9. Part III: Investment Promotion and Protection

A. Article 10: Promotion, Protection and Treatment of Investments

1) Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.
2) Each Contracting Party shall endeavour to accord to Investors of other Contracting Parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (3).
3) For the purposes of this Article, 'Treatment' means treatment accorded by a Contracting Party which is no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is the most favourable.
4) A supplementary treaty shall, subject to conditions to be laid down therein, oblige each party thereto to accord to Investors of other parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (3). That treaty shall be open for signature by the states and Regional Economic Integration Organisations which have signed or acceded to this Treaty. Negotiations towards the supplementary treaty shall commence not later than 1 January 1995, with a view to concluding it by 1 January 1998.
5) Each Contracting Party shall, as regards the Making of Investments in its Area, endeavour to:
   a) limit to the minimum the exceptions to the Treatment described in paragraph (3);
   b) progressively remove existing restrictions affecting Investors of other Contracting Parties.
6) a) A Contracting Party may, as regards the Making of Investments in its Area, at any time declare voluntarily to the Charter Conference, through the Secretariat, its intention not to introduce new exceptions to the Treatment described in paragraph (3).
   b) A Contracting Party may, furthermore, at any time make a voluntary commitment to accord to Investors of other Contracting Parties, as regards the Making of Investments in some or all Economic Activities in the Energy Sector in its Area, the Treatment described in paragraph (3). Such Commitments shall be notified to the Secretariat and listed in Annex VC and shall be binding under this Treaty.

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7) Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable.
8) The modalities of application of paragraph (7) in relation to programmes under which a Contracting Party provides grants or other financial assistance, or enters into contracts, for energy technology research and development, shall be reserved for the supplementary treaty described in paragraph (4). Each Contracting Party shall through the Secretariat keep the Charter Conference informed of the modalities it applies to the programmes described in this paragraph.
9) Each state or Regional Economic Integration Organisation which signs or accedes to this Treaty shall, on the date it signs the Treaty or deposits its instrument of accession, submit to the Secretariat a report summarising all laws, regulations or other measures relevant to:
   a) exceptions to paragraph (2); or
   b) the programmes referred to in paragraph (8).

   A Contracting Party shall keep its report up to date by promptly submitting amendments to the Secretariat. The Charter Conference shall review these reports periodically.

   In respect of subparagraph (a) the report may designate parts of the energy sector in which a Contracting Party accords to Investors of other Contracting Parties the Treatment described in paragraph (3). In respect of subparagraph (b) the review by the Charter Conference may consider the effects of such programmes on competition and Investments.
10) Notwithstanding any other provision of this Article, the treatment described in paragraphs (3) and (7) shall not apply to the protection of Intellectual Property; instead, the treatment shall be as specified in the corresponding provisions of the applicable international agreements for the protection of Intellectual Property rights to which the respective Contracting Parties are parties.
11) For the purposes of Article 26, the application by a Contracting Party of a trade-related investment measure as described in Article 5(1) and (2) to an Investment of an Investor of another Contracting Party existing at the time of such application shall, subject to Article 5(3) and (4), be considered a breach of an obligation of the former Contracting Party under this Part.
12) Each Contracting Party shall ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to Investments, investment agreements, and investment authorisations.

Outline

I. Introduction

Part III of the ECT sets forth the provisions on substantive protection of investments. Part III is entitled 'Investment Promotion and Protection'.

Promotion and protection of investments are of course different things, certainly from a legal perspective. As a matter of *policy*, promotion and protection of investments are closely linked. That explains why the two concepts are addressed in one and the same article of the ECT: Article 10, which is entitled 'Promotion, Protection and Treatment of Investments'.

Promotion of investment is concerned with attracting and permitting foreign investments. Protection of investment deals with the way in which investments must be treated, once they have been made. In the ECT there is a distinction between the two concepts. The provisions which are dealing with promotion of investments are so-called soft law understandings, that is to say that the Contracting Parties *agree to endeavour to achieve* certain results. This essentially means that the obligations concerning the promotion of investments are not enforceable under the dispute settlement mechanism laid down in Article 26 of the ECT. The provisions dealing with investment protection, on the other hand, are usually referred to as so-called hard law provisions. Among other things the application of this dispute settlement mechanism presupposes that an investment has already been made.[1]

The promotion of investments is addressed in the first sentence of Article 10(1) where reference is made to 'make Investments, which in turn is a reference to 'Make Investments' and 'Making Investments' as defined in Article 1(8) of the ECT. [2] Further provisions on Making Investments are found in paragraphs (2), (3), (4), (5), (6) of Article 10.

As far as the protection of investments is concerned, Article 10(1) identifies five specific obligations for Contracting Parties with respect to Investments, i.e. with respect to investments meeting the requirements made under Article 1(6) of the ECT.[3] The obligations correspond to the following standards of treatment of Investments:

– fair and equitable treatment;
– most constant protection and security;
– no unreasonable or discriminatory measures;
– treatment no less favourable than that required by international law, including treaty obligations; and
– observance of obligations; the so–called umbrella clause.

Article 10 sets forth further obligations for Contracting Parties with respect to Investments.

[1] For commentary on Article 26, see p. 414 *et seq.*, *infra*.
[2] For commentary on Article 1(8), see p. 132 *et seq.*, *supra.*
[3] For commentary on the definition of Investment, see p. 67 *et seq.*, *supra.*

Article 10(7) provides for national and most-favoured-nation treatment of Investments. In Article 10(11) it is made clear that certain trade-related investment measures described in Article 5 of the ECT are to be regarded as breaches of obligations under Part III of the ECT.[4] Article 10(12) obliges Contracting Parties to maintain effective means for the assertion of claims and the enforcement of rights.

That Article 10 was a difficult—and perhaps controversial—provision to negotiate is illustrated by the fact that it is accompanied by four understandings, three declarations, two chairman's statements, and one decision, all of which will be addressed below. Most of the negotiating difficulties seem to have been caused by issues concerning promotion of investments and the pre-investment regime in general. These issues were referred to supplementary negotiations intended to result in a separate treaty. As per paragraph (4) of Article 10 the plan was to conclude the supplementary treaty by 1 January 1998. As of today, no such treaty has been concluded.

An illustrative example of the foregoing is Declaration 4 made by Canada and the United States. It reads:

DECLARATION With respect to Article 10

Canada and the United States each affirm that they will apply the provisions of Article 10 in accordance with the following considerations:

For the purposes of assessing the treatment which must be accorded to Investors of other Contracting Parties and their Investments, the circumstances will need to be considered on a case-by-case basis. A comparison between the treatment accorded to Investors of one Contracting Party, or the Investments of Investors of one Contracting Party, and the Investments or Investors of another Contracting Party, is only valid if it is made between Investors and Investments in similar circumstances. In determining whether differential treatment of Investors or Investments is consistent with Article 10, two basic factors must be taken into account.

The first factor is the policy objectives of Contracting Parties in various fields insofar as they are consistent with the principles of non-discrimination set out in Article 10. Legitimate policy objectives may justify differential treatment of foreign Investors or their Investments in order to reflect a dissimilarity of relevant circumstances between those Investors and Investments and their domestic counterparts. For example, the objective of ensuring the integrity of a country's financial system would justify reasonable prudential measures with respect to foreign Investors or Investments, where such measures would be unnecessary to ensure the attainment of the same objectives insofar as domestic Investors or Investments are concerned. Those foreign Investors or their Investments would thus not be 'in similar circumstances' to domestic Investors or their Investments. Thus, even if such a measure accorded differential treatment, it would not be contrary to Article 10.

The second factor is the extent to which the measure is motivated by the fact that the relevant Investor or Investment is subject to foreign ownership or under foreign control. A measure aimed specifically at Investors because they are foreign, without sufficient countervailing policy reasons consistent with the preceding paragraph, would be contrary to the principles of Article 10. The foreign Investor or Investment would be 'in similar circumstances' to domestic Investors and their Investments, and the measure would be contrary to Article 10.[5]

Neither Canada nor the United States has signed the ECT.

[4] For commentary on Article 5, see p. 147 *et seq.*, *supra.*

[5] Final Act of the European Energy Charter Conference, Declaration 4.

II. 1) Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area.

The language makes clear that the sentence deals with the making of investments, or the promotion of investments. The obligations set forth thus do not concern the protection of already made investments but relate to the pre-investment phase. The first sentence of Article 10(1) identifies two obligations for Contracting Parties: they must 1) encourage and 2) create stable, equitable, favourable and transparent conditions with respect to the making of investments. 'Making Investments' and 'Make Investments' are defined in Article 1(8) of the ETC.[6] These obligations are different from those relating to the post-investment phase.

The obligations in the first sentence of Article 10(1) are obligations to facilitate and to make best efforts concerning the pre-investment phase. The obligations are binding as far as they go, even if they are sometimes referred to as 'soft law obligations'. The obligations require Contracting Parties to take active measures—'shall encourage' and 'shall create'—with a view to establishing favourable conditions for foreign investments. If a Contracting Party fails to encourage and to create favourable conditions for the Making of Investments—for example by promoting legislation which actively discourages, or tries to stop, foreign investments—it is in breach of the Treaty. The sanctions for breaching the pre-investment obligations are found in Article 27 of the ECT, i.e. diplomatic negotiations or arbitration.[7] As mentioned above,[8] dispute settlement under Article 26 of the ETC is generally not available since application of this provision presupposes that an Investment has been made.[9]

Even though the obligations in the first sentence are not subject to Article 26 dispute settlement, the language used there is important for informing and elucidating the meaning of the post-investment obligations laid down in Article 10, including the fair and equitable treatment standard.[10]

There is a certain degree of overlap between 'fair and equitable' treatment and the concepts referred to in the first sentence—stable, equitable, favourable, and transparent conditions. The meaning of these concepts has been clarified over time by the interpretation of arbitral tribunals of the fair and equitable treatment standard. This treatment standard typically includes most of the concepts referred to in the first sentence of Article 10(1).[11]

Article 10(1) refers to 'transparent conditions for Investors … ' . No explanation or guideline is provided as to the detailed meaning of transparency. Article 20 of the ECT which is in Part IV of the Treaty addresses transparency.[12] Paragraph (1) of Article 20 deals with trade, whereas Paragraph (2) deals with 'other matters covered by the Treaty' which obviously includes matters affecting investments. It is possible that guidance can be sought from paragraph (2) of Article 20 when analyzing 'transparency' under Article 10(1). Paragraph (2) of Article 20 reads:

[6] See p. 132 *et seq.*, *supra*.
[7] For commentary on Article 27, see p. 475 *et seq.*, *infra*.
[8] See p. 183 *et seq.*, *supra*.
[9] For commentary on Article 26, see p. 414 *et seq.*, *infra*.
[10] For a discussion of the fair and equitable treatment standard see p. 187 *et seq.*, *infra*.
[11] See p. 187 *et seq.*, *infra*.
[12] For commentary on Article 20, see p. 353 *et seq.*, *infra*.

Laws, regulations, judicial decisions and administrative rulings of general application made effective by any Contracting Party, and agreements in force between Contracting Parties, which affect other matters covered by this Treaty shall also be published promptly in such a manner as to enable Contracting Parties and Investors to become acquainted with them. The provisions of this paragraph shall not require any Contracting Party to disclose confidential information which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of any Investor.

It is possible that also the obligation of Contracting Parties to designate one or more so-called enquiry points laid down in paragraph (3) of Article 20 could play a role when assessing the transparency requirement under Article 10(1).

In *Mamidoil v. Albania*[13] claimant argued that even for a country in transition, the Albanian legal framework was 'exceptionally unstable unclear, and contradictory'.[14] In claimant's view Albania breached its obligations under Article 10(1) in the following respects:

When it did not inform Claimant about possible plans for the port of Durres, which started to emerge with the conclusion of the contract with the international consultant under the IDA credit in December 1998, i.e. before the approval of the investment plan of 6 January 1999 and the execution of the lease contract in June 1999, and which finally led to the Land Use Plan of June 2000. '*Claimant would not have entered into the Lease Contract—through its subsidiary—had Respondent acted openly and transparently about its future plan. No reasonable businessman invests several million USD into a project the legal future of which is uncertain*';

When it reduced the minimum storage capacity in 2002 which opened the market for '*floods of competitors*' that were no longer under the obligation to invest millions in a tank farm, and re-increased it in 2008, shortly before Claimant's subsidiary stopped its business;

When it decided '*to completely and finally shut down the port of Durres*' without ever having ordered Claimant to relocate the tank farm or specified the conditions of relocation, although the trading permit was limited for that reason;

When it did not specify what permits would be needed and what would be their requirements.[15]

The tribunal rejected claimant's arguments that respondent had failed to provide a stable and transparent legal framework. In reaching its conclusions, the tribunal emphasized the communist heritage of the Albanian State, as well as the necessities of the present and future to move away from this heritage.[16] The tribunal noted—after a detailed review and analysis of the circumstances—that the laws complained of 'were transparent and clear'[17] and that the legal texts 'were stable and transparent'.[18] Another relevant factor for the tribunal was claimant's failure to perform a due diligence of the legal system with a view to finding out the legal requirements for obtaining licences and permits.[19]

In *Blusun v. Italy*[20] and in *Antin v. Spain*[21] the claimants raised the issue of transparency. The tribunals did not deal with transparency separately, but as forming part of FET in general. In *Blusun v. Italy* claimants failed to convince the tribunal. In *Antin v. Spain*, however, respondent was found to have breached the fair and equitable treatment standard under the ECT.

[13] *Mamidoil Jetoil Greek Petroleum Products Société S.A. v. Republic of Albania*, Award dated 30 March 2015.
[14] *Mamidoil v. Albania*, at para. 590. [15] Ibid. [16] Ibid., at paras. 625, 629.
[17] Ibid., at para. 671. [18] Ibid., at para. 674. [19] Ibid., at para. 671.
[20] See *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic*, *supra*, at paras. 159–62.
[21] See *Antin Infrastructure Services Luxembourg S.à.r.l. and Antin Energia Termosolar B.V. v. Kingdom of Spain*, *supra*, at paras. 416–22.

Several tribunals have taken a similar approach and have thus not treated the stability and transparency obligations as a separate obligation, but rather treated this as an illustration of the obligation to respect the legitimate expectations of the investor: *Plama v. Bulgaria*,[22] *Isolux v. Spain*,[23], *Eiser v. Spain*,[24] and *Novenergia v. Spain.*[25]

III. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment.

1. Background

The concept of fair and equitable treatment (FET) is not new. Most investment protection treaties today, be they bilateral or multilateral, provide for fair and equitable treatment of foreign investments.[26]

An early reference to the concept is found in the 1948 Havanna Charter for an International Trade Organization. In the event the Charter never entered into force and the International Trade Organization never saw the light of day. References to FET have since been made in several international instruments such as the 1959 the Abs-Shawcross Draft Convention on Investments Abroad,[27] the OECD Draft Convention on the Protection of Foreign Property of 1967,[28] and the OECD Draft Negotiating Text for a Multilateral Agreement on Investments.[29]

Even though most investment protection treaties have clauses dealing with FET, they are seldom identical. The language used varies. Every treaty clause dealing with FET must be interpreted in accordance with Article 31 of the Vienna Convention, due account taken of its context as well as of the object and purpose of the treaty. Thus, whilst the concept of FET is widely accepted, there is no one, generally accepted definition of the FET standard of treatment.

There are, however, certain common distinctive features of the FET standard.

In general, the purpose of most FET clauses is to fill gaps not covered by other standards of treatment in the treaty in question. As a consequence there is usually a certain degree of overlap between FET and other standards of protection in the treaty. Despite such overlap, it is generally accepted that FET is, an autonomous standard.[30]

[22] *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award dated 27 August 2008.

[23] *Isolux Infrastructure Netherlands B.V. v. The Kingdom of Spain*, Award dated 12 July 2016.

[24] *Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain*, ICSID Case No. ARB/13/36, Award dated 4 May 2017.

[25] *Novenergia II – Energy & Environment (SCA) SICAR v. The Kingdom of Spain*, Award dated 15 February 2018.

[26] For general comments on fair and equitable treatment, see Dolzer and Schreuer, Principles of International Investment Law (2nd edn. 2012) 130–60; McLachlan, Shore, and Weiniger, International Investment Arbitration: Substantive Principles (2nd edn. 2007) 226–47; Newcombe and Paradell, Law and Practice of Investment Treaties: Standards of Treatment (2009) 255–97; Schreuer, 'Fair and Equitable Treatment in arbitral Practice', 6 Journal of World Investment & Trade (2005) 357; Dolzer, 'Fair and Equitable Treatment: A Key Standard in Investment Treaties', 39 International Lawyer (2005) 87; Vasciannie, 'The Fair and Equitable Standard in International Investment Law and Practice', 70 British Yearbook of International Law (1999) 133; Yannaca Small, 'Fair and Equitable Treatment: Have its Contours Fully Evolved?', in Yannaca Small (ed.), Arbitration under International Investment Agreements (2nd edn. 2018) 501 Paparinskis, The International Minimum Standard and Equitable Treatment(2013);Palombino,Fair and Equitable Treatment and the <Fabric of General Principles (2018);Tudor,The Fair and Equitable Treatment Standard in the International Law of Foreign Investment(2018).

[27] UNCTAD, International Investment Instruments: A Compendium, Vol. V (2001) 395.

[28] OECD Draft Convention on the Protection of Foreign Property (1967), 7 ILM (1968) 117.

[29] UNCTAD, International Investment Instruments: A Compendium, Vol. IV (2001) 148.

[30] Cf. e.g. Schreuer, Fair and Equitable treatment (FET): Interactions with Other Standards, in Coop and Ribeiro (eds), Investment Protection and the Energy Charter Treaty (2008) 63.

Arbitral tribunals thus usually separate FET from other standards of protection and determine alleged FET violations as a discrete issue. There is also general agreement that FET is intended as an obligation of international law which must thus not be interpreted or applied based on the municipal law of the host State.

The FET standard is objective in nature, in the sense that an investor need not show that some other investor, e.g. of the host State's nationality, has received better treatment. The investor only needs to establish that the treatment he has received is not fair and equitable. It is also widely accepted that the FET standard must be applied in an objective manner, that is to say that an arbitral tribunal cannot do whatever individual arbitrators happen to think is fair. The standard must rather be applied juridically and be based on rational principles and state practice, due account taken of previously rendered awards.[31]

One issue which has caused debate is the question whether the FET standard is anything more than the obligation under customary international law to respect the 'international minimum standard' for the treatment of aliens. Does the FET standard offer an autonomous standard in addition to customary international law? Ultimately the answer to this question must depend on the interpretation of the treaty clause in question providing for the FET standard. Much will depend on *how* such a clause will refer to customary international law, if at all, and also on the context in which the clause appears. For example, if no reference is made to the international minimum standard in the clause, or in the treaty, it would seem difficult to read in such a reference by providing for 'fair and equitable treatment' in the treaty.

The debate on the relationship between the FET standard and customary international law was particularly heated with respect to Article 1105(1) of the NAFTA which reads:

> Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.[32]

Following the decisions of the tribunals in *S.D. Myers* and *Pope & Talbot* which gave different interpretations of Article 1105(1), the NAFTA Free Trade Commission—composed of representatives of the three States with the power to adopt binding interpretations[33]—concluded that the article reflects the customary international law minimum standard and does not require treatment in addition to and beyond what is required by customary international law.[34]

The relevance of NAFTA practice in this respect is probably limited for the interpretation of other investment protection treaties, also considering the fact that it is still no general agreement on the existence, let alone content, of an international minimum standard of treatment of aliens.[35]

As far as Article 10(1) of the ECT is concerned there is nothing in the text to suggest that the FET standard refers to anything other than an autonomous standard. There is no linkage to customary international law in general, nor to the international minimum standard in particular. It should be noted, however, that the penultimate sentence of Article 10(1) does have a general reference to international law: 'In no case shall such

[31] Cf. e.g. *ADF Group v. United States of America*, Award dated 9 January 2003, at para. 184.

[32] North American Free Trade Agreement, adopted 17 December 1992, entered into force 1 January 1994, 32 ILM (1993) 605.

[33] NAFTA Article 1132(2).

[34] FTC Note of Interpretation dated 31 July 2001.

[35] Cf. e.g. Sornarajah, The International Law on Foreign Investment (2004) 136–54; 328–32.

Investments be accorded treatment less favourable than that required by international law, including treaty obligations'.[36]

The reference to international law is to customary international law. This is clear since the sentence also refers to treaty obligations. The reference to customary international law in the penultimate sentence of Article 10(1) does not change the status of the FET standard as an autonomous standard. The natural interpretation and reading is that the two standards are separate and distinct and should be so applied, that is to say, with a view to determining whether conduct has occurred, or measures have been taken, which constitute a failure to provide FET to the Investor, or whether application of the penultimate sentence of Article 10(1) is triggered.

The FET standard is broad and vague in nature. It is therefore difficult to define. In fact, it is probably impossible to provide a definition in the abstract which would be relevant for all types of alleged violations of the standard. Whilst there are certain common distinctive features of the FET standard,[37] in the final analysis the facts and circumstances of each individual case will be decisive for the application of the standard. It is thus necessary to analyze previously rendered awards, properly to understand the meaning and scope of application of the FET standard.

Reference is often made to the *Neer* case, decided in 1926 as the *locus classicus* concerning the standard of treatment for foreigners. The case concerned the murder of a US citizen and had nothing to do with foreign investments. The Claims Commission which tried the allegation that the Mexican authorities had not diligently pursued the criminal investigation said this:

> […] the treatment of an alien to amount to an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.[38]

This is undoubtedly a high threshold. The Commission found that the claimant had not met the test, and thus dismissed the claim.

A more modern decision referred to in this context is the *ELSI* case.[39] The case, which concerned the requisition by local government in Italy of an industrial plant, owned by US shareholders, was decided by a Chamber of the International Court of Justice. Whilst the relevant treaty referred to 'arbitrary' action, rather than fair and equitable treatment, the decision is often referred to in the context of the FET standard. The Court said the following concerning 'arbitrariness':

> Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. […] It is a wilful disregard of due process of law an act which shocks, or at least surprises a sense of judicial propriety.[40]

In the circumstances, the Court found that the standard so outlined had not been violated.

Over the years, arbitral tribunals have developed other and more modern approaches to defining the FET standard in investment protection treaties. An illustrative example is the *Waste Management* case decided in 2004 under the NAFTA.[41]

[36] For a commentary on this standard of protection, see p. 190, *infra.*
[37] See p. 190 *et seq.*, *infra.*
[38] *Neer (United States of America v. Mexico*) (1926) 4 RIAA 60–2.
[39] *Electronica Sicula SpA (ELSI) (US v. Italy),* ICJ Reports (1989) 15.
[40] Ibid., at para. 128.
[41] *Waste Management, Inc. v. United Mexican States*, Final Award, 30 April 2004.

