in Latvenergo. By an amendment of 3 August 2000 to the Latvian Energy Law the company was defined as 'a national economy object of the State economy' that shall not be privatized. According to the agreement, Nykomb accepted to build a cogeneration plant in the town of Bauska, which was to produce electric power and heat on the basis of natural gas, the electric power to be purchased by Latvenergo and distributed over the national grid, and the heat to be purchased and distributed by the Bauska municipality. In 1999 the plant was built and was ready to start but a dispute arose over the purchase price to be paid by Latvenergo. After unsuccessful attempts to reach an amicable settlement Nykomb on 11 December 2001 requested arbitration at the Stockholm Chamber of

place in a public-service market dimension. The arbitral tribunal noted that, as highlighted by the claimant, the operation by which the conduct of Latvenergo was treated as if it were an integral part of the state and by which the veil of its corporate personality was pierced (or lifted) was based on customary international law (applicable under Art 26 (6) of the Treaty), the State Responsibility draft of the International Law Commission, as well as on Article 22 (1, 3 and 4) of the Treaty, that however merely reinforced the special attribution norm set out by the former.[56] Also, the respondent's argument by which the arbitral tribunal had no jurisdiction on the ground that Article 22 was placed in Part IV of the Treaty, which merely focuses on administrative and legal arrangements, whereas Article 26, which regulates the settlement of disputes between an investor and a contracting party, required that the claims had to be based on alleged breaches of the rules on international cooperation as established under Part III of the Treaty, was dismissed.[57] As a matter of fact, the arbitral tribunal noted that the claimant had stated that the provisions Article 22 did not give rise to any separate claim, but were rather invoked as provisions which clarified the scope and contents of other treaty provisions, among them the ones included in Part III of the Treaty. The tribunal found that the interpretation and application of the relevant articles of the ECT, Articles 10 and 13, were best considered under the merits part of the award, and that the references to Article 22 could not be dismissed as such as inadmissible in the form the references were relied on.[58]

22.20 In *Petrobart Ltd v. The Kyrgyz Republic*,[59] the claimant asserted that the Republic had failed to ensure that its state enterprise conducted its activities in a manner consistent with the Republic's obligations under Part III of the Treaty (Art 22(1) of the Treaty). As a matter of fact, *Kyrgyzgazmunaizat* (KGM) was a state-owned enterprise, maintained and established and indeed wholly controlled by the Kyrgyz Republic. KGM, by failing to honour its contractual commitments when due, had acted in a manner inconsistent with the Republic's obligations under Part III of the Treaty, having particularly failed to observe the agreement it entered into with an investor (last sentence

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Commerce in accordance with Art 26.4.c of the ECT. See *Nykomb Synergetics Technology Holding AB v. The Republic of Latvia*, Energy Charter Treaty (ECT), Arbitral Award, 16 December 2003. https://www.italaw.com/sites/default/files/case-documents/ita0570.pdf, acccessed 4 July 2018.

56 Ibid., at para 1(2)(3).

57 Ibid.

58 Ibid., at para 2(3).

59 Petrobart Ltd, registered in Gibraltar, contracted with Kyrgyzgazmunaizat (KGM), the Kyrgyz state gas company, to supply 200,000 tons of gas condensate. Petrobart made five deliveries but was only paid for the first two as KGM was in severe financial difficulties. Therefore, in 2003 Petrobart submitted a request for arbitration against the Kyrgyz Republic to the Arbitration Institute of the Stockholm Chamber of Commerce under the Energy Charter Treaty, claiming, inter alia, the acts of the Kyrgyz Republic breached the obligations of Art 22 ECT aiming to ensure that a state enterprise conducts its activities in a manner consistent with the Republic's obligations under Part III (Art 22(1)). See *Petrobart Ltd v. The Kyrgyz Republic*, Energy Charter Treaty (ECT), SCC Case No. 126/2003, Arbitral Award, 29 March 2005. <https://www.italaw.com/sites/default/files/case-documents/ita0628.pdf>, acccessed 4 July 2018.

of Art 10(1)). As a consequence, under Article 22(1) of the Treaty, from the claimant's point of view the contracting state had to assume liability for the acts of the state-owned entity.[60]

22.21 The case at issue poses an interesting question concerning the relationship between Article 10(1) and Article 22 of the ECT. As some authors argued, the last sentence of Article 10(1), the so-called 'umbrella clause,' emphasises the principle of *pacta sunt servanda* by making it an obligation of each Contracting Party to 'observe any obligations it has entered into with an Investor or an Investment of an Investor of any other contracting party'. Thus, a breach of such an obligation covered by Article 10(1) may constitute a violation of a Contracting Party's obligations under the ECT. It could also be argued that the umbrella clause of Article 10(1), when read together with Article 22, may have far-reaching implications on commercial contracts for the sale of goods, delivery of services, etc. which have been entered into by an investor and a legal entity controlled or owned by the host state. In the light of Article 10(1), assuming a wide interpretation of the umbrella clause, it could be argued that the host state may become responsible under the ECT (in addition to any liability of the state-owned company under the commercial agreement) for a wide range of actions or omissions of state enterprises in the fulfilment of agreements for the sale of goods and delivery of services, and so on.[61]

22.22 In any case, the tribunal rejected the claim under Article 22(1) that the Republic failed in its obligation to ensure that the state enterprise KGM conducted its business in a manner consistent with Part III of the Treaty, highlighting how Article 22(1) of the Treaty could not be read as an effective sovereign guarantee by the Kyrgyz Republic of KGM's debt. This article merely required a Contracting Party that owned a state enterprise to ensure that the state enterprise acted consistently with Part III of the Treaty. The Republic's obligations under Part III were, in essence, to refrain from expropriation and to accord national treatment to companies from other Contracting Parties. KGM's insolvency, which existed prior to the effective date of the Treaty and which was not caused by the Republic, did nothing to breach those Part III obligations.[62]

22.23 It has to be mentioned that in relation to the hypothesis of trade in energy materials and products[63] and energy-related equipment[64] between Contracting Parties, where at

60 Ibid., at Part VII, 1(D).

61 See Kaj Hober, 'Investment Arbitration and the Energy Charter Treaty,' (200) 1(1) *Journal of International Dispute Settlement* 159.