The dispute concerned a concession for the disposal of waste and involved several allegations with respect to the conduct of municipal bodies and the Mexican courts. On the issue of fair and equitable treatment, the tribunal said:

> The minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.[42]

FET is a broad, vague and perhaps even an elusive concept. Tribunals have grappled with it. Attempts have been made at broad descriptions and definitions. In the final analysis, however, the facts and circumstances of the individual case seem to be decisive. There are, however, certain recurring themes, or elements of the FET standard, which are observable in arbitral practice. They include: stability and predictability (including legitimate expectations); transparency; due process; freedom from harassment and coercion; freedom from discrimination; and good faith.

Generally speaking most of these elements of FET are relevant also for interpreting and applying the FET standard in Article 10(1) of the ECT.

2. Fair and Equitable Treatment and the ECT

a. The Text

The text first raises the question whether 'fair and equitable treatment' is to be applied as two different, and separate, concepts, or as one concept. It seems to be widely accepted that 'fair and equitable treatment' is viewed as one, unified concept.

Pursuant to the Vienna Convention, in addition to the ordinary meaning of terms used, it is necessary to look at the 'context' in which they appear. As mentioned above,[43] with respect to 'fair and equitable treatment', the first sentence of Article 10(1) provides helpful context. The first sentence provides examples of the kind of conditions for foreign investment that the FET standard is intended to encourage, *viz.*, stable, equitable, favourable, and transparent conditions. Whilst the first sentence of Article 10(1) deals with the pre-investment phase, it provides important context for the pre-investment treatment standard with respect to foreign investments. The first sentence of Article 10(1) thus suggests several factors which need to be taken into account when determining whether the FET standard has been violated.

In addition to 'context', the object and purpose of the ECT must also be taken into account when interpreting 'fair and equitable'. This means that the preamble and Article 2 of the ECT, referring to the European Energy Charter, must be made part of the interpretative exercise.[44]

[42] Ibid., at para. 98.
[43] See p. 185 *et seq.*, *supra.*
[44] For commentary on the Preamble see p. 54 *et seq.*, *supra*, and on Article 2, see p. 142 *et seq.*, *supra*.

b. General Comments

Many ECT awards have addressed the FET standard. Based on these awards the following elements can be identified as having formed part of the tribunals' analyses of the FET standards:

- stability and predictability (including legitimate expectations);
- transparency;
- denial of justice and due process; and
- freedom from harassment and discrimination

In addition to discussing the specific elements listed above, ECT tribunals have provided comments of a more general nature concerning the FET standard.

In one of the early awards—*Petrobart v. Kyrgyzstan*[45] —the tribunal did not analyze the various elements of FET. Rather, the tribunal concluded that the respondent State had violated Article 10(1) in its entirety primarily by transferring assets away from Kyrgyz Gazmunaigaz (KGM) to the detriment of its creditors, which included Petrobart as the seller of gas condensate to KGM, as well as by intervening in domestic court proceedings which negatively affected Petrobart. The tribunal found 'it sufficient to conclude that the measures for which the Kyrgyz Republic is responsible failed to accord Petrobart a fair and equitable treatment to which it was entitled under Article 10(1) of the Treaty'.[46]

In another early case—*Amto v. Ukraine*[47] —the tribunal noted that there is considerable overlap within Article 10(1), including between the FET standard and the protection against unreasonable and discriminatory conduct. According to the tribunal, the result of the overlap is that 'a claimant can plead that the same conduct breaches various obligations in Article 10(1) in circumstances where the content and relationship between the obligations is not clear.' [48]

In *Al-Bahloul v. Tajikistan*,[49] the claimant, as part of his FET argument, relied on respondent's failure to meet legitimate expectations regarding the issuance of licences. The tribunal decided this issue based on the burden of proof. It said:

> [. . .] it is the Tribunal's opinion that Claimant had a right to rely upon Respondent's commitment to issue the four further exploration licenses, but this claim based on legitimate expectations fails for lack of evidence of actual reliance thereon.[50]

In *Electrabel v. Hungary*[51] the main FET claim related to the effect of a 2008 EU Commission decision ordering Hungary to terminate certain power purchasing agreements. The tribunal took the view that Hungary was obliged by EU law to comply with the decision, which in the opinion of the tribunal precluded FET liability for Hungary under the ECT. The question was rather whether Hungary had irrationally or arbitrarily interpreted the decision. The tribunal concluded that this was not the case, partly because there was no practical way for Hungary to comply with its EU

[45] *Petrobart Limited v. the Kyrgyz Republic*, Award dated 29 March 2005.
[46] Ibid., at p. 76.
[47] *Limited Liability Company Amto v. Ukraine*, Award, dated 26 March 2008.
[48] Ibid., at para. 74.
[49] *Mohammed Ammar Al-Bahloul v. The Republic of Tajikistan*, Partial Award On Jurisdiction and Liability, dated 2 September 2009.
[50] Ibid., at para. 210.
[51] *Electrabel S.A. v. The Republic of Hungary, Decision On Jurisdiction*, Applicable Law and Liability, date 30 November 2012.

law obligations except to terminate the power purchase agreement. The tribunal also concluded that Hungary had not been under an obligation to challenge the decision issued by the EU Commission. With respect to the time prior to the decision, the tribunal found that Electrabel had not demonstrated that Hungary had failed to take reasonable steps to protect the investment, which was made before Hungary became a member of the EU.[52]

Such steps could, for example, have included an application for an exemption from Hungary's obligations under EU law.

The tribunal further noted that the most important function of the FET standard is the protection of the reasonable and legitimate expectations of an investor. With respect to regulatory changes, the tribunal said:

> While the investor is promised protection against unfair changes, it is well established that the host State is entitled to maintain a reasonable degree of regulatory flexibility to respond to changing circumstances in the public interest. Consequently, the requirement of fairness must not be understood as the immutability of the legal framework, but as implying that subsequent changes should be made fairly, consistently and predictably, taking into account the circumstances of the investment.[53]

In *Energoallians v. Moldova*[54] the facts resembled those in *Petrobart* in that the reorganization of a state-owned company—Moldtranselectro—resulted in the company ceasing its activities and therefore ceasing to receive revenue.

The company was consequently unable to pay its debts. The tribunal—by majority—found that the failure to take into account the company's creditors—which included the claimant—violated the FET standard under Article 10(1).[55]

In *Stati et al v. Kazakhstan*[56] the parties and the tribunal agreed that the application of the FET standard must take into account the specific factual circumstances of the case and that these had to be evaluated in the legal context of the ECT.[57] The tribunal stated that 'treatment' in Article 10(1) indicated an evaluation of a more general nature rather than of a particular action. The tribunal then went on to evaluate a string of measures which it concluded constituted 'coordinated harassment by various institutions of the Respondent', which amounted to a breach of the FET standard laid down in Article 10(1) of the ECT.[58]

In *Mamidoil v. Albania*[59] the tribunal made an initial statement with respect to the specific situation of the respondent State. Referring to the fact that Albania had just emerged from its communist regime and a subsequent economic crisis, the tribunal said:

> The Tribunal holds that these circumstances matter. An investor may have been entitled to rely on Albania's efforts to live up to its obligations under international treaties, but that investor was not entitled to believe that these efforts would generate the same results of stability as in Great Britain, USA or Japan.[60]

[52] Ibid., at paras. 6.66–6.77. [53] Ibid., at para. 7.77.
[54] *Energoallians v. Moldova*, Award dated 23 October 2013. [55] Ibid., at para. 356–70.
[56] *Anatole Stati, Gabriel Stati, Ascom S.A. Terra ref Trans Trading Ltd v. The Republic of Kazakhstan*, Final Award, dated 19 October 2013.
[57] Ibid., at paras. 94.1–94.7. [58] Ibid., at para. 1086.
[59] *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. The Republic of Albania*, Award dated 25 March 2015.
[60] Ibid., at para. 626.

As will be discussed below,[61] one important element of the FET standard is the legitimate expectations of investors and the extent to which the legal and regulatory framework of the host State can give rise to such expectations. This was a central issue in *Charanne v. Spain*[62] and in most of the subsequent similar cases against Spain.[63]

In discussing the regulations for the renewable energy sector which had been changed by the Spanish government, the arbitral tribunal in Charanne stated, *inter alia*, that a State is entitled to maintain a reasonable degree of regulatory flexibility to respond to changing circumstances and the public interest.[64] The tribunal also took the view that the FET standard does not mean that the law existing at the time when the investment is made will be frozen or will never change.[65]

c. Stability and Predictability (Including Legitimate Expectations)

The first sentence of Article 10(1) refers to 'stable' conditions for Investors to make Investments. Stability is widely accepted as an important element of the FET standard. As a matter of general principle, it could be said that 'predictability' is an inherent element of stability. Stability and predictability in turn form the basis for the 'legitimate expectations' of an investor. The debate concerning the FET standard has to a large degree focused on the concept of 'legitimate expectations'. Whilst no reference is made to this concept in Article 10(1), it is generally accepted that the 'legitimate expectations' of investors constitute a central element of the FET standard.

Arbitral jurisprudence is clear on the point in time which is relevant for determining the legitimate expectations of an investor, *viz*., the point in time when the investment is made. This of course raises the question of when an investment is deemed to have been made.[66]

The legitimate expectations of an investor is broadly speaking, typically based on the economic, legal and regulatory framework of the host State at the time of the investment. The legal framework includes legislation, treaties and case law. This includes the investment framework in general, and any framework specific to the economic sector in which the investment is made.

Legitimate expectations can also be based on statements by and conduct of representatives of the host State. Specific representations and assurances, as well as contractual undertakings may play an important role in this context. Statements may be more or less explicit, and even implicit. It will depend on the circumstances of the individual case what weight is to be given to such statements.

The general philosophy underlying the concept of legitimate expectations is that the investor has a right to expect that the framework existing at the time of the investment will remain stable and predictable. This does not mean that the host State is prevented from amending the framework. It is beyond dispute that the host State has the power to regulate its economy and economic activities in its territory. In doing so, however, the legitimate expectations of investors must be taken into account. The difficulty here is to strike the right balance between these competing interests.

[61] See p. 194 *et seq.*, *infra.*

[62] *Charanne B.V. Construction Investments S.A.R.L. v. The Kingdom of Spain,* Final Award dated 21 January 2016.

[63] See p. 202 *et seq.*, *infra.*

[64] Ibid. at para. 500 (quoting *Electrabel v. Hungary*).

[65] Ibid., at para. 499.

[66] See discussion at 96 *et seq.*, *supra.*

Reliance on the investment framework at the time of the investment, also raises the questions of the extent to which the investor must perform a due diligence analysis of the framework so as to ascertain the economic, legal, and political risks involved.

In one of the first ECT awards dealing with the FET standard—*Plama v. Bulgaria*[67] — the tribunal to a large degree relied on non-ECT awards which had been relied upon by the parties. With respect to legitimate expectations, the tribunal noted that such expectations include 'reasonable and justifiable' expectations taken into account by the investors.[68]

In the view of the tribunal such expectations would include conditions specifically offered by the State to the investor when the investment was made and on which the investor relied.[69] The tribunal added that 'the state maintains its legitimate rights to regulate and this right should also be considered when assessing the compliance with the standard of fair and equitable treatment'.[70]

In its analysis of the case before it, the tribunal observed that investors are not protected against any and all changes in the legislation of the host State. The tribunal found that Bulgaria had not made any promises or other representations to freeze its legislation on environmental law.[71]

In *Al-Bahloul v. Tajikistan*,[72] the tribunal found that the investor had the right to rely on the host State's commitment to issue relevant exploration licences, but that the investor failed to prove that he had in fact relied on his expectations.[73]

As mentioned above, legitimate expectations can only be created at the time when the investment is made. In *AES v. Hungary*[74] one of the issues which the tribunal addressed was the proper interpretation of 'the time of the investment'. Respondent argued that the original investment was made in 1996 when AES had bought the shares in the locally incorporated company. AES argued that 2001 was the relevant time at which AES made investments in the power generation plant. The tribunal concluded that AES had made investments both in 1996 and in 2001 and analyzed the investors' legitimate expectations as per each point in time.[75] The dispute concerned the re-introduction in 2006 and in 2007 of administrative pricing in the energy sector after administrative prices had been abolished as of 1 January 2004. Two earlier arbitrations between the same parties had been settled by a settlement agreement in 2001, which in the view of AES set forth certain commitments by Hungary.

With respect to the initial investment made in 1996, the tribunal noted that AES could have no legitimate expectations regarding the conduct of Hungary about which it complained in the arbitration.[76] The tribunal observed that the privatization materials and the relevant investment agreements made clear that Hungary would continue to set 'maximum administrative prices for electricity sales indefinitely into the future.'[77]

With respect to the investments made in 2001, AES relied on certain government materials and the 2001 settlement agreement.

[67] *Plama Consortium Limited v. Republic of Bulgaria*, Award dated 27 August 2008.
[68] Ibid., at para. 176. [69] Ibid. [70] Ibid., at para. 177. [71] Ibid., at para. 219.
[72] *Mohammed Ammar Al-Bahloul v. The Republic of Tajikistan*, Partial Award On Jurisdiction and Liability, dated 2 September 2009.
[73] Ibid., at para. 210. The tribunal did, however, address these commitments in connection with its analysis of the umbrella clause, see discussion at p. 237 *et seq.*, *infra.*
[74] *AES Summit Generation Ltd, and AES Tisza Eromu Kft v. Republic of Hungary*, Award dated 23 September 2010.
[75] Ibid., at paras. 9.3.14–9.3.16. [76] Ibid., at para. 9.3.15. [77] Ibid.

In the view of AES, in the settlement agreement Hungary had explicitly promised not to frustrate the purpose and intent of the agreement. The parties agreed that the clause in question was not a stabilization clause. After having analyzed the documents relied on by AES, the tribunal concluded that the investors could not legitimately have expected that an administrative pricing regime would not be introduced under any circumstances.[78]

In *Mamidoil v. Albania*,[79] the claimant relied on alleged legitimate expectations based on assurances from the respondent that claimant would be entitled to use the tank farm in question for twenty years as planned.

The tribunal, however, concluded that there were no explicit assurances by the State.[80] The tribunal therefore examined the conduct of the State, and other circumstances, with a view to determining if legitimate expectations had been created. The majority of the tribunal noted that the investor was aware that the infrastructure of the host State as well as the regulatory framework was inadequate. The regulatory changes undertaken subsequent to the investment were found to be guided by a long-term perspective and not by erratic considerations. Such changes included a land use plan as well as a prohibition for petroleum tankers to be discharged at the port in question.

The majority found that the investor could not have legitimately expected to operate the tank farm without obtaining the required permits to make the operation compliant with Albanian law, nor to have access to the port during the life of the contract.[81]

Renewable Energy Disputes

In *Charanne v. Spain*[82]—the first of many renewable energy cases against Spain to reach an award—the tribunal had to deal with regulatory changes concerning photovoltaic solar power plants. Several similar cases have been commenced against Italy, the Czech Republic, and other Contracting Parties.

In order properly to understand and evaluate these renewable energy cases , and their relevance in the context of the FET standard, it is necessary to have a fairly detailed knowledge of the relevant regulatory framework and the changes and amendments made to the framework. The following provides a brief summary of the regulatory framework in Spain as set out in the arbitral awards.[83]

The Regulatory Framework in Spain

The development of a renewable energy sector in Spain goes back to the 1992 United Nations Framework Convention on Climate Change, pursuant to which, Spain and other industrialized nations, committed to a reduction in 'greenhouse gases' and to the allocation of resources to tackle climate change.

Pursuant to the subsequent Kyoto Protocol of 1997, the EU and other contracting parties were tasked with the achievement of ambitious targets to reduce greenhouse gases over the period 2008–12. Part of the EU's proposal was to encourage the development of renewable energy technologies. It foresaw both an environmental and an economic benefit in that an investment in renewable energy project would stimulate employment in the EU.

[78] Ibid., at para. 9.3.26.

[79] *Mamidoil Jetoil Greek Petroleum Products Société S.A. v. Republic of Albania*, Award dated 30 March 2015.

[80] Ibid., at para. 691. [81] Ibid., at para. 735.

[82] *Charanne B.V. and Construction Investments S.A.R.L. v the Kingdom of Spain*, Final Award dated 21 January 2016.

[83] The regulatory frameworks in Italy and the Czech Republic are discussed *infra* at p. 213 *et seq*.

In the Renewables Directive of 2001, the EU set forth binding targets for the consumption of renewable energy. The EU recognized that it would be necessary to put in place government-backed financial incentives to attract the necessary private sector investment.

In November 1997 Spain adopted a new Electricity Law (**Law 54/1997**), which reformed the electricity sector in Spain and anticipated the development of a regulatory regime applicable to renewables. Recognizing that renewables projects involved pioneering technology and higher upfront capital costs, Law 54/1997 of 27 November 1997 on the electric power sector introduced two separate regulatory regimes, one for traditional generation plants (the 'Ordinary Regime') and the other (the 'Special Regime') for the generators of electricity from non-consumable renewable energies. Under the Ordinary Regime, remuneration derived solely from the wholesale market price of electricity. Under the Special Regime, generators benefitted from a premium set by the Spanish Government over and above the wholesale market price. The Special Regime applied to energy production facilities registered in the (Registro Administrativo de Instalaciones de Producción Eléctrica en Region Special) (Administrative Registry for Electrical Power Generating Units) ('RAIPRE'). The basis of remuneration for those generators benefitting from the Special Regime was the so-called feed-in-tariff (FIT), calculated in EUR per kWh of electricity produced. Law 54/1997 required the amount of that premium to be set out in statutory terms by a Government regulation, according to a general principle stated in Article 30.4 of the Law 54/1997:

> In order to determine the premium, account shall be taken of the level of delivery voltage of the energy to the grid, effective contributions to improvement of the environment, saving in primary energy and energy efficiency, production of economically justifiable useful heat and the investment costs which have been incurred, in order to achieve reasonable rates of return by reference to the cost of money in the capital market.

In addition to *Acts* of the Spanish Parliament, i.e. laws, the Spanish electric power sector is governed by the following normative acts, in order of hierarchy. *Royal Decree – Laws* (RDL) which have the force of an Act of Parliament and may be enacted by the Government in situations of extraordinary need or urgency. The Government also issues *Royal Decrees* (RD) which are regulations issued pursuant to powers granted by an Act. *Ministerial Orders* may be issued by ministerial departments to implement Royal Decrees. The Government may also issue *Resolutions* to implement Royal Decrees. There are also so-called renewable energy plans which are standard setting regulations issued by the national regulator of the Spanish electric power sector.

Royal Decree 2818/1998 of 23 December 1998 on electricity production installations supplied by renewable energy, waste or cogeneration ('**RD2818/1998**') in essence recognized that the elevated running costs of the renewable energy plants and the level of technology demanded by them would not allow for competition in a free market.
Generators qualified under the Special Regime had the right to be connected to, and supply electricity to, the national grid. Plants that used as a primary energy source any of the non-consumable renewable energies, biomass or any kind of bio fuel were granted a premium to be reviewed by the Government on an annual basis, pursuant to Article 28.2 of the Royal Decree.

Other features of RDL818/1998 included:

- Owners of registered installations could choose between selling their electricity to distributors in exchange for a feed-in tariff for each kWh produced (the '**Fixed Tariff**'. also

known as '**Regulated Tariff**') (Article 28.3), or on the wholesale market and receive a feed-in premium on top of the market price (the '**Premium Option**') (Articles 23. 28 and 28.3);
- Premiums and tariffs were to be updated each year by the Ministry of Energy considering the evolution of an index, i.e. the average electricity market price (Article 28.2);
- Premiums would be revised every four years considering the evolution of electricity market price, the installations' demand coverage and the effect on the management of the Electricity System as a whole (Article 32);
- No time limit was set for the application of premiums or tariffs (Preamble)
- A transitional period was established for existing facilities to join the new regime

Royal Decree 1432/2002 of December 2002 ('**RD1432/2002**'), established a methodology for the approval or modification of the average, or reference, electricity tariff. It also amended a number of the provisions of the Royal Decree 2017/1997 of 26 December 1997 ('**RD2017/1997**'), governing the organization and regulation of the procedure for the settlement of transmission, distribution and tariff retailing costs, the permanent costs of the system and diversification and security of supply costs.

Royal Decree 436/2004 of 12 March 2004 ('**RD436/2004**') abolished RD2818/1998 and established a new methodology for the updating and systematization of the legal and economic regime for electric power production in the Special Regime. Pursuant to RD436/2004, qualifying installations benefited either from a regulated (fixed) tariff or else a premium payment over and above the wholesale market price per kWh of energy produced. The Preamble and Article 1 of the Royal Decree stated its purpose:

> The purpose of this Royal Decree is to unify the legislation developing and implementing the 1997 Electricity Act with respect to electricity production under the special regime, and in particular concerning the economic arrangements for those installations. The intention is, therefore, to continue down the path first taken by Royal Decree 2818/1998 on the generation of electricity by facilities supplied by renewable energy resources or sources, waste or cogeneration. This time, however, there is the added advantage of being able to take advantage of the stability system at large by Royal Decree 1432/2002, dated December 27th, establishing the methodology for the approval or modification of the average or reference tariff, to provide those who have decided or will decide in the near future to opt for the special regime with a durable, objective and transparent framework.

The values of the regulated tariff and of the premium were to be calculated by reference to the '*tarifa media de referencia*' ('TMR'), fixed by the Government. Further, RD436/2004 remuneration continued to be based on the level of production of the plant, being paid in Euros per kWh. The more efficient the plant and the higher the level of production, the greater the remuneration and the margin that it would receive.

Article 33 of RD 436/2004 stated the following with respect to photovoltaic plants:

> Photovoltaic solar energy facilities in Sub-Group 6.1.1. of no greater than 100 KW with installed power.
>
> Tariff: 575 per cent during the first 25 years from their start-up and 460 percent thereafter.
>
> All other photovoltaic energy facilities in Sub-Group 6.1.1:
>
> Tariff: 300 per cent for the first 25 years from their start-up and 240 per cent thereafter.
>
> Premium: 250 per cent during the first 25 Years from their start-up and 200 per cent thereafter.
>
> Inventive: 20 per cent.

Article 40.3 provided that:

> The tariffs, premiums, incentives and supplements resulting from any of the revisions provided in the section shall apply solely to the plants that commence operating subsequent to the date of the entry into force referred to […] and shall not have a backdated effect on any previous tariffs and premiums.

The **Renewable Energy Plan** of Spain 2005–10, maintained the Spanish Government's commitment to cover at least 12% of the total energy consumption with renewable sources in 2010, and incorporated two objectives indicated for 2010—29.4% of electricity generation with renewables and 5.75% of bio fuels for transportation—adopted under the 2000–10 plan.

While the 2005–10 Plan acknowledged that the premiums offered by RD 436/2004 had stimulated new projects, it envisioned further substantial expenditure for the development of all types of energy during the stated five-year period. It was noted in the Plan that it is therefore 'essential to place the various technologies in a position where they are sufficiently profitable to be attractive to investors and to facilitate access to bank loans. It is in this context that public aid is required, for the reasons already stated, as an essential factor in stimulating the growth of the various renewable energy sectors. The principal type of public aid identified as necessary for the generation of electricity from renewable sources was the payment of a premium by the state electricity system to purchase this type of electricity.'

In order to ensure the profitability of projects using different technologies and to assist them in ensuring an appropriate finance package, the 2005–10 Plan made several technical-financial assumptions and determined—among such assumptions—that the project type profitability would be calculated based on maintaining an internal rate of return ('IRR') close to 7% on equity, (before financing) and after tax.

On 23 June 2006, the Spanish Government issued **Royal Decree Law 7/2006** on the adoption of urgent measures for the energy sector. As highlighted in the Preamble of this regulation, it was enacted to address inefficiencies in the remuneration system governed by RD 436/2004 caused mainly as a result of the link between the premiums to the TMR. This was explained in the report that preceded the adoption of this Royal Decree as follows:

> In addition, to avoid increasing the remuneration in the current regulatory framework there is an urgent need, prior to the first review of the tariff in July of 2006, to ex exclude them from the application of the review of the prices, premiums, incentives and tariffs established in RD 436/2004, of 12 March, until the evaluation of its remuneration regime.

RD 7/2006 essentially did two things: 1) it suspended the subsidies to the renewable energy sector until a new remuneration regime could be developed and 2) it gave priority of access to the grid to renewable producers, allowing them to sell their electricity output in preference to non-renewable energy producers.

On 25 May 2007, the Spanish Government issued **Royal Decree RD 661/2007** regulating the Special Regime for the production of electrical energy. The basic aim of this Decree was to create a more transparent legal and regulatory framework. As noted in the Preamble of this regulation, the experience accumulated during the application of RDs 2818/1998 and RD 436/2004 made it clear that certain technical aspects needed to be regulated in order to contribute to the growth of technologies operating in the Special

Regime, while maintaining the security of the electrical system, ensuring the quality of the supply and minimizing the restrictions on the production of renewable energy. In particular, the regulator considered it necessary to de-link the remuneration of the Special Regime from the TMR, 'guaranteeing the owners of special regime installations a reasonable return for their investment, and the consumers of electricity an assignment of the costs attributable to the electricity system which is also reasonable.'

The purposes of Royal Decree 661/2007 were, as stated in its first article, 'to establish a legal and financial framework for the production of electrical energy regime under the special regime in replacement of Royal Decree 436/2004 of 12 March, establishing the methodology for updating and systematization of the legal and economic framework for the activity of the production of electrical energy under the special regime by a new regulation for the activity of the production of electrical energy under the special regime.' The following are the main characteristics of Royal Decree 661/2007.

First, RD 661/2007 maintained the right, provided for in RD 436/2004, of production facilities operating under the Special Regime to choose one of two types of 'feed-in tariffs (FIT), that is, the amount to be paid to them for each unit of electricity that they fed into the state grid: 1) selling electricity at a Fixed Tariff per unit of production that included a pre-determined renewable energy premium, referred to as the Fixed Tariff Option or 2) selling electricity directly on the day-ahead market or the futures market, or through a bilateral contract, and receiving the negotiated price plus a Premium, subject to floors and caps, referred to as the 'Premium Tariff Option.' The installation had to make a choice between the two for at least a year and inform the appropriate state authority at least one month before the choice was to take effect. It further introduced upper and lower limits for the sum of the hourly price in the daily market, plus a reference premium.

In line with the Renewable Energy Plan 2005–10, the regulatory impact report for RD 661/2007 stated that:

> The regulated tariff has been calculated in order to ensure a return of between 7% and 8% depending on the technology.

Secondly, RD 661/2007 established a mechanism to update the Fixed Tariff, the Premium, and the upper and lower limits, in order to account for inflation. Thus, Article 44(1) of RD 661/2007 provided that these elements would be updated pursuant to the Consumer Price Index (CPI) less twenty-five basis points or fifty basis points after 31 December 2012. This inflation-adjusting mechanism applied to all installations, irrespective of the date on which the installation started to operate.

Thirdly, it maintained the 'priority in access, connection and of dispatch' to installations operating in the Special Regime, thereby assuming that all the production of a qualified installation could be introduced into the grid in accordance with the established tariff.

Finally, RD 661/2007 allowed a qualified installation to use natural gas to generate up to 15% of its production, a privilege that enabled it to maintain normal output in times of low sunshine, for example on exceptionally cloudy days.

Royal Decree 1578/2008 of 26 September 2008 ('**RD1578/2008**')—on the remuneration for the electric energy production activity using photovoltaic solar technology (Solar photovoltaic (PV) and not concentrated solar power (CSP) installations) subsequent to the deadline for maintenance of the remuneration under RD661/2007—established a regime for photovoltaic investors that had registered after the closing of the RD661/

2007 'Tariff Window'. Spain included in RD1578/2008 a mechanism for the centralized control and planning of photovoltaic installation development in the form of a Pre-Assignment Register. RD1578/2008 revised downwards the remuneration provided for in RD661/2007 for photovoltaic installations and opened the possibility to benefit from the Special Regime to installations that missed the deadline for registering in RAIPRE.

Royal Decree Law 6/2009 of 30 April 2009 ('**RDL6/2009**'), introduced a register of pre-allocation pursuant to which, projects had to meet certain criteria in order to be registered and to qualify for the RD661/2007 tariffs. Once registered, projects had a maximum of thirty-six months within which to enter into commercial operation. RDL6/2009, as did RD1578/2008, required qualifying installations to meet these criteria as a preliminary step towards full registration with RAIPRE and then obtaining the benefit of the RD661/2007 regime. In both RD1578/2008 and RDL 6/2009 it was noted that in accordance with RD661/2007, there would be no change of economic regime once a plant was registered.

In July 2010, the Spanish Government made public an agreement that it had reached with the CSP (Concentrated Solar Power) Plants and wind sectors. There was to be a limit on the number of production hours for CSP Plants, which enjoyed the tariff benefits. Further, new installations qualifying under RD661/2007 would be limited for the first twelve months of operation only to the fixed tariff option, but thereafter, they could elect between the fixed tariff and premium options. The use of gas in the production of electricity in the context of the fixed tariff option would be permitted up to 15% rather than 12%.

The agreement was formalized by Royal Decree 1614/2010 of 7 December 2010 ('**RD1614/2010**'), regulating and modifying certain aspects relating to the production of electricity based on thermoelectric and wind technologies. RD1614/2010 included a stabilization provision in terms similar to Article 44.3 of the RD661/2007 at Article 4:

> Stabilisation commitments: For solar thermoelectric technology facilities that fall under Royal Decree 661/2007 of 25 May. The revisions of tariffs, premiums and upper and lower limits referred to in article 44.3 of the aforementioned Royal Decree, shall not affect facilities registered definitively in the Administrative Registry of production facilities entitled to the special regime that is maintained by the Directorate General for Energy and Mining Policy as of 7 May 2009, nor those that were to have been registered in the Remuneration Pre-Assignment Registry under the fourth transitional provision of Royal Decree Law 6/2009 of 30 April, and that meet the obligation envisaged in its articles 4.8, extended until 31 December 2013 for those facilities associated to phase 4 envisaged in the Agreement of the Council of Ministers of 13 November 2009.

Pursuant to Royal Decree Law 14/2010 of 23 December 2010 ('**RDL14/2010**')—on urgent measures to correct the tariff deficit in the electricity sector—a cap was imposed on the hours of production eligible to receive the FITs.

Royal Decree 1565 of 29 November 2010 ('**RD1565/2010**') modified RD6618/2007 by eliminating the right of solar photovoltaic installations to a lifetime FIT and introduced a limitation of FIT to twenty-five years.

RDL14/2010 established urgent measures to correct the tariff deficit: it applied i) a maximum number of hours of operation on solar photovoltaic installations, and ii) a fee for all those using the transport and distribution networks, which was also an implementation of Commission Regulation (EU) No. 8385/2010 of 23 September 2010.

In early 2012, Spain began a process of taking steps to alter its framework for the encouragement and regulation of renewable energy production. The thrust of those

measures was to reduce the amount of compensation that producers of electricity through renewable sources of energy would receive for the electricity they sold to Spanish governmental entities. The stated impetus for this apparent change in policy was to address the 'tariff deficit' that Spain's public finances were experiencing. This expression referred to the financial situation of the Electricity System whereby its costs, including the payments it made for electricity provided by privately owned generating facilities, exceeded the revenues it earned from consumers of electricity. While the Electricity Law required the Government to manage the system in such a way that its costs and revenues would balance, in 2012 the Government of Spain, instead of increasing the retail tariff that it charged electricity consumers, decided to introduce an amendment to the remuneration scheme for the installations operating in the Special Regime. On 27 January 2012, the Spanish Government introduced Royal Decree Law 1/2012 (**RDL 1/2012**). It eliminated the feed-in renumeration regime facilities. Facilities which had been finally registered in the RAIPRE were excluded from RDL 1/2012.

Another measure taken by Spain was the passage of ***Law 15/2012***, effective 1 January 2013.

As stated in its Preamble, the objective underlying Law 15/2012 was to harmonize the Spanish tax system with an efficient and respectful use of the environment. In this context, Article 1 of Law 15/2012 introduced a levy on the value of the production of electricity and its incorporation into the electricity system. Law 15/2012 did not distinguish for the purpose of the implemented levy between production of energy by installations registered in the Ordinary or Special Regime. Law 15/2012, moreover, modified Article 30 of the Electricity Law by limiting the right of installations in the Special Regime to a premium in respect of renewable energy and thus depriving installations from receiving premiums in respect of energy produced using natural gas.

Law 15/2012 introduced a 7% tax on all revenue from generation of electricity whether from conventional or renewable sources. The preamble to the law explained that the measure was introduced to address the tariff imbalance and environmental concerns.

On 2 February 2013, the Spanish Government issued **Royal Decree Law 2/2013**, reducing the amount of the premium to which installations registered in the Special Regime had a right under RD 661/2007 to 0.0 € cent/kWh, while maintaining the regulated tariff, which was the second option for generators covered by the Special Regime. It was explained in the General Provisions of RDL 2/2013 that this amendment was introduced with the double objective of guaranteeing a reasonable rate of return to facilities in the Special Regime, while avoiding at the same time over-remuneration. RDL 2/2013 further introduced amendments to the mechanism for updating the premiums. Royal Decree Law 2/2013 replaced the reference to inflation, indexed with reference to the Spanish consumer price index (CPI) with a new one, the Spanish 'CPI at constant tax rates, excluding unprocessed foods and energy products'.

A few months later, the Spanish Government made further amendments to the remuneration system applicable to the renewable energy sector in Spain. On July 12, 2013 it enacted **Royal Decree Law 9/2013**, which amended Article 30(4) of the 1997 Electricity Law. Under RD 9/2013, the remuneration of installations producing renewable energy would be composed of the revenue derived from market participation and an additional remuneration which would cover the investment costs of an efficient and well-run company. According to the Preamble of this Royal Decree Law, this remuneration scheme would 'make it possible for renewable, co-generation and waste energy installations to

cover the costs needed to compete in the market on an equal level with other technologies and to obtain a reasonable rate of return.'

On 27 December 2013, Spain adopted **Law 24/2013**, which superseded the 1997 Electricity Law. Law 24/2013 abolished the distinction between the Ordinary and the Special Regimes in the 1997 Electricity Law and replaced it with a specific remuneration to be paid to renewable energy producing installations, which would be reviewed periodically. For the approval and monitoring of the specific remuneration, a specific remuneration register was created under the Ministry of Industry, Energy and Tourism. In the General Provisions of Law 24/2013, the legislator explained that the 1997 Electricity Law had failed in guaranteeing the financial balance of the system, as it lacked the necessary flexibility to cope with significant changes to the electricity system or economic trends.

In 2014, Spain adopted **Royal Decree 413/2014**, which provides for a regulatory regime intended to guarantee installations a reasonable return, calculated for a standard facility and in reference to the activity of an 'efficient and well-managed' plant. This amendment attempted to ensure that the higher costs of an inefficient company would not be taken into consideration in the application of the European Union State aid rules concerning compensation granted for the provisions of general economic interest.

While the concept of a reasonable return was to be linked to the performance of a standard facility, the rate of return could be greater in circumstances where the specific facility is able to out-perform its associated standard facility. This Royal Decree provides for the rights and obligations of installations producing electricity from renewable energy sources, cogeneration and waste, including the specific remuneration that the installations would be entitled to earn a reasonable rate of return. Some details of the new regime, however, were left to the government regulators who subsequently articulated them in **Ministerial Order 1ET/1045/2014** of 16 June 2014. This Ministerial Order sets out the parameters for 'standard facilities' to be applied for the calculation of the specific remuneration for the production of electricity from renewable energy sources, cogeneration and waste, where such facilities were either receiving premium payments under RDL 9/2013, or which complied with the requirements to receive such payments under RD 413/2014 and Law 24/2013.

Arbitral Awards Involving Spain

The claimants in *Charanne v. Spain* made their investments in 2009 against the background of the then existing regulatory framework. Changes to this framework were made in 2010. Claimants argued that the changes violated the FET standard, in particular since the changes frustrated the legitimate expectations of the claimants. The changes brought about reductions in the feed-in tariffs which in the view of the claimants changed, with retroactive effect, the legal and economic regime on which they had relied when making their investments.

Addressing legitimate expectations, the tribunal started out by noting that based on the principle of good faith under customary international law a State cannot induce an investor to make investments, thereby generating legitimate expectations later to ignore the commitments which had generated such expectations.[84]

The tribunal then tried whether any specific commitments, directed to the claimants, had been adopted by Spain. The tribunal found that this was not the case. In

[84] *Charanne v. Spain*, at para. 486.

doing so, it rejected the argument by the claimants that the regulatory framework existing at the time of the investment constituted specific commitments because the provisions in question were limited to a specific and limited group of investors. The tribunal said:

> To convert a regulatory standard into a specific commitment of the state, by the limited character of the persons who may be affected, would constitute an excessive limitation on power of states to regulate the economy in accordance with the public interest.[85]

Having thus concluded that there was no specific commitment in relation to the investors, the tribunal went on to examine whether the general legal order in force at the time of the investment could have generated legitimate expectations such that the existing rules would not be modified. Referring to previously rendered awards dealing with similar circumstances, the tribunal found that this was not the case.[86]

The tribunal said:

> In this case, the Claimants could not have the legitimate expectation that the regulatory framework established by RD 661/2007 and RD 1578/2008 would remain unchanged for the lifetime of their plants. Admitting the existence of such an expectation would, in effect, be equivalent to freeze the regulatory framework applicable to eligible plants, although circumstances may change. Any modification in the amount of the tariff or any limitation of the number of eligible hours would then constitute a violation of international law. In practice, the situation would be the same that if the State had signed a stabilisation clause or adopted a commitment to not modify the regulatory framework. The Arbitral Tribunal cannot support such a conclusion. The Claimants have made very clear that they do not claim to have had the legitimate expectation that the regulatory framework would remain unchanged. The Tribunal's conclusion according to which, in the absence of a specific commitment, the Claimants could not have a reasonable expectation that the regulatory framework established by RD 661/2007 and RD 1578/2008 remain frozen is reinforced by the fact that the jurisprudence of the highest Spanish judicial authorities had clearly established, prior to the investment, the principle that national law allowed to make changes to the regulation.[87]

In this context the tribunal noted that in order to rely on legitimate expectations, investors need to perform a due diligence analysis of the legal framework for the investment, which should include relevant case law. Had they done so, in the view of the tribunal, the claimant 'could have easily foreseen possible adjustments to the regulatory framework as those introduced by the rules of 2010.'[88]

Whilst the tribunal found that an investor could not—absent a specific commitment—have a legitimate expectation that the legal framework existing at the time of the investment would remain unchanged, it also found that an investor does have a legitimate expectation that when modifications are in fact made, they will not be unreasonable, disproportionate, or contrary to public interest.[89] The tribunal then went on to analyze whether the 2010 changes to the existing regulatory framework met these criteria. The tribunal found that the changes introduced were reasonable, proportionate and not in violation of the public interest. In its view the 2010 amendments did not violate Article 10(1) of the ETC.[90]

[85] Ibid., at para. 493. [86] Ibid., at paras. 499–503. [87] Ibid., at paras. 503–4.
[88] Ibid., at para. 505. [89] Ibid., at paras. 513–14. [90] Ibid., at paras. 527–32.

One arbitrator dissented partially. He did not agree with the majority's interpretation of legitimate expectations. In his view, legitimate expectations can be created not only by specific commitments but also based on the legal framework at the time of the investment.[91] The special regime created for photovoltaic power generation was in his view capable of creating—and did create—such expectations.

The regime encouraged investments in the sector, was aimed at a limited number of potential investors and provided guarantees, without which the claimants would not have made the investments.[92] The dissenting arbitrator also did not agree with the majority's view that an acceptance of claimants' arguments would amount to freezing the regulatory framework. Rather, he emphasized that the State has every right to exercise its regulatory power, but added that 'if in the valid exercise of that regulatory power the host State affects acquired rights or legitimate expectations, the State must compensate the damage caused'.[93]

The changed regulatory framework for the Spanish renewable energy sector was also the focus in *Isolux v. Spain*.[94]

In *Isolux v. Spain* the circumstances were similar with the important difference that the claimant also relied on changes to the regulatory framework introduced after 2010.

The claimant took the position that it had the legitimate expectation that Spain would respect its commitment to a long-term fixed feed-in-tariff and a stable and predictable framework. This legitimate expectation was essentially based on the regulatory framework at the time of the investment which was 29 October 2012. The tribunal thus had to determine whether the framework could have generated the legitimate expectations that there would be no modifications.[95] The tribunal found that there was no such legitimate expectation.

In particular, the tribunal noted that the regulatory framework had already been modified several times prior to claimant's investment. It said that these modifications 'showed a very unstable character of a regulatory framework that the government had the power and the duty to adapt to the economic and technical needs of the moment', within the Law on the Electricity Sector.[96]

The tribunal also emphasized that the legality of the amendments to the regulatory framework had been verified by the Spanish Supreme Court on several occasions between 2005–12. The tribunal referred, *inter alia*, to a decision by the Supreme Court of 9 December 2009 where the court explained that the only limit to the power of the government to modify its regulatory framework is the guarantee given by the Law on the Electricity Sector of a reasonable return for investors.[97] It was undisputed that a reasonable investor ought to perform an extensive legal due diligence prior to making his investment; the tribunal noted that knowledge of important decisions from the highest authority regarding the regulatory framework for investments could therefore be assumed.[98]

The tribunal noted that the preservation of the regime existing at the time of the investment—the so-called Special Regime—could not have been considered as an expectation, independently of its content, and that at the time of the investment—October

[91] Ibid., dissenting opinion at para. 5. [92] Ibid., at paras. 6–7. [93] Ibid., at para. 11.
[94] *Isolux Infrastructure Netherlands B.V. v. The Kingdom of Spain*, Award dated 12 July 2016.
[95] Ibid., at para. 784. [96] Ibid., at para. 788. [97] Ibid., at para. 792.
[98] Ibid., at para. 794.

2012—all investors were aware of, or should have been aware of, that the system was going to be modified.[99]

One arbitrator dissented, essentially along the same lines as in *Charanne v. Spain*. The dissenting arbitrator also took issue with the majority's view that the amendments to the regulatory framework were foreseeable.

In *Eiser v. Spain*[100] the dispute concerned three concentrated solar power (CSP) plants in Spain. Claimant argued that they made their investments in October 2007 reasonably relying on inducements and promises by Spain, in particular on the regime established in Royal Decree (RD) 661/2007.[101] When deciding to proceed with their investment, claimants relied on advice from local counsel and experts. Spain's conduct at the time of the investment, and subsequently, reassured claimants that their expectations of a stable regulatory regime were reasonable. During 2012–14 Spain took a series of measures[102] which in claimants' view radically changed the regulatory regime, replacing it with a completely different and arbitrary regime. In claimant's view the changes constituted a violation of the FET standard under Article 10(1) of the ECT.

The respondent denied any violation of the FET standard. It argued, *inter alia*, that it is entitled to change its regulatory regime to meet compelling economic challenges, such as the tariff deficit in order to serve the public welfare.

The tribunal started out its analysis by noting that absent explicit undertakings directly extended to investors and guaranteeing that laws and regulations will not change, investment treaties do not eliminate a State's right to modify its regulatory regime to meet evolving circumstances and public needs.[103] It went on to say that the FET standard under the ECT does protect investors from a fundamental change to the regulatory regime in a manner that does not take account of the circumstances of existing investments made in reliance on the prior regime.[104]

After having reviewed the effects of the new regulatory regime, the tribunal concluded that:

> […] the evidence shows that Respondent eliminated a favorable regulatory regime previously extended to Claimants and other investors to encourage their investment in CSP. It was then replaced with an unprecedented and wholly different regulatory approach, based on wholly different premises. This new system was profoundly unfair and inequitable as applied to Claimants' existing investment, stripping Claimants of virtually all of the value of their investment.[105]

Further expanding on its understanding of the FET standard in Article 10(1), the tribunal noted that regulatory regimes can of course evolve and change. They cannot, however, 'be radically altered as applied to existing investments in ways that deprive investors who invested in reliance on those regimes of their investment's value.'[106]

The tribunal went on to say:

> Claimants could not reasonably expect that there would be no change whatsoever in the RD 661/2007 regime over three or four decades. As with any regulated investment, some changes had to be expected over time. However, Article 10(1) of the ECT entitled them to expect that Spain would not drastically and abruptly revise the regime, on which their investment depended, in a way that

[99] Ibid., at para. 803.

[100] *Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain*, ICSID Case No. ARB/13/36, Award dated 4 May 2017.