62 See *Petrobart Ltd, supra* note 59.

63 A list of energy materials and products is included in Annex EM I107 to the ECT. Such a list includes: nuclear energy, coal, natural gas, petroleum and petroleum products, electrical energy, and other energy sources like Fuel wood and Wood charcoal.

64 A list of energy-related equipment is included in Annex EQ I to the ECT.

least one of them is not a member of the WTO, Article 29 of the ECT establishes that the provisions of the WTO Agreement shall be applied. In particular, Understanding No. 14 included in the Final Act of the ECT has clarified that, for the cases that fall under the provision of Articles 29, Article XVII of GATT 1994 will apply instead of Article 22 of the ECT. Specifically, Article XVII GATT establishes that, where a Contracting Party establishes or maintains a state enterprise, it undertakes that 'such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports and exports by private traders'.[65]

22.24 Finally, due to the fact that WTO Members could express preference for WTO rules when enacting different treaties,[66] a cornerstone of the ECT trade regime is represented by the non-derogation from WTO rules.[67] Specifically, in Article 4 of the ECT, the Contracting Party have expressly opted for such a choice. The provision includes a non-derogation from WTO Agreement clause establishing that: 'Nothing in this Treaty shall derogate, as between particular Contracting Parties which are members of the WTO, from the provisions of the WTO Agreement as they are applied between those Contracting Parties.' As a result, for trade among parties to the GATT, Article 4 of the ECT safeguards the continued applicability of the provisions included in the General Agreement on Tariffs and Trade framework, generating, in practice, the same legal effects achieved for non-parties to the GATT by the above-mentioned Understanding No. 14.[68]

COMMENTARY

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22.25 Many ECT member states continue to have state-owned enterprises which play a major role in the energy industry. The role of Article 22 is to ensure that the impact or influence of state-owned enterprise (SOE) is no greater than that of a privately owned corporation, and that the state does not use a SOE to exert dominance in the energy system, or subsume a monopolistic position. To that end, Article 22(1) of the ECT requires that any state enterprise conducts its operations consistently with

65 See General Agreement on Tariffs and Trade 1994, Art XVII 1(a).

66 See Joost Pauwelyn, 'The Application of Non-WTO Rules of International Law in WTO Dispute Settlement,' in Patrick F.J. Macrory, Arthur E. Appleton, and Michael G. Plummer (eds), *The World Trade Organization: Legal, Economic and Political Analysis* (Springer, 2007), p. 1419.

67 See Yulia Selivanova 'The Energy Charter and the International Energy Governance,' in Yulia Selivanova (ed.), *Regulation of Energy in International Trade Law: WTO, NAFTA, and Energy Charter* (Wolters Kluyer, 2011), p. 376.

68 See Wälde, *supra* note 8, p. 488.

Articles 10–17 of the ECT. Furthermore, Article 22(2) of the ECT requires that no Contracting Party encourages a SOE to act in a manner inconsistent with its obligation under the ECT. Further, if a SOE holds a regulatory or administrative role, the SOE is required to exercise the authority granted to it in a manner that is consistent with the contracting Party's obligations under the ECT.[69] If a SOE is in involved in the provisions of goods and services, then that entity must act in accordance with the national treatment provisions of Article 10.[70]

22.26 Wälde notes that international law is generally ill-equipped to deal with the complex issues arising out of the wrongful acts of non-state actors in the area of international economic law.[71] In order to address the wrongful acts of a state, the rules of attribution in international law are laid out in the ILC Draft Articles on State Responsibility.[72] However, Article 22 of the ECT creates an obligation for the state to be responsible for the conduct of its state enterprises and entities in energy transactions. Wälde notes that by making the state responsible for regulating and supervising the activities of state and privileged enterprises, the ECT solves the problems inherent in the attribution-based approach to international responsibility under international law.[73]

22.27 Article 22 of the ECT, therefore, forces a contracting state to be liable for its failure to ensure that their SOEs comply with the trade and investment provisions of the ECT. This provides assurance to investors making an energy investment in a member state, since there are no attribution requirements for the state's wrongful acts where the member state has breached the provisions of the ECT, an investor is provided access to dispute resolution measures in investments with State and privileged enterprises. Such a remedy is available under Article 26 of the ECT.

22.28 Article 22 has been utilised by a number of contracting parties for claims. Such cases include:

Nykomb v. Latvia.[74] This case addressed the activities of Latvenergo, Latvia's state-owned enterprise were attributable to the state. The tribunal held in the affirmative.

Petrobart Ltd v. The Kyrgyz Republic.

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69 ECT, Art 22(3).

70 ECT Arts 2292), 22(3) and 22(4).

71 See Thomas Wälde and Patricia Wouters, 'State Responsibility and the Energy Charter Treaty: The Rules Regarding State Enterprises, Entities, and Subnational Authorities,' (1997) 2 *Hofstra Law and Policy symposium* 117, 130.

72 In particular see Arts 3–10. International Law Commission, Draft Articles on Responsibility of States for Internationally Wrongful Acts (2001).

73 Wälde and Wouters, *supra* note 71, p. 128.

74 *Nykomb Synergetics Technology Holding AB v Latvia*, Stockholm Rules (Energy Charter Treaty) Award, 16 December 2003, Stockholm Intl Arb Rev 2005.