[101] See p. 198 *et seq.*, *supra.* [102] See p. 201 *et seq.*, *supra.* [103] Ibid., at para. 362.

[104] Ibid., at para. 363. [105] Ibid., at para. 365. [106] Ibid., at para. 382.

destroyed its value. But this was the result of RDL 9/2013, Law 24/2013, RD 413/2014 and implementation of the new regime through Ministry implementing Order IET/1045/2014.[107]

In describing the changes brought about by RDL 9/2013, the tribunal noted that Spain introduced a new regulatory approach which significantly reduced the projected revenues of claimants.[108]

Spain argued that as a matter of Spanish law claimants were entitled to a reasonable return on their investment and could not reasonably have had any other expectations.[109]

The tribunal said:

> Spain's new regulatory regime deemed this reasonable return to be a pre-tax return of 7.398% on the hypothetical asset value of a hypothetical 'efficient' plant. This equated to 5.2% after tax on the hypothetical asset base. The new target return was calculated on the basis of Spain's ten-year government bonds, plus an unexplained differential of 3%. Respondent deemed this target rate, which is identical in all 'standard' installations, to be the 'reasonable return' required by Spanish law. By contrast, according to Respondent's Ministry of Industry, Energy and Tourism, the RD 661/2007 regime on the basis of which Claimants made and financed their investment was structured to provide substantially higher after-tax returns to successful CSP investors:
>
> With regard to technologies in need of a boost in view of their limited development, such as biogas or solar-thermoelectric, profitability shall rise to 8% for facilities that choose to supply distributors and between 7% and 11% return for those participating in the wholesale market.
>
> Because the new system provided for the reduced target rate of return based on a hypothetical 'efficient' plant, facilities like Claimants', which incurred higher initial construction and financing costs in order to attain increased production later, necessarily had a lower return on their investment. As explained below, the Tribunal has serious reservations about basing the new regulatory regime on the hypothetical costs of a hypothetical 'efficient' plant. However, standing alone, the Respondent's decision to alter the target rate of return potentially available to existing investors as done here casts into question the fairness and equity of the change to the new regime.[110]

The tribunal explained its reference to hypothetical costs in the following way:

> The new regime pays no regard to actual costs (including loan servicing) or actual efficiencies of specific existing CSP plants. Moreover, within limits intended to assure threshold amounts of production, remuneration no longer is based on the amount of electricity generated. Instead, existing plants' remuneration is based on their generating capacity and regulators' estimates of the hypothetical capital and operating costs, per unit of generating capacity, of a hypothetical standard installation of the type concerned. The regulatory regime also sets the regulatory life of a plant. Once set, neither the regulatory life nor the prescribed 'initial value of the investment' can be changed.
>
> While some systems of utility regulation do set rates at a level designed to attain a preapproved rate of return based on asset values, such regulation involves actual asset values and is typically confined to monopolies such as water utilities or pipelines. RDL 9/2013's approach is quite different. Spain's regulators prescribed a target rate of return for a hypothetical efficiently run facility having hypothetical financial and operating costs per unit of generating capacity.[111]

The other major concern of the tribunal with respect to the new regime was that the new regime was, in the view of the tribunal, applied retroactively to existing facilities.[112] The tribunal noted:

[107] Ibid., at para. 387 (footnotes omitted). [108] Ibid., at para. 389.
[109] Ibid., at para. 392. [110] Ibid., at paras. 392–3. [111] Ibid., at paras. 398–9.
[112] Ibid., at para. 400.

Respondent's new regime allows it, in setting remuneration going forward, to take account of supposedly excess returns received by a CSP plant prior to the change to the new system in 2014. Thus, a CSP plant could in principle have its subsidies reduced or even eliminated altogether, should regulators conclude that it had previously received payments greater than required to attain the idealized target return.[113]

In the arbitration, Spain argued that its actions were consistent with the assurances of a reasonable return found in Spanish law and with the requirements of the Spanish Constitution and its actions were regularly upheld by the Spanish courts.[114] Among other cases Spain relied on a decision by the Spanish Supreme Court dated 17 December 2015 which upheld the constitutionality of RDL 9/2013. i.e. the new legislation which repealed RD 661/2007. The tribunal noted:

This, however, is not a sufficient response to Claimants' claims, which also must be tested against the obligations Respondent assumed by becoming a party to the ECT. Indeed, Spain's Supreme Court indicated in its 17 December 2015 decision that under Spanish law, the question of conformity with Spain's Constitution and with the requirements of the ECT are quite different.[115]

In *Novenergia v. Spain*,[116] the claimant having made its investment in 2007, complained about measures taken by Spain in 2010, and subsequently.

Claimant argued that Spain had undermined and destroyed the Special Regime introduced by RD 661/2007 by promulgating and implementing the following laws and regulations:

RD 1565/2010: introduced a cap on the number of years for which the FIT was available;

RDL 14/2010: introduced a cap on the number of yearly production hours entitled to the FIT;

Law 15/2012: introduced a 7% tax on energy production with a dramatic effect on remuneration (though its effects were somewhat mitigated by the Specific Regime); and

RDL 2/2013: modified the mechanism for updating the FIT. From being indexed to the CPI, updates of the FIT became indexed to a significantly less beneficial ad hoc CPI.

RDL 9/2013 and Law 24/2013: repealed the Special Regime and modified Law 54/1997, including defining the concept of 'reasonable rate of return' as a cap on returns. A Specific (rather than a 'Special') Regime was introduced with a remuneration based on the investment costs of 'model facilities' defined with reference to 'an efficient and well-managed company', but provided no content to these concepts. The new Specific Regime applied retrospectively to the entire lifespan of PV plants. It affected those plants that had already begun operation and had already registered with the RAIPRE. This regime could be revised, without limitation, every six years.

RD 413/2014 and Order 1045/2014: provided the details for the operation of the Specific Regime. Remuneration became contingent on a litany of criteria that were wholly different from those in the Special Regime—criteria that investors were unaware of when investing in their PV plants and registering them with the RAIPRE under RD 661/2007. Further, said criteria could (and the expectation was that they would) easily be extensively reviewed, changed, and amended going forward.[117]

The tribunal started out its analysis by addressing the question whether claimant's expectations were legitimate and reasonable. The claimant argued that Spain by virtue of Law

[113] Ibid., at para. 402. [114] Ibid., at para. 372. [115] Ibid., at para. 373.

[116] *Novenergia II – Energy & Environment (SCA) SICAR v. The Kingdom of Spain*, Award dated 15 February 2018.

[117] Ibid., at paras. 189–90.

54/1997 and RD 661/2007 had in the photovoltaic sector offered a guaranteed FIT to producers of renewable energy for lifetime under the Special Regime.[118]

The tribunal agreed with claimant. With respect to the regulatory framework the tribunal said:

In the Tribunal's view, a number of relevant statements or assurances were made by the Respondent with respect to the Special Regime, as initially introduced through Law 54/1997 and further developed by RD 661/2007 and legislation in between:

(e) In Law 54/1997, it was stated that RE facilities admitted to the Special Regime would be authorized to incorporate 'all the energy produced by them into the system' and would 'obtain reasonable rates of return' as set by the government.
(f) RD 436/2004 was enacted as expressly aiming at 'provid[ing] those who have decided or will decide in the near future to opt for the special regime with a durable, objective, and transparent framework'.
(g) Under RD 436/2004, PV plants were entitled to incorporate into the grid all of the electric energy produced in exchange for a FIT or premium for the lifespan of the PV plants.
(h) Under RD 661/2007, which replaced RD 436/2004, PV plants enrolled in the RAIPRE before the cut-off date would be entitled to (i) incorporate all of their net production into the grid; (ii) a FIT that would only be updated in accordance with the national CPI, and (iii) receive a fixed FIT for the lifespan of the PV plants.[119]

The tribunal also referred to additional information which had been provided to claimant:

Moreover, the investors were provided with the following information:

(a) In the prospectus 'The Sun Can Be All Yours', the IDAE, an organ of the Kingdom of Spain, wrote with respect to investments in the PV sector that '[t]he return on the investment is reasonable and can sometimes reach up to 15%' and offered 'significant financing of the investment'.
(b) In REP 2005–2010, with respect to the Special Regime, the Kingdom of Spain declared that 'the proper functioning of these mechanisms must be guaranteed […] to maintain investor's confidence' and that it should maintain 'investor's confidence […] through a stable and predictable support scheme'.
(c) In a new prospectus in the 'The Sun Can Be All Yours' series in June 2007, the IDAE wrote that investors in the PV sector would 'obtain[] a maximum return on the investment' throughout the lifespan of the facility, namely through the FIT in RD 661/2007.[120]

Spain referred to several warning signs which in its view should have alerted claimant to the fact that the Special Regime would not remain intact during the lifetime of the photovoltaic plants.[121] The tribunal noted, however, that the vast majority of the sources referred to by Spain post-dated claimant's investment.[122] With respect to statements which pre-dated claimant's investment, the tribunal said:

As regards statements in relation to 'economic sustainability' and 'reasonable rate of return' the Tribunal finds the Respondent's arguments unconvincing, since these principles were still generally vague and insufficiently defined at the time of the Claimant's investment.Precise content was given to these principles through the introduction of Law 15/2012 and RDL 9/2013, which were enacted long after the Claimant had already made its investment. Accordingly, they cannot

[118] Ibid., at para. 663. [119] Ibid., at para. 666 (footnotes omitted).
[120] Ibid., at para. 668 (footnotes omitted). [121] Ibid., at para. 671. [122] Ibid.

be considered apposite for the assessment of the reasonability of the Claimant's expectations at the time of the investment, as the Respondent suggests.[123]

The next step in the tribunal's analysis was to address the question whether changes made to the regulatory framework after 2007 constituted a violation of the fair and equitable treatment.

The tribunal began with the changes introduced in 2010, i.e. RD 1656/2010 and RDL 14/2010. The tribunal concluded that these changes did not violate the fair and equitable standard.[124] Nor did RD 2/2013, in the view of the tribunal.[125]

The tribunal moved on to address changes introduced in 2013 and 2014, i.e. RDL 9/2013, RD 413/2014, Law 24/2013 and Ministerial Order 1054/2014.

Spain had argued and emphasized that the focus must be on the economic impact of the challenged measures on claimant's investment. In Spain's view the impact was negligible since claimant was still making a reasonable profit.[126]

The tribunal responded in the following way to this argument:

> In the Tribunal's view, the assessment of whether the FET standard has been breached is a balancing exercise, where the state's regulatory interests are weighed against the investors' legitimate expectations and reliance. It is not simply sufficient to look at the economic effect that the challenged measures have had. Destruction of the value of the investment is clearly determinative in the assessment of whether a state has breached Article 13 of the ECT, but it is but one of several factors to consider when determining whether a state has breached Article 10(1) of the ECT. Nevertheless, in the Tribunal's opinion, the economic effect on a claimant's investment is an important factor in the balancing exercise pursuant to Article 10(1) as well, as it can go towards showing a change in the essential characteristics of the legal regime relied upon by investors in making long-term investments.[127]

The tribunal concluded that the changes introduced via RDL 9/2013, Law 24/2013, RD 413/2014, and Ministerial Order 1045/2014 amounted to a breach of the fair and equitable treatment standard. The tribunal explained its conclusion in the following way:

> Taking into account the Kingdom of Spain's statements and assurances prior to and in connection with the implementation of RD 661/2007, the legitimate expectations of the Claimant, and the changes introduced through RDL 9/2013, the Tribunal considers these challenged measures as radical and unexpected. The manner in which the Kingdom of Spain adopted the measures including and subsequent to RDL 9/2013 fell 'outside the acceptable range of legislative and regulatory behaviour' and 'entirely transform[ed] and alter[ed] the legal and business environment under which the investment was decided and made'. Moreover, the challenged measures adopted in 2013 and 2014 had a significant damaging economic effect on the Claimant's investments as evidenced by the Claimant's invoked expert reports and the Claimant's opening statement during the Hearing. The Claimant's demonstratives, displayed during the Hearing, showed lower revenues on all of the PV Plants, the majority of which showed a decrease between 24 and 32% between 2013 and 2016. In the Tribunal's view, the measures implemented in 2013 and 2014 by the Respondent certainly constitute a substantial deprivation of the Claimant's investment. Consequently, the Tribunal considers the Kingdom of Spain's actions as drastic and unexpected in a manner that is contrary to the Kingdom of Spain's obligation to provide FET to investors.[128]

[123] Ibid., at para. 673. [124] Ibid., at para. 688. [125] Ibid., at para. 689.
[126] Ibid., at para. 692. [127] Ibid., at para. 694 (footnotes omitted).
[128] Ibid., at para. 695 (footnotes omitted).

In *Masdar v. Spain*,[129] claimant invested in three concentrated solar power plants – Gemasolar in November 2008 and Arcosol and Termesol in 2009. Claimant submitted that it invested in the reasonable expectation that the solar plants would benefit from the regime introduced under RD 661/2007 for the lifetime of the plants and there would be no retroactive changes.[130]

Claimant argued that certain measures taken by Spain completely eliminated its expectations and the foundation on which it had made its investments.[131]

The measures referred to by claimant were: Law 15/2012; RDL 2/2013; RDL 9/2103; Law 24/2013; RD 413/2014 and Ministerial Order 1054/2014.[132]

In its analysis the tribunal focused on determining which kind of commitments from a State can give rise to protected legitimate expectations of an investor. The tribunal started out by identifying two approaches to the question: one approach is that such commitments can result from statements in general legislation, whereas the other approach requires that such commitments be specific.[133]

In the case before it, the tribunal found that specific commitments had been issued by Spain.

In December 2009 each of the three plants received a letter in the form of a resolution by the Directorate General for Energy Policy and Mines confirming that the plants had been entered in the so-called Pre-Allocation Registry for Compensation and that the economic regime in RD 661/2007 was to be applied to the plants.[134] The plants were subsequently registered with RAIPRE. The resolution expressly stated that the plants were to benefit from the guarantees of RD 661/2007.

The tribunal continued:

> Second, on 1 December 2010, Torresol had sent three letters to the Ministry of Industry, Tourism and Business, Directorate General of Energy Policy and Mines in the names of Gemasolar, Arcosol-50, and Termesol, respectively. Each of the letters set out its request that: '[…] *the compensation conditions for the facility* **throughout its operating life** *be communicated*.' (Emphasis added)
>
> Third, the Ministry of Industry, Tourism and Business answered these three requests, which sought specific clarification in respect of each facility as to the '[…] *compensation conditions for the facility* **throughout its operating life** […]' by sending a further three letters, each of which was addressed to one of the three Plants, by which it:
>
> '*[c]ommunicates that, currently, and by virtue of the provisions of section 1 of the fifth transitional provision of Royal-Decree-law 6/2009, dated 30 April,* ***the retribution applicable to the installations consists of the tariffs, premiums, upper and lower limits and supplements established in Royal Decree 661/2007, dated 25 May*** *[…]*' (Emphasis added)
>
> It would be difficult to conceive of a more specific commitment than a Resolution issued by Spain addressed specifically to each of the Operating Companies, confirming that each of the Plants qualified under the RD661/2007 economic regime for their '*operational lifetime*'.[135]

The tribunal found that claimant's legitimate expectations had not been met and that Spain was in breach of its fair and equitable treatment obligation under Article 10(1) of the ECT.[136]

[129] *Masdar Solar & Wind Cooperatief U.A. v. Kingdom of Spain*, Award dated 16 May 2018.
[130] Ibid., at para. 356. [131] Ibid., at paras. 379, 464. [132] See p. 201 *et seq.*, *supra.*
[133] Ibid., at paras. 489–90. [134] Ibid., at para. 516. [135] Ibid., at paras. 518–20.
[136] Ibid., at paras. 521–2.

In *Antin v. Spain*,[137] the claimants invested in two concentrated solar power (CSP) plants in 2011. The investments were made under the Special Regime provided by RD 661/2007 and subsequent regulations as per the date of the investment. The regulatory framework at the time of the investment formed the basis for the legitimate expectations of the investors.

The claimants argued that these expectations were twofold.

First, at the time it made its investments, they expected that the plants would be subject to the FIT regime for their entire operational life, since they complied with all applicable registration requirements. Spain's undertakings in this regard were sufficiently specific to generate legitimate expectations, since (i) it provided stabilization commitments in Article 4 of RD 1614/2010 for CSP plants and (ii) repeatedly confirmed in face-to-face meetings that its intention was for the FIT to apply for the lifetime of the plants without any retroactive changes.

Secondly, the claimants expected that any future changes to RD 661/2007 would only apply to new installations, while existing installations would remain unaffected. Spain had expressly made such stability commitment in Article 44(3) of RD 661/2007 and later confirmed this interpretation by issuing RD 1578/2008, which introduced reductions of tariffs payable to PV installations, but only to those that did not qualify for FITs under RD 661/2007. Article 4 of RD 1614/2010 further reinforced these stability commitments. The claimants' expectations were enhanced by specific assurances by Spain's public officials that the economic regime would not be changed to the detriment of existing CSP installations.

The claimants further argued that their expectations were reasonable and legitimate based on the offers and promises made by the Spanish Government.[138]

In claimant's view these expectations were frustrated by the elimination of all the key features of the RD 661/2007 regime which amounted to a violation of Spain's FET obligation under the ECT. In particular, claimants argued that the key features were eliminated when Spain (i) withdrew the FIT for electricity production using natural gas under Law 15/2012 and then capped the use of natural gas for essential technical purposes through Ministerial Order IET/1882/2014; (ii) introduced the TVPEE which constitutes a disguised and unjustified cut of the FIT; (iii) eliminated the Premium through RDL 2/2013; (iv) replaced the CPI-linked updating mechanism for the FIT by a lower index also through RDL 2/2013; and finally, (v) eliminated the RD 661/2007 economic regime in its entirety through RDL 9/2013 and introduced a substantially less favourable regime without FIT.[139]

When addressing and analyzing the arguments put forward by the parties, the tribunal summarized its understanding of the FET standard under Article 10(1) of the ECT in the following way:

'In sum, considering the context, object and purpose of the ECT, the Tribunal concludes that the obligation under Article 10(1) of the ECT to provide FET to protected investments comprises an obligation to afford fundamental stability in the essential characteristics of the legal regime relied upon by the investors in making long-term investments. This does not mean that the legal framework cannot evolve or that a State Party to the ECT is precluded from exercising its regulatory powers to adapt the regime to the changing circumstances in the public interest. It rather means that a regulatory regime specifically created to induce investments in the energy sector cannot be

[137] *Antin Infrastructure Services Luxembourg S.à.r.l. and Antin Energia Termosolar B.V. v. Kingdom of Spain*, Award dated 15 June 2018.

[138] Ibid., at para. 510. [139] Ibid., at para. 511.

radically altered—i.e., stripped of its key features—as applied to existing investments in ways that affect investors who invested in reliance on those regimes.'[140]

Spain argued that as a matter of Spanish law, the claimants were only entitled to a reasonable return on their investment; they could not reasonably have had other expectations.[141]

The parties disagreed whether the new regime complied with the principle of reasonable return. Against the background of the parties' arguments and the terms of the ECT the tribunal noted that:

> … the issue at hand is not whether the New Regime provides a 'reasonable return', but rather how such 'reasonable return' is determined. To comply with the stability and predictability requirements under the ECT, the methodology for determining the payment due to CSP installations must be based on identifiable criteria.[142]

The tribunal then went through the methodology for determining the 'reasonable return' under the New Regime and concluded that it was not based on any identifiable criteria. The tribunal said:

> Based on the evidence on the record of this arbitration, the Tribunal concludes that the methodology for determining the 'reasonable rate of return' under the New Regime is not based on any identifiable criteria. On the contrary, what Spain labels a 'reasonable rate of return' seemingly depends on governmental discretion. This is in plain contrast with the relative precision of the Original Regime—in force when the Claimants made their investment—which provided for objective and identifiable criteria for determining the remuneration due to CSP plants, which were expressly specified in the regulation and were dependent on the market.[143]

Spain also argued that the measures which were disputed by the claimants were adopted to address the Tariff Deficit and to preserve the sustainability of the electricity system.

Whilst the tribunal recognized that addressing the Tariff Deficit, constituted a legitimate public policy for Spain, it noted that the Tariff Deficit arose before Spain had any significant renewable energy capacity. The tribunal therefore rejected Spain's suggestion that the incentives offered under the Original Regime caused the Tariff Deficit, nor did it accept that the incentives for CSP plants played a significant role in the accumulation of the Tariff Deficit.[144]

In *Greentech v. Spain*[145] the claimants invested in three Spanish companies which operated three photovoltaic facilities under RD 661/2007.

The claimants challenged the following measures introduced by Spain subsequent to the investments made by the claimants: RD 1565/2010; RD 14/2010; Law 15/2012; RDL 2/2013; RDL 9/2013; Law 24/2013; RD 413/2014 and Ministerial Order IET/1045/2014.

In its reasons the tribunal started out by determining the scope of the FET standard under the ECT. It noted that when a State has not made any specific commitment with respect to legal stability a host State has space reasonably to modify the legal or regulatory framework in question without breaching an investor's legitimate expectations.[146] It

[140] Ibid., at para. 510.
Ibid., at para. 561.
[141] Ibid., at para. 510.
Ibid., at para. 561.
[142] Ibid., at para. 562. [143] Ibid., at para. 568. [144] Ibid., at paras. 570–2.
[145] *Greentech Energy System A/S, Foresight Luxembourg Solar 1 S.A.R.L., Foresight Luxembourg Solar 2 S.A.R.L., GWM Renewable Energy I S.P.A, GWM Renewable Energy ll S.P.A v. Kingdom of Spain.*
[146] *Greentech v. Spain*, at para. 356.

added that the State's right to regulate must be subject to limitations so as not to render investor protections meaningless.[147]

The tribunal then went on to discuss whether the claimants had legitimate expectations that the tariff regime under RD 661/2007 would not change.

The conclusion drawn by the tribunal was that claimants did not have legitimate expectations that they would receive the FIT under RD 661/2007 for the entire lifetime of the plants. The tribunal concluded, however, that they had the legitimate exception that the legal and regulatory framework would not be abruptly and fundamentally changed, thereby depriving the investors of a significant part of their projected revenues.[148]

In addition to the express language of RD 661/2007 the tribunal referred to statements by Spanish officials emphasizing the stability of the remuneration regime for facilities registered under RD 661/2007 and promoting the possibility of returns for investors well above 7%.[149]

The final question then for the tribunal to address was whether Spain did abrogate the RD 661/2007 regime, and if so, whether claimants' legitimate expectations were breached by Spain.

In the tribunal's view none of the changes introduced by RD 1565/2010, RDL 14/2010 or RD 2/2013 met the threshold requirement of a fundamental change of the regulatory framework.[150]

The tribunal then turned to the new regime that was introduced by Spain pursuant to RDL 9/2013, Law 24/2013, RD 413/2014 and Ministerial Order 1045/2014. In the view of the majority of the tribunal these changes abrogated the RD 661/2007 regime and introduced a number of fundamental changes to the support scheme for claimants' plants.[151]

The majority of the tribunal concluded that Spain had violated the FET standard in Article 10(1) of the ECT. It explained:

> The majority of the Tribunal concludes that the Respondent's enactment of the New Regulatory Regime constituted a fundamental change to the legal and regulath.ory framework that crossed the line from a non-compensable regulatory measure to a compensable breach of the FET standard in the ECT.[152]

Awards Concerning Renewable Energy Involving Italy and the Czech Republic

In *Blusun v. Italy*[153] the dispute concerned a photovoltaic project in the region of Puglia, in the municipalities of Brindisi and Mesogne. The claimant argued that Italy had breached Article 10(1) of the ECT by failing to create stable, equitable, favourable and transparent conditions in the Italian energy sector. Italy had also breached claimant's legitimate expectations in breach of the FET standard.

The project companies involved were eventually declared bankrupt, due to lack of financing. Claimants argued that Italy was responsible for this failure because it caused legal insecurity which was the effective cause of the failure to attract financing.

Claimants relied on four occasions which in its view caused legal instability.

First, it relied on a decision by the Constitutional Court of Italy regarding a regional law which had been challenged by the government. The tribunal noted that the government's

[147] Ibid., at para. 364. [148] Ibid., at para. 365. [149] Ibid., at para. 378.
[150] Ibid., at para. 388. [151] Ibid., at para. 390. [152] Ibid., at para. 398.
[153] *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic*, Award dated 27 December 2016.

challenge was made well before claimant's investment; claimant thus took the risk that the challenge could succeed. The tribunal also noted that the decision did not generate any real doubt as to what the applicable regime was.[154]

Secondly, claimants relied on a decree implementing an EU Directive, the so-called Romani Decree. The decree in turn resulted in the Fourth Energy Account.[155] The Romani Decree amended the conditions for access to feed-in-tariffs under the Third Energy Account of photovoltaic plants. One major aim of the amendment was to reduce incentives and thereby feed-in-tariffs. The tribunal observed that while the reduction in FITs was quite substantial, it was not crippling or disabling. It was a response to a genuine fiscal need. The tribunal also noted that the reduction in incentives was proportionately less than the reduction in the cost of photovoltaic technology in 2010.[156] In conclusion, the tribunal found that the 'Romani Decree and the Fourth Energy Account, taken overall, were not disproportionate, did not violate specific commitments made to the promotion of PV plants, and did not breach Article 10(1), first sentence of the ECT.'[157]

Thirdly, claimants argued that the publication of a series of lists by the responsible authority gave rise to confusion and consternation on the Italian solar market. The Fourth Energy Account established a register of large plants eligible for FIT to be administered by the authority in question. Lists were published, amended, and withdrawn which in claimants' view caused uncertainty. The tribunal concluded that Italy had acted in good faith in the complicated task of compiling the lists, and that in doing so, Italy had not breached any applicable standards of due diligence.[158]

Fourthly, claimants relied on a stop work order issued by the Municipality of Brindisi, which was based on alleged violations of zoning regulations. In claimants' view, this was the final blow to the project. The tribunal did not agree with the claimant. The tribunal said:

> The order was temporary in effect, was legally motivated, and was dealt with reasonable promptness. It was not arbitrary or discriminatory, but fell well within the range of legal risk of an industrial enterprise, in particular, one based on debatable regulatory grounds.[159]

In addition to the claim of legal instability—which was based on the first sentence of Article 10(1)—claimants based their claim on the FET standard—in particular legitimate expectations—on the second sentence of Article 10(1).

In rejecting claimants' argument, the tribunal said, *inter alia*, the following:

> In the absence of a specific commitment, the state has no obligation to grant subsidies such as feed-in tariffs, or to maintain them unchanged once granted. But if they are lawfully granted, and if it becomes necessary to modify them, this should be done in a manner which is not disproportionate to the aim of the legislative amendment, and should have due regard to the reasonable reliance interests of recipients who may have committed substantial resources on the basis of the earlier regime. These considerations apply even more strongly when the context is subsidies or the payment of special benefits for particular economic sectors.[160]

Claimant had argued that they had reasonable expectations to find a stable regulatory environment and that there was no reason to believe that an incentive system for photovoltaic projects would come to an end. To this the tribunal responded:

[154] Ibid., at para. 329. [155] Ministerial Decree dated 5 May 2011. [156] Ibid., at para. 342.
[157] Ibid., at para. 343. [158] Ibid., at para. 350. [159] Ibid., at para. 360.
[160] Ibid., at para. 372.

But a reasonable market expectation as to some state of affairs, justified or not, is not a basis for shifting risks to the public sector, i.e. the state budget. Circumstances change and in the absence of specific commitments, the risk of change is for entrepreneurs to assess and assume.[161]

Another ECT award involving the renewable sector in Italy was rendered in December 2018, *Greentech v. Italy.*[162] The dispute arose out of investments by NovEnergia, NIP, and Greentech in Italian companies owning a total of 134 photovoltaic (PV) plants located in Italy. The investments were made during the period from 2008 to 2013. Claimants alleged that they were induced to make those investments, *inter alia*, by Italian legislation, regulatory decrees, and contractual provisions that provided financial incentives. Foremost among those measures were the *Conto Energia* decrees providing for incentive tariff premiums, fees added to the market price, lasting for a twenty-year period starting from each PV plant's connection to the grid and execution of an agreement with the *Gestore dei Servizi Energetici* (GSE). Beginning in 2012, Italy implemented a series of measures that allegedly diminished the value of the incentives and culminated in Law Decree No. 91/2014 of 24 June 2014 (the '*Spalma-incentivi* Decree'), which allegedly harmed Claimants and their respective investments.

Claimants alleged that Italy had not accorded their investments fair and equitable treatment and was therefore in breach of Article 10(1) of the Energy Charter Treaty.

Like in Spain, the Italian legislation concerning investments in the renewable energy sector was prompted by various EU initiatives. The Italian regulatory framework was essentially structured in the following way.[163]

Italy implemented Directive 2001/77/EC by enacting *Legislative Decree No. 387* on 29 December 2003, which provided that specific criteria to promote solar energy would be set forth in ministerial decrees adopted by the Minister of Productive Activities in consultation with the Ministry of Environment and Protection of Natural Resources.

Legislative Decree No. 387 provided that the criteria established through the implementing decrees must not impose any new costs on the state budget. It also provided that incentives '[f]or electricity produced by photovoltaic conversion of solar energy [shall] provide for a specific rate with decreasing amount and duration, such as to ensure a fair return on the costs of investment and operation.' The 'decreasing amount' of the incentive rates was related to the anticipated operational cost reductions as PV technology improved.

In 2005, pursuant to Legislative Decree No. 387, Italy initiated a system by which qualified PV facility operators received incentive payments for each unit of electricity generated, which were paid in addition to the wholesale electricity prices which those operators received. This was effected through a series of so called '*Conto Energia*' (Energy Account) ministerial decrees. The incentive tariffs were structured as a premium that accrued in addition to the market prices received by PV operators. Each of the *Conto Energia* decrees expressly provided that the tariff premiums, once granted, would be paid for a twenty-year period commencing from the date of a PV plant's entry into operation.

Since Legislative Decree No. 387 did not allow the costs of incentives to be borne by the State, those costs were passed on to electricity consumers through electricity bills. The

[161] Ibid., at para. 373.

[162] *Greentech Energy Systems A/S, NovEnergia II Energy & Environment (SCA) SICAR, and NovEnergia II Italian Portfolio SA v. the Italian Republic*, Award dated 23 December 2018.

[163] *Greentech v. Italy*, at paras. 107–30.

AEEG (Authority for Electrical Energy and Gas) collected those fees from consumers to cover the incentive tariff costs. The GSE was the state-owned company responsible for paying the incentive tariffs to electricity producers under the *Conto Energia* decrees.

The GSE confirmed the right to a specific tariff rate by means of a letter to the person or company holding the project rights to a PV facility, as well as by a contract entered into with the person or company. Contracts between the GSE and the owners of PV facilities became effective on the date when the PV facility entered into operation.

The first *Conto Energia* decree, which applied to eligible PV facilities under 1 MW in capacity, was enacted on 28 July 2005 (as amended in 2006, '*Conto* I'). *Conto* I, prior to its amendment in 2006, set a national target for total PV capacity of 300 MW, which was raised to 1000 MW in 2006.

Conto I provided for eligible PV facilities to receive fixed incentive premiums for a twenty-year period.

Conto I also provided for tariffs to be adjusted upward for inflation according to the ISTAT (Italian National Statistics Institute) index. The inflation adjustment was revoked in the 2006 amendment to *Conto* I, and subsequent *Conto Energia* decrees did not provide for an ISTAT inflation adjustment.

Under *Conto* I, a PV operator seeking to obtain incentive tariffs was required to submit a formal request. After receiving a provisional authorization, the developer had to commence and complete construction and connect to the grid within a certain time limits – no later than twenty-four months from the authorization to grid connection.

The second *Conto Energia* decree ('*Conto* II') was enacted on 19 February 2007. *Conto* II eliminated the preliminary authorization phase that existed under *Conto* I and instead provided that PV producers could apply for the incentive benefits upon entry into operation of their facilities. *Conto* II provided for an increased capacity threshold, permitting facilities over 1 MW to apply for incentive tariffs, and a cumulative installed capacity of 1,200 MW.

Under *Conto* II, eligible PV facilities could obtain incentive tariffs at rates that varied depending upon certain criteria, including the facility's nominal capacity and size, and when the facility entered into operation. The rates were lower than those under *Conto* I. Facilities entering into operation prior to 31 December 2008 received a slightly higher rate than those which entered into operation between 1 January 2009 and 31 December 2010.

The period of eligibility for *Conto* II was extended by the so-called 'Salva Alcoa' decree, which enabled PV plants built by 31 December 2010 and entering into operation by 30 June 2011 to benefit from the *Conto* II incentives.

The third *Conto Energia* decree ('*Conto* III') was enacted on 6 August 2010. Under *Conto* III, eligible PV facilities entering into operation by 31 December 2011 could obtain tariff premiums ranging from EUR 0.251 per kWh to EUR 0.362 per kWh, with plants entering into operation in 2012 and 2013 receiving a somewhat reduced rate. Qualification of new PV facilities under *Conto* III was available until the threshold of 3,000 MW in cumulative installed capacity was reached, although facilities that entered into operation within fourteen months of the date when the threshold was reached could also receive the tariffs.

Italy implemented Directive 2009/28/EC by issuing *Legislative Decree 28 of 3 March 2011*, referred to as the 'Romani Decree'. The Romani Decree implemented various changes, *inter alia*, a shorter qualifying period for *Conto* III tariffs, requiring eligible

plants to enter into operation by 31 May 2011 instead of 31 December 2013, the original cut-off date. In connection with the modified qualifying period, the Ministry of Economic Development was to establish revised incentive tariffs for PV plants entering into operation after 31 May 2011, resulting in the fourth *Conto Energia* decree. The Romani Decree also required that future incentive tariff decrees take into account cost reductions already achieved for PV technology and the level of incentives being offered in other EU countries.

The fourth *Conto Energia* decree ('*Conto* IV') was enacted on 5 May 2011. *Conto* IV provided that eligible PV plants entering into operation between 31 May 2011 and 31 December 2016 could qualify for incentive tariffs lasting for a twenty-year period according to rates set forth therein.

Conto IV instituted measures to limit the increasing costs of the incentive tariff programmes, including by setting caps on total programme costs for semester, precluding approval of further PV facilities within a semester once the threshold had been reached. Additionally, *Conto* IV set a national target of 23,000 MW of cumulative installed capacity, which was said to correspond to an annual cost for the incentives of between EUR 6 billion and EUR 7 billion.

The fifth and final *Conto Energia* decree ('*Conto* V') was enacted on 5 July 2012 and entered into force on 27 August 2012. *Conto* V provided that it would cease to apply thirty days after the AEEG issued a resolution stating that Italy had added EUR 700 million to the total cost of the incentive tariffs programme, amounting to a total cost of EUR 6.7 billion per year. Tariffs provided for under *Conto* V became unavailable to new PV facilities after 6 July 2013.

As mentioned above, *Conto* V provided for a somewhat altered structure of tariff incentives, intended to reduce costs to end-consumers. PV plants up to 1 MW could qualify for an 'all-inclusive tariff' consisting of the price of the electricity, the value of the incentive premium, plus a further specific tariff for self-consumed energy. PV plants over 1 MW received a fluctuating amount based on the difference, if positive, between the 'all-inclusive tariff' and the 'hourly zonal price'.

Each PV operator receiving incentives under the *Conto Energia* framework first received confirmation of its right to a specific tariff in a letter from the GSE ('Tariff Recognition Letter'), which expressly stated that the tariff would remain constant for a twenty-year period.

Afterward, the operator would enter into a contract with the GSE. These agreements ('GSE Agreements') set forth the specific tariff incentive rate that the PV operator would receive and the specific dates comprising a twenty-year period during which the incentive would be paid. The relevant contractual wording was substantively the same in GSE Agreements under *Conto* I, *Conto* II, *Conto* III, and *Conto* IV.

In addition to feed-in tariff premiums under the *Conto Energia* decrees, Legislative Decree No. 387 also established an 'off-take regime' whereby the GSE directly purchased electricity from certain smaller renewable energy producers at minimum guaranteed prices ('MGP Scheme'). The MGP Scheme was designed to ensure economic survival and minimum remuneration of smaller facilities, regardless of the trend of market prices, since those facilities were considered to have higher relative operating costs. Under the MGP Scheme, PV plants with a capacity below 1 MW received either a certain minimum guaranteed price or the market wholesale price, whichever was greater. The minimum guaranteed prices were introduced by *AEEG Resolution no. 34 in 2005*, which

was replaced by *Resolution no. 280 in 2007*. PV plants eligible for the off-take regime could also benefit from tariff incentives under the first four *Conto Energia* decrees.

Further, similar to the GSE Agreements under the *Conto Energia* decrees, PV producers that participated in the MGP Scheme entered into contracts with the GSE. Those contracts had a one-year term that was subject to automatic renewal, with terms and conditions set by the AEEG.

The measures briefly described below—initiated by Italy—were disputed by the claimants in the basis that they were said to constitute breaches of Article 10 (1) of the ECT.[164]

On 23 December 2013, Italy enacted *Law Decree No. 145/2013*, referred to as the '*Destinazione Italia*' law decree. The *Destinazione Italia* law decree provided two options for PV plant producers: i) to continue to receive the *Conto Energia* incentives at the same rate for the remainder of the twenty-year period, but to foreclose the possibility of receiving additional incentives thereafter; or ii) to accept reductions to the *Conto Energia* incentives, but to receive them for seven additional years, for a total of twenty-seven years.

On 24 June 2014, Italy enacted Law Decree No. 91/2014, known as the '*Spalma-incentivi* Decree', pursuant to which the tariffs previously granted to PV facilities over 200 kW according to the five *Conto Energia* decrees were modified as from 1 January 2015.

Article 26(3) of the *Spalma-incentivi* Decree provided that producers would have a choice from among three options for the method of calculating new tariffs that would apply to PV facilities.

In addition to changing the *Conto Energia* incentive tariffs, the *Spalma-incentivi* Decree altered the way in which they were disbursed. According to claimants, before the *Spalma-incentivi* Decree, incentive tariffs were paid based on actual electricity generated monthly.

Article 26(2) of the *Spalma-incentivi* Decree specified that, as from the second half of 2014, the GSE would pay tariffs in constant monthly installments based upon 90% of a plant's estimated yearly average production of electricity. The balance adjustment payment, based on actual production, would be paid by 30th June of the following year.

In addition to modifying the amount, duration, and disbursement mechanism of the incentive tariffs, the *Spalma-incentivi* Decree repealed and replaced the administrative fee provided for under Article 10(4) of *Conto* V, basing the new fee solely on the PV plant's capacity, instead of its effective output of energy. The new fee ranged from EUR 1.20 per kW (for plants above 1 MW of capacity) to EUR 2.20 per kW (for plants between 3 and 6 kW of capacity) and was payable annually by off-setting incentive tariff payments due under GSE Agreements.

From 2011 until 2013, the MGP Scheme underwent a review and consultation process, with the AEEG requesting data from electricity producer associations and from the *Politecnico di Milano*, which produced a report in July 2013. Italy modified the MGP Scheme at the end of 2013. On 31 October 2013, the AEEG issued a consultation document that proposed to define the minimum guaranteed prices based on the average operating costs of renewable energy facilities, plus 8%. For PV facilities, the minimum guaranteed price would be approximately EUR 37.8 per MWh produced. Then, on 19 December 2013, the AEEG issued Resolution No. 618/2013/R/EFR ('Resolution 618'), establishing a minimum guaranteed price of EUR 38.9 per MWh. Resolution 618 also reduced the cap on eligible electricity generation from 2 million kWh per year to 1.5 million kWh per year.

[164] *Greentech v. Italy*, at paras. 143–61.

On 23 December 2013, under the *Destinazione Italia* law decree, PV facilities over 100 kWh in capacity that were receiving *Conto Energia* tariffs were excluded from the MGP Scheme. Only plants not exceeding 100 kWh in capacity could still obtain both the minimum prices and the *Conto Energia* tariffs.

Conto I, as originally implemented in 2005, included an inflation adjustment according to the ISTAT index. The inflation adjustment was, however, revoked in 2006 pursuant to an amendment to *Conto* I. Subsequent *Conto Energia* decrees did not provide for an inflation adjustment.

On 26 March 2013, the GSE issued a press release stating that the *Consiglio di Stato* had upheld the cancellation of ISTAT adjustments and stating that the GSE would no longer provide ISTAT-adjusted tariffs. In March 2015, the GSE announced that it would claim reimbursement of ISTAT adjustment amounts granted since 2005 by offsetting past payments against future payment of *Conto* I tariffs. In 2016, the GSE notified PV producers of the amounts of overpayments that the GSE planned to recover.

One feature of *Conto* V was a new requirement that, starting from 1 January 2013, all PV producers receiving incentive tariffs pursuant to any of the five *Conto Energia* decrees pay an annual administrative fee. The administrative fee—fixed at EUR 0.00005 per kWh—was intended to cover the GSE's management, audit, and control costs.

Conto V expressly permitted the administrative fee to be collected by means of an offset, according to a method determined by the GSE. The GSE implemented its collection by offsetting the administrative fee from the GSE's first payment of incentive tariffs to each producer in a given year.

As noted above, the *Spalma-incentivi* Decree repealed and replaced the administrative fee provided for under Article 10(4) of *Conto* V, basing the new fee solely on the PV plant's capacity, instead of its effective output of energy.

In its analysis, the arbitral tribunal addressed the various categories of measures taken by Italy.

Based on the arguments and evidence presented to it, the majority of the tribunal found that claimant's legitimate expectations had been frustrated in regard to the reduction of the incentive tariffs.[165]

With respect to other measures complained of—change of payment terms; modification of minimum guaranteed price scheme; cancellation of inflation adjustment; and administrative fee and imbalance cost—the majority of the tribunal concluded that the legitimate expectations of the claimants had not been frustrated.

As regards the tariff reductions under the so-called *Spalma-incentivi* Decree and the question of legitimate expectations, the claimants argued that organs and officials of the Italian Republic made explicit promises or guarantees, as well as 'informal' or implicit assurances, that the incentive tariff rates granted under each of the *Conto Energia* ministerial decrees would remain the same for twenty years. Thus, claimants argued, Italy created conditions whereby photovoltaic investors formed legitimate expectations that the incentive tariff rates would remain constant for two decades. Claimants identified multiple categories of regulations, documents, statements, policies, and behaviour on which their expectations were based, including the following:

[165] Ibid., at para. 455.

(i) the *Conto Energia* decrees, each of which specified certain tariff rates for a twenty-year period;
(ii) the GSE Agreements, which also specified certain tariff rates for certain PV facilities for a twenty-year period;
(iii) the GSE letters informing PV operators of their eligibility under particular *Conto Energia* decrees;
(iv) declarations of and publications by Italian national and regional authorities and officials regarding the *Conto Energia* regime; and
(v) the declared purposes and policies underlying the *Conto Energia* regime.[166]

The tribunal noted that at the time of investing claimants 'had been led to believe, reasonably, that the incentive tariffs would remain the same as promised in the *Conto Energia* decrees, GSE Letter and GSE Agreements throughout a twenty-year period'.[167]

The tribunal also noted that States do of course retain the sovereign prerogative to amend their laws, but if the State gives an investor express assurances that no amendment would occur, the investor must be fairly compensated if these assurances are violated.[168]

The tribunal continued:

> Given the specificity of the assurances Italy offered (*Conto Energia* decrees, statements and conduct of Italian officials, and individual GSE letters and GSE Agreements), those assurances bear the hallmarks of (borrowing the *Parkerings* tribunal's language) 'an agreement, in the form of a stabilisation clause or otherwise'. Italy thus crossed a threshold such that the reduction of the incentive tariffs by the *Spalma-incentivi* Decree defeated Claimants' legitimate expectations. The majority of the Tribunal notes that while some of Italy's specific assurances remain relevant to both the present analysis and the umbrella clause, analyzed separately below, such assurances play a different role in relation to the standards under fair and equitable treatment and under the umbrella clause. Professor Sacerdoti in his dissenting opinion expresses the view that with respect to the FET standard, Italy did not undertake any 'obligation' to refrain from modifying the *Conto Energia* regime. In contrast, the majority considers that the combined weight of the evidence shows that Italy did indeed undertake such obligations, relevant to the first two sentences of ECT Article 10(1). In this connection, Italy gave assurances giving rise to legitimate expectations on the part of Claimants, and did so irrespective of any other duties in regard to the umbrella clause.[169]

Antaris v. Czech Republic[170] was the first published ECT award dealing with renewable energy in the Czech Republic. The claimants argued that respondent had breached its obligations under the ECT by repealing incentive schemes to attract investors in photovoltaic power generation. The respondent took the view that it had never made any stabilization commitment to claimants, it had not otherwise violated legitimate expectations; and the measures were reasonably tailored to achieve appropriate and rational state objectives.

In summary the Czech incentive regime was structured in the following way.[171]

In 1992 the Czech Republic implemented two tax incentives through Act 586/1992 (the '*Act on Income Tax*'). Section 19(1)(d) provided an exemption from income tax for the year in which solar facilities were put into operation and the following five calendar years (the 'Income Tax Exemption'). Section 30, with Annex I, provided an accelerated depreciation period (between five to ten years) for specific categories of electrical

[166] Ibid., at para. 408. [167] Ibid., at para. 447. [168] Ibid., at para. 452.
[169] Ibid., at para. 453.
[170] *Antaris Solar GmbH and Dr. Michael Göde v. Czech Republic*, Award dated 2 May 2018.
[171] Ibid., at paras. 81–8.

equipment and components for photovoltaic installations, such as solar panels, inverters, switchboards, fuse boxes, cut-out boxes and security camera systems (the 'Shortened Depreciation Period').

The Act on Promotion of Energy Production from Renewable Energy Sources was adopted on March 31, 2005 and entered into force on 1 August 2005 (the '**Act on Promotion**'). In summary, it provided that:

1) investors would have a connection to the grid on a preferential basis (Section 4(1));
2) investors would have a period of 15 years for recovery of their investment through the fee-in-tariff (the '**FiT**') (Section 6(1)(b)(1));
3) the level of revenues per unit of electricity from renewable sources would be maintained, as a minimum, with promotion by FiT, for a period of 15 years from the year of putting the plant into operation, taking into accounting price index of industrial products (Section 6(1)(b)(2));
4) As from 2007, the FiT set by the Energy Regulatory Office (the 'ERO') for the subsequent calendar year was not to be lower than 95% of the value of the FiT valid in the year during which a decision was made on their new values (Section 6(4)), the effect of which was that the FiT granted to photovoltaic plants put into operation in any given year could not be reduced by more than 5% with respect to the FiT granted to photovoltaic plants put into operation in the previous year (the '5% Break-Out Rule').

Section 4 of ERO (the Energy Regulatory Office) Regulation 475/2005 (the 'Technical Regulation') provided:

In order for the 15-year pay-back period to be assured through the support by Purchasing Prices [FiT] of electricity produced from renewable sources, technical and economic parameters of an installation producing electricity from renewable sources must be satisfied, where the producer of electricity from renewable sources shall achieve, with the given level of Purchasing Prices

(a) an adequate return on invested capital during the total life of the installation, such return to be determined by the weighted average cost of capital (WACC), and
(b) the net present value of the cash flows after tax over the total life of the installation, using a discount rate equal to WACC, at least equal to zero.

In May 2005, the ERO made available on its website its 'Report on the procedure of specification of basic parameters of the regulatory formula and price specification for the 2nd regulatory period in the field of electrical energy.' In the section 'Subsidy for Electrical Generation From Renewables' the Report stated:

Minimum purchase prices of electricity from individual renewable resources are specified in relation to the amounts of investment and operation costs of the individual categories of resources. The calculation was based on the method of net present value of the generated project cash flows (NPV CF) for the period of the given technology life equal to zero at the discount rate of 7%. . . . .

The weighted average cost of capital ('WACC') was defined by the Technical Regulation as:

. . . weighted average of the expected interest rate on lending for investment in projects designed for using renewable sources for electricity generation and the expected return on equity of an investor in a project designed for using renewable sources for electricity generation.

The Technical Regulation was subsequently amended by ERO regulations 364/2007 and 409/2009, which modified the technical and economic parameters and fixed the estimated lifetime of new photovoltaic plants at twenty years.

Article (2)9 of ERO Regulation 140/2009 (the '**Pricing Regulation**') provided that (1) FiTs would be applied throughout the estimated lifetime of plants (i.e. twenty years);

and (2) the FiT was to increase each year by between 2% and 4% taking into account the inflation price index for industrial producers throughout the lifetime of the plants. The FiT was to be set by the end of November for the following year.

Starting in 2010 changes were introduced to the incentive regime. In summary, they were the following.[172]

Act 137/2010 entered into force on 20 May 2010. It repealed Section 6(4) of the Act on Promotion pursuant to which the FiT could not decrease the FiT more than 5% per year. It abolished the 5% rule only for those solar plants connected to the grids from 2010 onwards.

The four plants owned by claimants were constructed and commissioned after the Act came into force but were connected to the grid before the critical date of 2011.

Act 102/2010 entered into force on 1 January 2011 introducing Sections 7(a)–(i) in the Act on Promotion, establishing a levy on revenues generated by photovoltaic power plants (the '**Solar Levy**'). It applied from 1 January 2011 to 31 December 2013 to revenues generated by photovoltaic power plants put into operation between 1 January 2009 and 31 December 2010. It was extended beyond 31 December 2013 by Act 310/2013 for photovoltaic power plants put into operation between 1 January 2010 and 31 December 2010.

The Solar Levy was originally set at 26% and 28% for payments to solar energy producers respectively under the FiT system and under the Green Bonuses system. It was withheld by the grid operator who paid the FiT or Green Bonuses to the renewable energy producers for the electricity produced.

Act 310/2010 set the Solar Levy at 10% for FiTs and 11% for Green Bonuses.

Article 1(2) of Act 310/2013 also cancelled all incentives for electricity generated by solar power plants placed into service after 1 January 2014.

Act 346/2010, which entered into force on 1 January 2011 amended the Act on Income Tax by repealing the Income Tax Exemption for RES producers, and the favourable depreciation allowances. Although it was prospective, it had the effect of removing tax exemptions and depreciation allowances which would otherwise have accrued.

Act 165/2012 on Promoted Power Sources which partly entered into force on 1 January 2013 and partly upon the publication on 30 May 2012 repealed the Act on Promotion. It left in place the method for determining FiT and Green Bonuses, as amended at the end of 2010, for plants put into operation before 1 January 2013, and introduced new rules for plants put into operation thereafter. It confirmed the Solar Levy and contained several provisions which negatively affected producers that put their plants into operation before 1 January 2013.

Act 310/2013 was adopted on 13 September 2013 and extended the Solar Levy beyond 31 December 2013, at a new decreased 10% rate (but only applying to 2010 PV plants and for the entire lifetime) and 11% levy on Green Bonuses. It also imposed new obligations concerning disclosure of major shareholders and conversion of shares only on foreign joint stocks companies producing electricity from RES. It cancelled RES support for PV plants commissioned after January 1, 2014.

On 19 November 2015, the ERO issued *Price Decision 5/2015*, which set the FiT applicable as of 1 January 2016 only to plants commissioned from 2013 to 2015, but not to plants put into operation from 2016 to 2021, thereby in effect removing the

[172] Ibid., at paras. 94–103.

FiT. But on 28 December 2015 the Czech Government adopted *Regulation 402/2015*, which overruled Price Decision 5/2015 and provided the incentives to renewable energy plants commissioned before 2013 must be paid, pending only the decision by the EU Commission on their compliance with the EU State aid law. On 29 December 2015 the ERO issued Price Decision 9/2015 setting FiT and Green Bonuses for renewable energy plants commissioned since 2006, including the claimants' plants.

In its reasons the tribunal identified as the first question to be addressed whether claimants made their investments in 2010 based on a legitimate and reasonable expectation borne out of an explicit or implicit representation by respondent that the value of their investment would not be diminished in the way claimants said it was.[173]

The tribunal explained its approach in the following way:

> The Tribunal does not accept that it should approach this question simply on the basis of the Claimants' argument that there is a free-standing obligation to provide a stable and predictable investment framework. Nor does it accept the Respondent's suggestion that no legitimate expectations as to stability can arise in the absence of a legislative or contractual stabilization arrangements.
>
> The Tribunal accepts that promises or representations to investors may be inferred from domestic legislation in the context of its background, including official statements. It is not essential that the official statements have legal force. There can be no doubt that both the Respondent and the ERO described the incentive regime in terms of a guarantee or promise of stability, and that the Czech Government effectively promoted the new regime at home and abroad and described its main element in terms of a guarantee.[174]

The tribunal went on to address the knowledge of the problems and issues arising out of the solar energy sector in the Czech Republic and it analyzed the testimony of Dr. Göde.

The tribunal came to the conclusion that Dr. Göde was 'essentially an opportunistic investor who saw a window of opportunity and who was aware, or should have been aware, that dealing with the solar boom was a fast-moving and controversial issue.'[175]

The tribunal accepted respondents' characterization that the solar power market in the Czech Republic was a bubble, that the government considered the FIT regime to be out of balance and that this 'would have been obvious to anyone who participated in industry discussions, or paid attention to warnings by specialist professionals, or read the local press.'[176]

Claimants had also argued that the measures taken by the Czech Government were unreasonable and arbitrary. The tribunal did not agree. It said:

> The Tribunal accepts that the Respondent had the rational objective of reducing excessive profits and sheltering consumers from excessive electricity price rises, and that its actions were not arbitrary or irrational. There was an appropriate correlation between the Respondent's objectives and the measures it took. There is nothing irrational or unreasonable about the imposition of a charge to regulate what the Respondent reasonably regarded as windfall profits and to reduce the impact on consumers, and the measures, which applied only to the most recent installations and therefore the ones able to earn the profits as a result of the decline in PV costs, were not disproportionate.[177]

d Transparency

Another important element of the FET standard is transparency, to which reference is made in the first sentence of Article 10(1) —'transparent conditions for Investors'.

[173] Ibid., at para. 364.
[174] Ibid., at paras. 365–6.
[175] Ibid., at para. 431.
[176] Ibid., at para. 434.
[177] Ibid., at para. 444.

Put in general terms transparency means that the legal and regulatory framework for investments must be easily accessible and understandable and that decisions concerning investments are based thereon and made available and known to the investors.

In *Plama v. Bulgaria*[178] the tribunal briefly addressed the FET standard. The tribunal said:

> Finally the Tribunal observes that the condition of transparency, stated in the first sentence of Article 10(1) of the ECT, can be related to the standard of fair and equitable treatment. Transparency appears to be a significant element for the protection of both the legitimate expectations of the Investor and the stability of the legal framework.[179]

The tribunal did not further elaborate on this statement since it took the view that the case could be decided on the facts 'whatever interpretation is made of the FET standard in the ECT'.[180]

In *Al-Bahloul v. Tajikistan*,[181] the tribunal acknowledged that transparency constituted an element of the FET standard. It did so by referring to a number of previously rendered awards.[182] All the claims based on transparency failed, however, due to lack of evidence.

e Denial of Justice; Violation of Due Process

It is widely accepted that a fair and just procedure is a standard element of the FET standard. In practice, the focus of this question is usually the right to be heard—in a broad sense—in judicial or administrative proceedings.

In *Amto v. Ukraine*[183] the claimant unsuccessfully argued that Ukrainian courts had committed a denial of justice. The claimant argued that the attempts of EYUM-10 to seek enforcement of its claims against Energoatom amounted to a denial of justice. The denial of justice argument related to six bankruptcy proceedings commenced against Energoatom. With respect to five of the proceedings the claimant argued that it had been prevented from participating in the proceedings because the court had failed to order the initial creditors publicly to announce the opening of the bankruptcy proceedings. The tribunal did not accept this argument primarily because the duty to publicize the commencement of the proceedings rested with the creditors and not with the court.[184] With respect to the remaining bankruptcy proceedings—which were initiated by EYUM-10—the claimant complained of various procedural irregularities, which delayed the proceedings. The tribunal concluded, however, that the delays were essentially due to the interrelationship between Ukrainian bankruptcy and company legislation as well as to the procedural steps taken by the debtor.[185] The claimant also argued that a decision by the relevant court of appeal had been influenced by a resolution issued by the government. The tribunal did not find proof of any such undue influence.[186]

In *Liman v.* Kazakhstan[187] claimants' FET claim focused on several instances of alleged denial of justice by Kazakh courts. At the outset, the tribunal explained the standard that it was going to apply. It stated:

[178] *Plama Consortium Limited v. Republic of Bulgaria* (ICSID Case No. ARB/03/24), Award dated 27 August 2008.
[179] Ibid., at para. 178. [180] Ibid., at para. 175.
[181] *Mohammad Ammar Al-Bahloul v. The Republic of Tajikistan*, Partial Award on Jurisdiction and Liability, dated 2 September 2009.
[182] *Al-Bahloul v. Tajikistan*, at para. 183.
[183] *Limited Liability Company AMTO v. Ukraine*, Award, dated 26 March 2008.
[184] *Amto v. Ukraine,* at para. 78. [185] Ibid., at para. 79. [186] Ibid.
[187] *Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan*, Award dated 11 October 2010.

The Tribunal emphasizes that an international arbitration tribunal is not an appellate body and its function is not to correct errors of domestic procedural or substantive law which may have been committed by the national courts. The Tribunal stresses that the threshold of the international delict of denial of justice is high and goes far beyond the mere misapplication of domestic law.[188]

The complaints raised by the claimants centred on the alleged invalidity of an assignment agreement and how the claims of invalidity had been treated by the courts of Kazakhstan. The arguments in the arbitration focused both on the procedural and substantive aspects of the court proceedings at various levels in Kazakhstan.

The tribunal found that the claimants had not been able to establish that the high threshold for a breach of Article 10(1) of the ECT had been reached. For example, with respect to a decision concerning the claimants application for supervisory review, which had been rejected by the Supervisory Court, the tribunal said:

On balance, the Tribunal cannot find that there is any proof that the decision was arbitrary, grossly unfair, unjust or idiosyncratic or involved any lack of due process. Therefore, the Tribunal concludes that the supervisory review in February 2005 did not breach ECT Article 10(1), second sentence.[189]

Both the tribunals in *Amto* and *Liman*, respectively, referred to and relied on *Mondev International Ltd. v. United States of America*, a 2002 NAFTA case, to identify an applicable standard to determine the scope of denial justice. The *Mondev* tribunal used the following standard:

The test is not whether a particular result is surprising, but whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns as to the judicial propriety of the outcome, bearing in mind on the one hand that international tribunals are not courts of appeal, and on the other hand that Chapter 11 of NAFTA (like other treaties for the protection of investments) is intended to provide a real measure of protection. In the end the question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment.[190]

Also the tribunal in *Al-Bahloul v. Tajkistan*[191] referred to the *Mondev* award. All claims concerning denial of justice were denied by the tribunal, most of them based on lack of evidence.[192] In one instance, the tribunal denied the claim based on the explanation that its role was not to sit as an appellate court on questions of Tajik law.[193]

In *AES v. Hungary*[194] the issue was whether the process by which the administrative price decrees were introduced was flawed in such a way that due process had not been observed. The arbitral tribunal did not accept this argument. The tribunal explained the standard it applied in the following way:

The Tribunal has approached this question on the basis that it is not every process failing or imperfection that will amount to a failure to provide fair and equitable treatment. The standard is

[188] Ibid., at para. 274. [189] Ibid., at para. 383.

[190] *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award dated 11 October 2002, at paras. 126–7.

[191] *Mohammad Ammar Al-Bahloul v. The Republic of Tajikistan*, Partial Award on Jurisdiction and Liability, dated 2 September 2009.

[192] *Al-Bahloul v. Tajikistan*, at paras. 224–36. [193] Ibid., at para. 237.

[194] *AES Summit Generation Ltd, and AES Tisza Eromu Kft v. Republic of Hungary*, Award dated 23 September 2010.

not one of perfection. It is only when a state's acts or procedural omissions are, on the facts and in the context before the adjudicator, manifestly unfair or unreasonable (such as would shock, or at least surprise a sense of juridical propriety) —to use the words of the Tecmed Tribunal—that the standard can be said to have been infringed.[195]

In particular, the tribunal emphasized that throughout the process there was an ongoing dialogue with the investor, that the investor was given deadlines within which to react and that the investor had the opportunity to subject the administrative process to judicial review by Hungarian courts, which the investor did not do. In conclusion, whilst the tribunal found that there were indeed procedural shortcomings, the administrative process 'did not fall outside the acceptable range of legislative and regulatory behaviour'.[196] That being the case, the tribunal found no violation of due process.

In *Energoalians TOB v. Republic of Moldova*,[197] the tribunal rejected a number of claims alleging denial of justice by Moldavan courts. The claims related to delays in Moldovan courts and to the fact that the General Prosecutor had initiated court proceedings concerning a contract between the claimant and Moldtranselectro, a state-owned company. With respect to the latter claim, the tribunal explained that a foreign investor entering into a contract with a state-owned company, should expect that the State might resort to available legal remedies.[198] The tribunal did find, however, that a decision by the Moldovan Audit Chamber, which in the view of the tribunal had a quasi—judicial role, following a proceeding in which claimant did not participate, violated due process. In that decision conclusions were drawn which contradicted facts confirmed by records and statements. The tribunal also noted that claimant unsuccessfully tried to appeal the decision of the Audit Chamber.[199]

In *Mamidoil v. Albania*,[200] the claimant complained about the taxation practice and filed for reimbursement of allegedly overpaid taxes with the District Court of Durres. The District Court accepted jurisdiction, but this was subsequently overturned by the Supreme Court. The claimant appealed this decision to the Constitutional Court which rejected the appeal.

In claimant's view, the respondent had committed a denial of justice because the Supreme Court, in refusing to accept the claim for reimbursement of taxes, had deviated from well-established jurisprudence on which claimant had relied.

The tribunal noted that it was not an appellate court and could not sit in judgment over decisions rendered by the Albanian Supreme Court or the Albanian Constitutional Court.[201] It nevertheless looked into the decisions of the Albanian courts and found that the decision of the Supreme Court was not 'clearly improper, discreditable or in shocking disregard of Albanian law'.[202] The claim for denial of justice was thus dismissed.

[195] *AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary*, Award at para. 9.3.40.
[196] Ibid., at para. 9.3.73.
[197] *Energoallians v. Republic of Moldova*, Award (in Russian) dated 23 October 2013.
[198] *Energoalians TOB v. Republic of Moldova*, at para. 357. [199] Ibid., at paras. 353, 356.
[200] *Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania*, ICSID Case No. ARB/11/24, Award dated 30 March 2015.
[201] Ibid., at para. 764. [202] Ibid., at para. 769.

IV. c) Such Investments shall also enjoy the most constant protection and security …

1. General Comments

This standard of protection—'the most constant protection and security'—incorporates a standard which goes back to Treaties of Friendship, Commerce and Navigation, signed by the United States in the nineteenth century. Today it is found in most investment protection treaties, albeit in different variants.[203] As is the case with respect to many other standards of protection, the language used is of a general and imprecise nature. Rendered ECT awards do, however, shed some light on how the standard has been understood.[204] In general terms, the standard deals with the host State's failure to protect the investment from damage caused by the State, or by others.

Whilst there is potential for overlap with the FET standard, the umbrella clause,[205] and with Article 10(12) of the ECT,[206] it is generally accepted by ECT tribunals that the 'constant protection and security' standard is to be analyzed and treated as a separate and stand-alone standard, thus going further than merely incorporating customary international law.

It is generally accepted that the standard does not place the host State under strict liability to provide 'constant protection and security'. The obligation has rather been characterized as one of exercising due diligence, which means that the host State must take measures which are reasonable under the circumstances.[207]

This standard of protection primarily involves the duty to grant *physical* protection and security. This may be the case when state organs use violence, or takes other measures which destroy the investment in question. The standard may also become relevant in cases of private violence—riots, demonstrations, etc.—where the host State has not taken sufficient and efficient measures to protect the investment.

There seems to be growing support for applying the standard also with respect to *legal* protection of the investor, i.e. that the host State must provide protection against infringements of the investor's rights. In *Siemens v. Argentina*,[208] for example, the tribunal concluded that the fact the BIT in question included intangible assets in the definition of investment meant that 'full protection and security' also covered legal protection. The tribunal said:

> As a general matter and based on the definition of investment, which includes tangible and intangible assets, the Tribunal considers that the obligation to provide full protection and security is wider than 'physical' protection and security. It is difficult to understand how the physical security of an intangible asset would be achieved.[209]

[203] For general comments on 'protection and security', see e.g. Dolzer and Schreuer, *op. cit.*, 160–6; MacLachlan, Shore and Weiniger, *op. cit.*, 247–50: Newcombe and Paradell, *op. cit.*, 307–14; Cordero Moss, Full Protection and Security in Reinisch (ed.), Standard of Investment Protection (2008) 131.

[204] See p. 228 *et seq.*, *infra.*

[205] For commentary on the umbrella clause, see p. 237 *et seq.*, *infra.*

[206] For commentary on Article 10(12), see p. 256 *et seq.*, *infra.*

[207] Dolzer and Stevens, *op. cit.*, at 61.

[208] *Siemens A.G. v. The Argentine Republic*, Award dated 6 February 2007.

[209] Ibid., at para. 303.

2. ECT Awards

In *Plama v. Bulgaria*,[210] the tribunal noted that the parties agreed that the standard imposed an obligation of due diligence, and observed that it is not absolute and does not imply strict liability for the host State.[211] The tribunal found that the standard involves 'an obligation actively to create a framework that grants security'.[212] In the arbitration, the claimant alleged several violations of the ECT. It was only with respect to two of them that the tribunal had reason to address the 'constant protection and security standard'.

First, the tribunal addressed claimant's argument that amendments of the Bulgarian environmental legislation had caused damage to its investment. The tribunal did not agree. In its view, the claimant had 'failed fully to appreciate the scope and specificities of Bulgarian legislation'.[213] The tribunal also noted that it 'was unable to establish a lack of due diligence in Respondent's treatment of Claimant and its investment with regard to the environmental amendments'.[214]

Secondly, claimant complained with respect to certain activities of the syndics appointed to manage Nova Plama while it was in bankruptcy in 1998–9. Among other things, the allegation was made that the syndics had incited workers to strike and act unlawfully at the installation in question. Despite reporting these events to the Bulgarian government, claimant said that it did not receive any practical assistance to restore order. The tribunal rejected these arguments since there was contradictory and conflicting evidence which meant that the claimant was not able to meet his burden of proof in this respect.[215]

The tribunal in *Liman, v. Kazakhstan*[216] took the view that this standard of protection does not cover contractual rights. The dispute partially concerned the validity under Kazakh law of a contractual assignment. The tribunal said the following:

> With regard to the standard of most constant protection and security, the Tribunal holds that this provision, which must have a meaning beyond, and distinct from, the standard of fair and equitable treatment, provides a standard which does not extend to any contractual rights but whose purpose is rather to protect the integrity of an investment against interference by the use of force and particularly physical damage.[217]

In *AES v. Hungary*,[218] the claimant argued that Hungary had breached the standard of constant protection and security by failing to ensure legal security when amending the Hungarian Electricity Act and when implementing new pricing decrees which completely undermined claimant's rights under a settlement agreement and a power purchase agreement. The tribunal did not accept this argument. It explained that while the standard can in appropriate circumstances extend beyond protection of physical security, 'it certainly does not protect against a State's right (as was the case here) to legislate or regulate in a manner which may negatively affect a claimant's investment, provided that the State acts reasonably in the circumstances and with a view to achieving objectively rational public policy goals'.[219]

The tribunal went on to say that claimant was seriously overreacting in trying to argue that the standard should protect a contractual arrangement which itself did not address the issue in question, *viz.*, reintroduction of price regulation. The tribunal concluded by

[210] *Plama Consortium Limited v. Republic of Bulgaria*, Award 27 August 2008.
[211] *Plama v. Bulgaria*, at paras. 179, 181. [212] Ibid., at para. 180. [213] Ibid., at para. 122.
[214] Ibid. [215] *Plama v. Bulgaria*, at para. 249.
[216] *Liman Caspian Oil BV v. The Republic of Kazakhstan*, Award dated 22 June 2010.
[217] *Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan*, at para. 289.
[218] See note 195, *supra.* [219] *AES v. Hungary*, at para. 13.3.2.

saying that 'the right to constant protection and security implies that no change in law that affects the investor's rights could take place, would be practically the same as to recognizing the existence of a non-existent stability agreement as a consequence of the full protection and security standard.'[220]

The tribunal in *Electrabel v. Hungary*[221] dealt with the standard of constant protection and security primarily in relation to claimant's arguments relating to pricing under the Power Purchase Agreement. Claimant argued that the instructions by the Hungarian government and the implementation by the state-owned company Magyar Villamos Müvek ('MVM') of such instructions, to reduce electricity prices, constituted a violation of this standard since Hungary failed to take positive steps to protect its investment and to prevent infringement of claimants' rights.[222]

The tribunal did not agree. It started out by observing that 'by promising full protection and security, Hungary assumed an obligation actively to create and maintain measures that promote security. The necessary measures must be capable of protecting the covered investment against adverse action by private persons'.[223]

The pricing dispute had its origin in a contract between Dunamenti and MVM, which included a dispute resolution clause. Referring to the possibility to resolve the dispute by resorting to the dispute resolution procedure under the contract, as well as to arbitration under the ECT, the tribunal concluded that Hungary had not violated its obligation to provide full protection and security under Article 10(1) of the ECT.[224]

In *Al-Bahloul v. Tajikistan*[225] the claimant referred to three circumstances as constituting a violation of the constant protection and security standard: 1) demands from the Tajik security forces for cash payments for alleged debts; 2) a Tajik director's alleged statement that his security could not be guaranteed if he failed to support a proposal on the reduction of shares; and 3) the alleged miscarriage of justice in the Tajik courts in failing to protect the claimant's shareholding interest in the joint venture companies in question.[226]

All three claims were rejected for lack of evidence. With respect to the third circumstance, the tribunal added that it could arguably cover a situation where there has been a demonstrated miscarriage of justice, but that it is not a matter of strict liability, and that an 'investor is not guaranteed that he will prevail in a court action under all circumstances'.[227]

The tribunal in *Mamidoil v. Albania*[228] had to deal with this standard of protection in relation to fuel smuggling, tax evasion, and fuel adulteration. The claimant argued that fuel smuggling and quality adulteration—while existing at the time of its investment—became worse as from 2003 since the government was incompetent and unwilling to make serious efforts to improve the situation. The claimant alleged that repeated requests to address the situation by taking concrete measures remained unanswered.[229]

In rejecting this argument, the tribunal noted that the investor was fully aware of the situation when it made its investment; it was part of the general business environment and investment conditions.[230]

[220] Ibid., at para. 13.3.5.
[221] *Electrabel v. Hungary, Decision on Jurisdiction*, Applicable Law and Liability, 30 November 2012.
[222] *Electrabel S.A. v. The Republic of Hungary*, at para. 7.81. [223] Ibid., at para. 7.145.
[224] Ibid., at para. 7.147.
[225] *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, Partial Award On Jurisdiction and Liability, dated 2 September 2009.
[226] *Mohammed Ammar Al-Bahloul v. The Republic of Tajikistan*, at para. 243.
[227] Ibid., at para. 2.46.
[228] *Mamidoil Jetoil Greek Petroleum Products Société S.A. v. Republic of Albania*, Award dated 30 March 2015.
[229] *Mamidoil v. Albania,* at paras. 805–6.
[230] Ibid., at para. 823.

The tribunal also noted that it had difficulties in understanding how tax evasion by third parties injured the investment of the claimant, all the more since the claimant increased its market share and increased its business.[231]

These circumstances in combination with the fact that Albania had taken numerous measures to combat smuggling, tax evasion and fuel adulteration lead the tribunal to conclude that the constant protection and security standard had not been violated.[232]

In *Isolux v. Spain*,[233] the claimant argued that the constant protection and security standard essentially was part of the FET standard. The tribunal observed that the main purpose of the standard is to guarantee the investor against harmful acts of third parties and state agents, and that claimant had not alleged that it was a victim of such acts.[234] The tribunal also noted that one of the owners of the claimant had—prior to the investment—in proceedings before the Spanish Supreme Court complained about the legal security in Spain resulting from five legislative changes in two years. The tribunal found that a 'party that decided to invest in a country that, according to it, lacks legal security, may not then turn to complain that such security was not provided'.[235]

In *Novenergia v. Spain*,[236] the claimant argued that respondent had failed to ensure that the claimant's investment enjoyed the most constant protection and security under Article 10(1) of the ECT. In its reasons, the tribunal noted that in its view this alleged breach was 'a further illustration of the FET standard'. Since it had already decided that respondent had breached the FET standard, the tribunal did not see the need further to expand on this standard of protection.[237]

V. d) [. . .] and no Contracting Party shall in any way impair by unreasonable and discriminatory measures their management, maintenance, use, enjoyment or disposal

1. General comments

Most investment protection treaties contain protections against unreasonable (arbitrary) and discriminatory treatment.[238] Put in general terms, it is sometimes difficult to distinguish between the two concepts, both at the theoretical and practical levels. There is considerable overlap between the concepts. At the same time, both terms are mentioned in the ECT as two separate standards. It is reasonable to assume that the drafters of Article 10(1), second sentence, wished the two standards to be treated differently, expressing different concepts.

There is also considerable overlap with the FET standard. Since all three standards potentially have a wide scope of application, this is not surprising, Measures which are unreasonable and discriminatory will almost always constitute a violation of the FET standard. Again, however, the drafters of the ECT wished the standards to be treated separately and differently.

[231] Ibid., at paras. 824 and 826. [232] Ibid., at paras. 827 and 828.
[233] See note 94, *supra.*
[234] *Isolux Infrastructure Netherlands B.V. v. The Kingdom of Spain*, at para. 817.
[235] Ibid., at para. 818. [236] See note 116, *supra.* [237] Ibid., at para. 714.
[238] For general comments on these two standards, see Dolzer and Schreuer, *op .cit*. at 191–7; Newcombe & Paradell, *op. cit*., at 298–306.

There is also potential overlap between unreasonable and discriminatory measures, on the one hand, and the international minimum standard of customary international law on the other hand.[239]

These treaty standards articulated in the ECT (unreasonable and discriminatory measures) are thus potentially covered also by customary international law.

As far as *unreasonable measures* are concerned they are often equated with *arbitrary* measures. It would seem difficult to find a meaningful difference between the two concepts. To define the meaning of unreasonable measures in the abstract is difficult, if not impossible. Investment tribunals have taken different approaches. A workable and practical approach was identified by the tribunal in *AES v. Hungary*.[240]

> There are two elements that require to be analyzed to determine whether a state's act was unreasonable: the existence of a rational policy; and the reasonableness of the act of the state in relation to the policy. A rational policy is taken by a state following a logical (good sense) explanation and with the aim of addressing a public interest matter. Nevertheless, a rational policy is not enough to justify all the measures taken by a state in its name. A challenged measure must also be reasonable. That is, there needs to be an appropriate correlation between the state's public policy objective and the measure adopted to achieve it. This has to do with the nature of the measure and the way it is implemented.[241]

As regards *discriminatory measures* it is to be noted that under customary international law there is no general obligation to treat aliens equally, nor to treat them as favourably as nationals. The most frequent problem with respect to foreign investments is discrimination based on nationality. In the ECT discrimination on the basis of nationality is dealt with in Article 10(7) which incorporates two specific standards of protection, *viz.*, national treatment and most-favoured-nation treatment.[242] The discriminatory measures referred to in Article 10(1) thus cover other forms of discrimination.

The ECT does not provide a definition of discriminatory measures, nor does it provide examples of what constitutes discrimination. Whilst it is clear that not every differentiated treatment of investors will constitute discrimination, it will be for investment tribunals to work out the criteria for 'discriminatory measures' in the meaning of Article 10(1) of the ECT. In so doing, it would seem that there are primarily three elements which tribunals need to take into account.

First, there is the question of relevant comparators. The investment of the complaining investor must be compared with other businesses to determine whether there is discrimination. Which other businesses should the tribunal look at? Put in general terms, like should be compared with like; that is to say only businesses in like circumstances should be compared. A tribunal must further decide if this means that the comparison must concern *exactly* the same kind of activities in the same sector of the economy. Generally speaking the answers to these questions will depend on the facts and circumstances of the individual case.

Secondly, a tribunal must determine whether there is in fact a difference in treatment between the activities of the complaining investor and other like activities. Even if there is a factual difference, the difference may not be of any consequence from an economic point of view, in which case the different treatment may not negatively affect the investor.

[239] See discussion at p. 185 *et seq.*, *supra.* [240] See note 195, *supra.*
[241] *AES Summit Generation Ltd, and AES Tisza Eromu Kft v. Republic of Hungary*, at paras. 10.3.7–10.3.9.
[242] For a commentary on Article 10(7), see p. 248 *et seq.*, *infra.*

Thirdly, a tribunal must also take into account any justifications of the differentiated treatment of investors. There may be situations where the host State has valid justifications for treating investors differently. If that is the case, it is possible that a tribunal could conclude that there are no discriminatory measures in the meaning of Article 10(1) of the ECT. In the final analysis, the conclusion of a tribunal in this respect will typically depend on the facts and circumstances of the individual case.

A further aspect which has been raised is the question of discriminatory intent. Generally speaking, tribunals do not seem to focus on intent, but rather on the effects and consequences of a particular measure.[243]

2. ECT Awards

In ECT awards rendered so far, some tribunals treat the two standards together in their reasons. This is usually explained by the fact that the parties in their briefs deal with the second part of the second sentence of Article 10(1) in the same section of their briefs. Tribunals have generally recognized, however, that unreasonable measures and discriminatory measures, constitute two different and separate standards, albeit overlapping with each other, and also with the FET standard.

a. Unreasonable Measures

In *Plama v. Bulgaria*[244] the tribunal defined unreasonable measures, as 'those which are not founded in reason or fact but on caprice, prejudice or personal preference.'[245]

The claimant in Al-*Bahloul v. Tajikistan*[246] argued that the following four measures were unreasonable: (i) failure to issue licences to allow commencement of drilling operations; (ii) failure to provide personnel and promised equipment; (iii) denial of travel visas; and (iv) frustration of a service contract by not issuing licences to the joint ventures in question, by dissolving a joint venture and by reducing Vivalo's shareholding in a joint venture.

With respect to claims (ii) and (iii) the tribunal dismissed them for lack of evidence. Claim (i) was addressed as part of claimant's umbrella clause argument. As to claim (iv) the tribunal concluded that some measures could not be attributed to the State and that other measures were in conformity with Tajik law or consequences of contractual arrangements.[247] Consequently, the tribunal dismissed also this claim.

Applying its definition of 'unreasonable measures' the tribunal in *AES v. Hungary*[248] analyzed the main reasons relied on by Hungary when introducing the price decrees. The tribunal did not accept that it had been reasonable to introduce the price decrees because the claimant did not agree to reduce the capacity to which they were entitled under the Power Purchase Agreement.[249] Nor did the majority of the tribunal accept that the re-introduction of administrative pricing was motivated by pressure from the EC Commission.[250] Rather, the tribunal concluded that the pricing decrees in question were motivated by widespread concerns relating to so-called excessive profits earned by electricity generators. The tribunal noted that in its view 'it is a perfectly valid and rational

[243] Cf. e.g. Dolzer and Schreuer, *op. cit.*, at p. 197. [244] See note 178, *supra.*

[245] *Plama v. Bulgaria*, at para. 184. In support of this definition, the tribunal referred to *Lauder v. The Czech Republic*, Final Award dated 3 September 2001, at paras. 221, 222 and 232. Most of the tribunal's analysis of 'unreasonable measures', however, seems to have been subsumed under its FET analysis.

[246] *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, Partial Award On Jurisdiction and Liability, dated 2 September 2009.

[247] *Al-Bahloul v. Tajikistan*, at para. 252.

[248] See note 195, *supra*. The definition suggested by the tribunal is set out at p. 279.

[249] *AES v. Hungary*, at para. 10.3.14. [250] Ibid., at para. 10.3.18.

policy objective for a government to address luxury profits. And while such price regimes may not be seen as desirable in certain quarters, this does not mean that such a policy is irrational'.[251]

The tribunal then addressed the need for a reasonable correlation between the policy objective of the state and the measures adopted to achieve it. The tribunal concluded that the price decrees and the amended legislation were 'reasonable, proportionate and consistent with the public policy expressed by the parliament'.[252] In reaching this conclusion the tribunal noted:

> [. . .] that before the amendment of the 2001 Electricity Act, Hungary had approached the generators to renegotiate the PPAs. Given that no agreement was reached, and in the absence of a specific commitment to the Claimants that administrative pricing was never going to be reintroduced, the Hungarian parliament voted for the reintroduction of administrative pricing, which parliament considered to be the best option at the moment.[253]

The claimant in *Mamidoil v. Albania*[254] alleged that primarily two measures were unreasonable, *viz*., (i) taxation of the import of petroleum products by assessing fictitious quantities in accordance with the bill of lading rather than actual quantities; and (ii) the closing of the port of Durres. The tribunal did not agree with these arguments. As to taxation, the tribunal noted that, whilst not in line with international practice, it is not unusual in tax law that tax is based on fictitious amounts. Also, the tribunal observed, the practice was in place when claimant made its investment.[255] In addition, claimant had in fact successfully brought claims in Albanian courts based on the argument that he had overpaid taxes.[256]

As to the port of Durres, the tribunal noted that when closing the port, Albania's conduct bore a reasonable relationship to some rational policy, which included a master plan for the port of Durres as part of a general transport sector strategy. Therefore it was not an unreasonable measure to close the port.[257]

The question of unreasonable measures also came up in *Isolux v. Spain*[258]. The claimant argued that the legislative measures introduced by the Spanish government were unreasonable. The tribunal first noted that under this standard of protection, the measures must have a negative impact on the investment. The tribunal was not convinced that this was the case, since the measures had not negatively affected the return on investments.[259]

Even if other options had been available to the State, this fact did not make the measures taken unreasonable, in the view of the tribunal. The tribunal found that the 'behavior of the state was a rational political action that was, like it or not, taken to protect the consumer'.[260]

The tribunal thus rejected claimants' argument that the measures were unreasonable.

In *Antin v. Spain*,[261] the claimants argued that the standard of reasonableness required Spain to show that the measures it took were taken in pursuance of a rational policy goal and were carefully tailored to achieve that goal.[262] In the view of the claimants the disputed measures did not met those conditions.

[251] Ibid., at para. 10.3.34. [252] Ibid., at para. 10.3.36. [253] Ibid., at para. 10.3.35.
[254] *Mamidoil Jetoil Greek Petroleum Products Société S.A. v. Republic of Albania*, Award dated 30 March 2015.
[255] *Mamidoil v. Albania*, at para. 787. [256] Ibid., at para. 789.
[257] Ibid., at paras. 791–2. [258] See note 94, *supra.*
[259] *Isolux Infrastructure Netherlands B.V. v. The Kingdom of Spain*, at para. 821. [260] Ibid., at para. 823.
[261] *Antin Infrastructure Services Luxembourg S.à.r.l. and Antin Energia Termosolar B.V. v. Kingdom of Spain*, Award dated 15 June 2018.
[262] *Antin v. Spain*, at para. 437.

In its reasons the tribunal did not deal with this argument separately, but rather as part of its overall analysis of the FET standard.[263]

A similar approach was taken by the tribunal in *Greentech v. Spain.*[264] In the view of the tribunal this standard of protection (no unreasonable or discriminatory measures) was part of, or at least linked, to the same standard set out in the FET standard. Also, the factual and legal basis relied on by the claimants were the same as with respect to the FET claim. The tribunal concluded:

> This being so, the Majority of the Tribunal has concluded that it has nothing further to add to its decision on the Claimants' FET claim above. Accordingly, the Majority of the Tribunal determined that it is unnecessary to reach on a separate determination of the Claimants' claim under the Impairment Clause, which has been effectively disposed of by the Majority of the Tribunal's decision of the Claimants' FET claim.[265]

b. Discriminatory Measures

In the first ECT award, *Nykomb v. Latvia*[266] the tribunal concluded that Latvia had subjected the investment to discriminatory measures. Windau, the wholly owned Latvian subsidiary of the claimant, was operating a co-generation plant producing electrical power and heat. On the basis of a contract with Latvenergo, a joint stock company in which the Latvian Republic held 100% of the shares, Windau delivered electrical power to Latvenergo at prices set by Latvian regulatory authorities and legislation. Claimant argued that Windau was entitled to a certain tariff and a multiplier of two, a so-called double tariff. Latvenergo, and the respondent, argued that the correct multiplier was 0.75. The claimant argued that it was subject to discriminatory measures since Latvenergo was paying the double tariff to other power generators in Latvia. The respondent did not deny that two other co-generation operators were being paid the double tariff. It asserted, however, that the situations were not comparable and that the power plants in question were different in many respects and had therefore been awarded different multipliers.

The tribunal noted that it had to compare like with like. The respondent had not shown, nor explained, the criteria or methodology used in determining the multipliers. All the information available to the tribunal suggested that the three co-generation plants were comparable and subject to the same laws and regulations. The tribunal concluded that in such a situation, the burden of proof lies with the respondent to establish that no discrimination has taken place, but that the respondent had not met this burden of proof.[267]

In *Amto v. Ukraine*[268] the claimant argued that the following measures amounted to discrimination: (i) measures taken by the tax authorities; (ii) intimidation, constant obstruction, and discrimination on the part of Energoatom; and (iii) inadequate funding of Energoatom by the State.

The tribunal did not accept these arguments. As to the activities of the tax authorities, the tribunal found that the tax authorities had taken their measures in compliance with Ukrainian legislation and that claimant had not been able to establish any discriminatory treatment.[269]

[263] Ibid., at para. 412. [264] See note 145, *supra.* [265] *Greentech v. Spain*, at para. 412.
[266] *Nykomb Synergetics Technology Holding AB v. The Republic of Latvia*, SCC, Award dated 16 December 2003.
[267] Ibid., at p. 34. [268] *Limited Liability Company AMTO v. Ukraine*, Award, dated 26 March 2008.
[269] *Amto v. Ukraine*, at para. 99.

As to the second argument, claimant stated it had from the very beginning been confronted by hostility from Energoatom and its management, linked to the fact that EYUM-10 was in foreign ownership. The tribunal rejected this argument for lack of evidence.[270]

The basis for claimants' third argument was that Energoatom experienced financial problems. Claimant argued that the respondent, i.e. the Ukrainian State, selectively funded Energoatom to enable it to pay certain creditors, but not others. Had Energoatom been properly funded, EYUM-10 would also have been paid. Instead it was discriminated against. The tribunal concluded that without further evidence it was not possible to establish the reason for the funding problems of Energoatom.[271] The tribunal also noted that 'the Claimant has not established any discriminatory intent on the part of the Ukraine against either the Claimant or EYUM-10'.[272]

The discriminatory measures addressed in *Plama v. Bulgaria*[273] concerned the effects of amendments of Bulgarian environmental law in 1999. The amendments applied prospectively only and exonerated investors from responsibility for past environmental damage. The claimant argued that the amendment was discriminatory because he was treated differently than one of his competitors; the amended legislation was discriminatory against prior investors. The tribunal rejected this argument for lack of evidence. In doing so, however, the tribunal noted:

> There is nevertheless, evidence that in the implementation of the 1999 amendment, there may have been some companies not covered by the state law which, nevertheless, received state assistance, whereas Nova Plama did not.[274]

In *AES v. Hungary*[275] the claimant argued that it had been discriminated against because the price fixed for AES Tizsa was the lowest of all generators in Hungary, foreign and local. The tribunal found, however that the price established for each generator was the result of using the same methodology for all generators.[276] It did not amount to discrimination because the uniform methodology was applied equally to all generators based on their differing assets and generating structures.[277]

The claimant also argued discrimination based on the fact that only four generators were affected by the price regulation. The tribunal noted that this was because the idea of a cap on prices based on the concept of 'reasonable returns' meant that generators earning below that return would not be affected by the regulation. It was therefore logical that such generators would not be affected by the regulation.[278]

The tribunal in *Electrabel v. Hungary*[279] noted that discriminatory effects of a measure are sufficient to constitute a violation of this standard of protection; there is no separate requirement to prove discriminatory intent. The tribunal also took the view that the impairment caused by the discriminatory measure must be significant.[280]

Against this background, the tribunal concluded that Dunamanti had been treated in the same way as all other generators earning profits in excess of the annual return considered reasonable by the Hungarian government. All generators were asked to adjust their prices in a similar way; the differences in their fees reflected the differences in profit

[270] Ibid., at para. 105. [271] Ibid., at para. 108. [272] Ibid.
[273] *Plama Consortium Limited v. Republic of Bulgaria*, Award 27 August 2008.
[274] *Plama Consortium Limited v. Republic of Bulgaria*, at para. 223. [275] See note 195, *supra.*
[276] *AES Summit Generation Ltd, and AES Tisza Eromu Kft v. Republic of Hungary*, at para. 10.3.43.
[277] Ibid., at para. 10.3.50. [278] Ibid., at paras. 10.3.51–10.3.52. [279] See note 221, *supra.*
[280] *Electrabel S.A. v. The Republic of Hungary,* at para. 7.152.

amongst the different generators.[281] The tribunal thus found that claimants had not established that the measures complained of were discriminatory.

In *Mamidoil v. Albania*[282] discrimination was alleged by claimant with respect to local refineries and traders being allowed to sell lower quality diesel on the market than that which international traders were allowed to sell. As a consequence, the measure favoured the only local refinery, AMRD S.A. The Albanian government had decided to grant the local refinery temporary protection from international competition for one year. This period was subsequently reduced to six months by a decision of the Supreme Court.

The tribunal concluded that the measures did not amount to discrimination:

> The measure concerned all traders that did not operate a refinery at the same time.
>
> Similarly situated competitors were thus treated equally. The differing treatment was owed to AMRO's activity of refining locally extracted crude oil. The Tribunal holds that the differentiation was rational for a short period and does not amount to discrimination under international law.[283]

VI. e) In no case shall such Investments be accorded treatment less favorable than that required by international law, including treaty obligations

This sentence has two components: the reference to international law, and the additional words 'including treaty obligations'.

The reference to international law is to customary international law. This raises the question of how the penultimate sentence of Article 10(1) relates to the preceding standards of protection, in particular perhaps to the FET standard.[284] It is possible that the reference to international law is intended to be some form of a catch-all clause which is to cover breaches of the international minimum standard which are not already covered by the preceding standards of protection in Article 10(1). This is probably a very unlikely scenario, i.e. that an investor and investment are maltreated in such a way so as to constitute a violation of customary international law, but not at the same time constitute a violation of the standards of protection in Article 10(1) of the ECT. If that were to be the case, such violation would be subject to the dispute resolution provisions in Article 26 of the ECT.[285]

The reference to international law should be read against the background of the following statement by the chairman of the session at which the ECT was adopted:

> I would like to note that the Russian Federation believes that the reference to international law in Article 10(1) is not intended to impose most favoured nation obligations with regard to Making of Investments. This is clearly in accordance with the intent of the negotiators who decided not to include in this first Treaty MFN obligations for the pre-investment stage.[286]

This statement—and its reference to 'this first treaty', i.e. the ECT—must be read in the context of the discussions about a separate treaty regarding the Making of Investments, to which reference is made in Article 10(4) of the ECT.[287]

[281] Ibid., at para. 7.153.
[282] *Mamidoil Jetoil Greek Petroleum Products Société S.A. v. Republic of Albania*, Award dated 30 March 2015.
[283] *Mamidoil v. Albania*, at para. 797.
[284] See discussion at p. 187 *et seq.*, *supra.*
[285] For commentary on Article 26, see p. 414 *et seq.*, *infra*.
[286] Chairman's Statement at Adoption Session on 17 December 1994.
[287] See discussion *supra* at p. 13 *et seq.* and *infra* at p. 246 *et seq.*

The other component is the reference to treaty obligations. The reference makes clear that the sentence covers not only breaches of customary international law, but also of treaty obligations. It is, however, unclear from the text which treaty obligations are meant to be covered, except that the reference is to other treaty obligations than those following from the ECT.

The sentence must be read together with Understanding 17 adopted with respect to Articles 26 and 27. It reads:

> The reference to treaty obligations in the penultimate sentence of Article 10(1) does not include decisions taken by international organizations, even if they are binding, or treaties which entered into force before 1 January 1970.[288]

The Understanding thus limits the scope of this provision. In addition to the temporal limitation, the Understanding seems to exclude decisions coming from the EU—regulations and directives—and also other international organizations.[289] Despite these limitations it remains an open question which treaty obligations are covered by the provision. The language used is open-ended. The text does not give much guidance, nor the ECT, except perhaps with respect to obligations under the WTO Agreement.

Article 4 of the ECT stipulates that nothing in the ECT shall derogate from the provisions of the WTO Agreement for Contracting Parties who are also members of the WTO.[290]

One possible interpretation of the reference to 'treaty obligations' could perhaps be that the effect of the provision should be limited to treaty obligations owed by the host State to the investor State. In the final analysis, however, it is not clear what the effect of the provision is. As of yet, no ECT tribunal has addressed this issue.

VII. f) Each contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any Contracting Party.

1. General Comments

The last sentence of Article 10(1) constitutes what is generally known as an 'umbrella clause'. The use if this term is explained by the fact that the general idea underlying such a clause is to bring claims based on contracts concluded between Investors and Contracting Parties under the protective umbrella of the treaty in question, here the ECT. Similar clauses exist in most BITs. Even though most umbrella clauses are similar, they are seldom identical. The proper meaning and effect of such clauses are therefore dependent on how they are to be interpreted and understood based on the rules of interpretation found in the Vienna Convention.

Already the first modern BIT entered into in 1959 between Germany and Pakistan had an umbrella clause. Explaining the meaning of this clause to the German Parliament, the German government said: 'The violation of such an obligation [of an investment agreement] accordingly will also amount to a violation of the international obligation contained in the present Treaty'.[291]

[288] Final Act of the European Energy Charter Conference, Understanding 17.

[289] It has been suggested that the intention was to 'preclude ECT dispute settlement with regard to the OECD Codes', Bamberger, An Overview of the Energy Charter Treaty, in Wälde (ed.), *op. cit.*, at p.10.

[290] For commentary on Article 4, see p. 146 *et seq.*, *supra.*

[291] Dolzer and Schreuer, *op. cit.*, at pp. 163.

The most controversial aspect of umbrella clauses is whether, to what extent, and under which conditions they place contracts between an investor and the host State under the protection of the investment treaty in question. This issue must be seen against the background of the traditional position of international law that it is unlikely that a breach by a State of its contractual obligations, *without more*, constitutes a breach by the host State of its international obligations. At the same time, in the post Second World War globalized economy States have become increasingly active as contracting parties and in commercial transactions. This raised concerns with investors as to whether contracts, or guarantees, or other obligations, entered into by States and governed by the law of the host State provided sufficient legal predictability and security. Umbrella clauses were viewed as one way of mitigating these concerns.[292]

The underlying philosophy seems to have been to incorporate the principle of *pacta sunt servanda* in umbrella clauses, such that a State is under a *treaty obligation* to fulfil agreements entered into between the State and the investor. Put differently: an umbrella clause typically transforms a contract claim into a treaty claim. This seems to have been the generally held view for a long time, although there was, admittedly, little discussion among scholars and practitioners alike about the nature and effect of umbrella clauses. This changed in 2003 with the decision in *SGS v. Pakistan*.[293]

In *SGS v. Pakistan* the tribunal found that the umbrella clause in the Pakistan-Switzerland BIT did not bring SGS's claim—based as it was on Pakistan's termination of its contract with SGS—under the protection of the BIT. SGS had commenced arbitration of its contract claims in Pakistan. Only subsequently did it commence arbitration based on the BIT. Dealing with the jurisdictional issue, the tribunal maintained a strict delineation between contract claims and treaty claims. It found that the arbitration clause in the contract was 'a valid forum selection clause so far as concerns the Claimant's contract claims which do not also amount to BIT claims.[294]

The tribunal went on to say that the umbrella clause did not transform contract claims into treaty claims. It said, *inter alia*, that the clause did not mandate the 'instant transformation of contract claims into BIT claims'.[295]

In the *SGS v. Philippines* case, decided on 29 January 2004, the tribunal was faced with a very similar situation. SGS's contract with the Philippines also had a forum selection clause according to which disputes were to be referred to the Philippines courts. The Swiss-Philippines BIT had an umbrella clause. The claims brought before the tribunal were based both on breach of contract and breach of treaty. SGS argued that the tribunal had jurisdiction over the contract claim by virtue of the umbrella clause. The tribunal agreed with SGS and concluded that an umbrella clause means that the violation of an investment agreement will lead to a violation of the investment protection treaty. As succinctly put by the tribunal: 'Article X (2) [the umbrella clause] means what it says.'[296]

[292] Dolzer and Schreuer, *op. cit.*, at pp. 167–8. For an overview of the history of umbrella clauses, see Sinclair, 'The Origins of the Umbrella Clause in International Law of Investment Protection', 20 Arbitration International (2004) 411.

[293] *SGS v. Pakistan*, Decision on Jurisdiction dated 6 August 2003.

[294] Ibid., at 441.

[295] Ibid., at 446.

[296] *SGS Société de Surveillance S.A. v. Philippines,* Decision on Jurisdiction dated 29 January 2004, at paras. 515, 518.

In the event, however, the tribunal decided that since the contract contained a forum selection clause referring to the Philippines courts, those courts had to rule on the obligations contained in the contract. In this context it said the following:

> SGS should not be able to approbate and reprobate in respect of the same contract. If it claims under the contract, it should comply with the contract in respect of the very matter which is the foundation of its claim.[297]

Even though the end result in the two SGS cases was the same—the contract claims were referred to the dispute settlement mechanism set forth in the investment agreement—they represent diametrically opposed views as to the interpretation and understanding of umbrella clauses. In between these two different views we find cases where tribunals have introduced the distinction between commercial and sovereign activities of a State—in its role as a contracting party—as an important factor.[298]

The jurisprudence with respect to umbrella clauses and their effect is still developing, characterized primarily by attempts to limit their scope of application. In the final analysis, however, umbrella clauses, like any other clause in a treaty, must be interpreted based on the rules and principles of treaty interpretation laid down in the Vienna Convention.

There are several additional aspects of umbrella clauses which require attention. *First*, on the assumption that it is accepted that an umbrella clause transforms a contract claim into a treaty claim, there is the question of how the tribunal is to determine *if* there is a breach of contract. If the contract in question has a choice-of-law clause the natural starting point would be to apply the law chosen by the parties. If the tribunal finds that there is a breach of contract, or put differently, that the State has failed to observe its obligations, such failure gives rise to a breach of the umbrella clause, which in turn is a breach of international law. If the contract in question is governed by the law of the host State, the situation becomes more complicated, particularly if there are subsequent changes in that law which negatively affect the investor and his investment. In such a situation, the investor could perhaps argue that the obligations entered into, and the commitments made, by the State were those existing at the time when the contract was entered into, and that the law of the host State as it then stood was part of that bargain. On this argument, subsequent changes in the law could amount to a failure by the State to observe its obligations.

Another element that tribunals might take into account when determining whether there is a breach of contract, is the nature of the breach. If the tribunal accepts the idea of distinguishing between commercial and sovereign acts, it will need to make this determination.[299] On this view, only breaches which are the consequences of the exercise of sovereign autonomy would be covered by an umbrella clause.

As far as the umbrella clause in Article 10(1) is concerned, interpreted pursuant to the Vienna Convention, the ordinary meaning of the clause does not admit a restriction to the effect that the clause is applicable only to obligations entered into by the State in its sovereign capacity.

[297] Ibid., at paras. 561–2.

[298] See *El Paso v. Argentina*, Decision on Jurisdiction dated 27 April 2006; *Pan America/BP v. Argentina*, Decision on Preliminary Objections, dated 27 July 2006 for a very helpful summary of the trends and development concerning umbrella clauses, see Dolzer and Schreuer, *op. cit.*, at pp. 168–75.

[299] See discussion at pp. 237–8, *supra.*

Secondly, there is the question of *who* the parties to the agreement are and *how* this issue is to be determined. The umbrella clause in the last sentence of Article 10(1) of the ECT, refers to 'Each Contracting Party' and the obligations 'it' has entered into. It is not clear, however, how 'it' is to be defined. The situation is similar in most BITs. If an agreement has been entered into by the government of the host State, or by a ministry of the host State, problems in this respect usually do not arise. If the party to the agreement is a State entity, rather than the State itself, or a territorial subdivision, questions may arise whether such entities fall under 'it' in an umbrella clause. Tribunals have approached this issue in different ways.

In *Noble Ventures v. Romania*[300] the tribunal applied customary international law to find that contracts between the investor and the Romanian State Ownership Fund were covered by the umbrella clause in the Romania-US BIT. The tribunal concluded that the Fund, albeit a separate legal entity under Romanian law, had acted as a governmental agency.[301] In reaching this conclusion the tribunal applied the ILC Articles on State Responsibility, in particular Article 5 thereof.[302]

The tribunal in *Eureko v. Poland*[303] seems to have taken the same approach when discussing the umbrella clause. The umbrella clause of the Netherlands-Poland BIT—Article 3.5—provided that each contracting party 'shall observe any obligations it may have entered into with regard to investments of investors of the other Contracting Party'. In its reasons, the tribunal focused on how to interpret and understand the substantive contents of the umbrella clause. The tribunal framed the issue before it thus:

> The question accordingly arises, quite apart from the Government of Poland being in breach of Articles 31 and 3.5 of the Treaty on the grounds stated above, is it in further breach of Article 3.5? In view of the tribunal the answer to that question must be in the affirmative, for the reasons that follow:[304]

The tribunal then went on to discuss the interpretation of the umbrella clause. It did not, however, address the question of attribution in this context. Previously in the award, the tribunal dealt with the question of attribution in some detail on the basis of the ILC Articles.[305] Since the tribunal does not again address the issue of attribution when discussing the umbrella clause, it seems reasonable to assume that it proceeded on the basis of its previous conclusions, that is that the Sale and Purchase Agreement was to be attributed to the State. The tribunal thus seems to have applied, albeit implicitly, the international law rules of attribution to define 'it' in the umbrella clause.

The same approach seems to have been taken by the tribunal in the *Nykomb* case.[306] One of the arguments relied upon by the respondent was that the contract between Latvenergo and Windau, which in its view formed the basis of Nykomb's claims, was a commercial contract and as such not protected by the ECT. The claimant relied on the umbrella clause of the ECT in this respect. In its reasons, the tribunal did not deal with

[300] *Noble Ventures v. Romania*, Award dated 12 October 2005.
[301] Ibid., at paras. 69–86.
[302] Ibid., at para. 70. For comments on Article 5 of the ILC Articles, see p. 45 *et seq.*, *supra.*
[303] *Eureko v. The Republic of Poland*, Partial Award dated 19 August 2005.
[304] Ibid., at para. 245.
[305] The dispute concerned the privatization of a Polish insurance company. The seller of the shares under the sales and purchase agreement was 'the State Treasury of the Polish Republic represented by the State Treasury Minister of the Polish Republic.' Under the Polish Civil Code the State Treasury is accorded legal personality and, in civil law, relationships is considered the subject of rights and duties pertaining to state property.
[306] *Nykomb Synergetics Technologies Holding AB v. Latvia*, Award dated 16 December 2003.

this provision in any detail. The tribunal did, however, conclude 'that in the circumstance of this case, the Republic must be considered responsible for Latvenergo's actions under the rules of attribution in international law.[307] It would thus seem clear that the tribunal used the rules of attribution in international law—as opposed to any rules of attribution in municipal law—to determine the relationship between Latvenergo and the Republic of Latvia for purposes of state responsibility.

A different approach was taken by the tribunal in *Impregilo v. Pakistan*[308] where it was found that the umbrella clause was not applicable because the State had not contracted in its own name. The contracts in question had not been entered into with Pakistan, but with the Pakistan Water and Power Development Authority which was a separate legal entity under Pakistani law. The tribunal concluded that 'these are agreements into which it had not entered. On the contrary, the Contracts were concluded by a separate and distinct entity.'[309]

Similar approaches have been taken by other tribunals.[310]

Similar problems may arise on the investor's side when the investor runs a locally incorporated company which enters into a contract with the host State. Some tribunals have rejected the application of umbrella clauses to contracts entered into by locally incorporated companies.

As far as the ECT is concerned, the umbrella clause therein is clear in that it accepts such contracts. The last sentence of Article 10(1) refers to any obligations 'it has entered into with an Investor or an *Investment of an Investor*.' As explained above,[311] a locally incorporated company qualifies as an Investment under Article 1(6) of the ECT.

Thirdly, it is sometimes discussed whether an umbrella clause is applicable only to *contracts* entered into by the host State, or if it is also applicable to unilateral acts, including legislation and executive acts. Arbitral jurisprudence generally seems to accept that umbrella clauses may cover unilateral undertakings.[312] Other tribunals have, however, taken a different approach and found that the words 'entered into', found in many umbrella clauses, must be read as limiting the scope of the clause to contractual undertakings.[313]

2. ECT Awards

Under Article 26(3)(c) of the ECT [314] Contracting Parties may avoid the effects of the umbrella clause by listing themselves in Annex I A of the ECT.

Four States are listed in Annex I A.: Australia, (a signatory, but not a ratifying State); Canada (neither a signatory nor a ratifying State); Hungary (a Contracting Party), and Norway (a signatory but not a ratifying State). The listed States do not give their

[307] *Nykomb v. Latvia*, at pp. 11–40.

[308] *Impregilo S.p.A. v. Islamic Republic of Pakistan*, Decision on Jurisdiction dated 22 April 2005.

[309] Ibid., at para. 223.

[310] See e.g. *Azurix v. Argentina*, Award dated 14 July 2006, at paras. 52, 384; *Hameslev v. Ghana*, Award dated 18 June 2010, at paras. 339–3530.

[311] See p. 121 *et seq.*, *supra.*

[312] See e.g. *Enron v. Argentina*, Award dated 22 May 2007, at paras. 269–77; *Noble Energy v. Ecuador*, Decision on Jurisdiction dated 5 March 2008 at paras. 154–7, and *Plama v. Bulgaria*, Award dated 27 August 2008. *supra*, at paras. 185–7.

[313] See e.g. *Noble Ventures v. Romania*, see note 312, *supra* at para. 51; *Continental Casualty v. Argentina*, Award dated 5 September 2008 at paras. 297–303.

[314] For commentary on Article 26, see p. 414 *et seq.*, *infra.*

unconditional consent, as foreseen in Article 26(3)(a) of the ECT, with respect to disputes arising under the last sentence of Article 10(1) of the ECT.

In *Nykomb v. Latvia*,[315] as mentioned above,[316] the claimant relied on the umbrella clause in relation to the contract which the wholly state-owned subsidiary Windau had signed with the wholly owned company Latvenergo. Whilst the tribunal did not deal with this argument in detail, it did conclude that Latvia must be held responsible for Latvenergo's actions.

Also the claimant in *Amto v. Ukraine*[317] relied on the umbrella clause. Claimant argued that the words 'any obligations' required a broad definition, which included both specific contractual obligations and general commitments in the municipal legislation of the host State. The tribunal noted that the umbrella clause covered also locally incorporated companies. It continued:

> This means that the ECT imposes a duty not only in respect of the investor which is otherwise customary in an investment treaty context, but also vis-a-vis a subsidiary company, established in the host state. This means that an undertaking by Ukraine of a contractual nature vis-a-vis EYUM-10 could very well bring into effect the umbrella clause. However, in the present case the contractual obligations have been undertaken by a separate legal entity, and so the umbrella clause has no direct application.[318]

The decisive point for the tribunal was thus that the contracts in question were not entered into by the State itself, but rather by Energoatom ZAES, a separate legal entity under Ukrainian law, wholly owned by the State.

In *Plama v. Bulgaria*[319] the tribunal noted that the umbrella clause is wide in scope since it refers to 'any obligations'. It went on to say that an 'analysis of the ordinary meaning of the term suggests that it refers to any obligation regardless of its nature, i.e. whether it be contractual or statutory.'[320]

The dispute in this part concerned a privatization agreement that the investor had entered into with the Bulgarian Privatization Agency and the effect of undertakings therein with respect to liability for environmental damage.

The tribunal found that:

> [. . .] no violation by Bulgaria of its contractual undertakings to PCL [Claimant]. The amendment of the Environmental Law did not breach Article 4 of the Second Privatization Agreement since this provision did not shift Nova Plama's liability to the State.[321]

Also the tribunal in *Liman v. Kazakhstan*[322] had to address the umbrella clause. The claimant argued that Kazakhstan had breached a licence agreement and thereby violated the last sentence of Article 10(1) of the ECT. The tribunal noted that in order to rule in favour of claimant on this point, claimant must be a party to the licence agreement. It also noted that Kazakh courts had invalidated the transfer of the licence to the claimant. In earlier sections of the award, the tribunal had concluded that the relevant decisions of the Kazakh courts did not violate international law and therefore had to be accepted when analyzing possible breaches of the ECT. Since the claimant was not a contracting party to the licence agreement, it could not rely on it for purposes of the umbrella clause.[323]

[315] *Nykomb Synergetics Technologies Holding AB v. Latvia*, Award dated 16 December 2003.
[316] See p. 240 *et seq.*, *supra.*
[317] *Limited Liability Company AMTO v. Ukraine*, Award, dated 26 March 2008.
[318] *Amto v. Ukraine*, at para. 110. [319] See note 178, *supra.*
[320] *Plama Consortium Limited v. Republic of Bulgaria,* at para. 186. [321] Ibid., at para. 224.
[322] See note 216, *supra.*
[323] *Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan*, at para. 442.

In a different context, the tribunal discussed whether the umbrella clause covers legislation on the protection of foreign investments. The tribunal noted that the words 'obligation it has entered into' seemed to suggest that a contractual or similar bilateral relationship had to exist between the investor and the host State. It then went on to say:

> On the other hand, the Tribunal acknowledges that in the context of consent to jurisdiction of arbitral tribunals, it is commonplace that the host state's unilateral offer in its national legislation to submit the dispute under certain international arbitration rules to the jurisdiction of an arbitral tribunal, once duly accepted by the claimant, is a sufficient and binding submission to arbitration. This offer can be accepted by the investor by submitting its claim to the arbitration institution or arbitral tribunal. Applying this reasoning to ECT Article 10(1), it could be argued that an abstract unilateral promise by the state in its national legislation and particularly in its laws directed to foreign investors is encompassed by the 'umbrella clause'.[324]

In the circumstances, the tribunal did not rule on this issue, because it was not necessary in order to decide the dispute.[325]

The tribunal in *Al-Bahloul v. Tajikistan*[326] started out by defining the umbrella clause. It noted that the provision is broadly worded referring to 'any obligation'. It then referred to the decision of the ICSID annulment committee in the *CMS v. Argentina* case taking a narrower view based on the words 'entered into', used in the BIT, leading to its conclusion that the clause is limited to obligations of a consensual nature.[327] The tribunal went on to say:

> In both cases. However, it is clear that the obligation must have been entered into 'with' an investor. Therefore, this provision does not refer to general obligations of the state arising as a matter of law.[328]

In support of his umbrella clause argument the investor relied on several agreements with the State Committee for Oil and Gas and also on joint venture agreements. With respect to one of the agreements with the State Committee the tribunal found that there was a breach and that therefore the umbrella clause was applicable.[329] As regards, the joint venture agreements, the tribunal took the view that they 'are not obligations undertaken by a state organ, but rather by state-owned enterprises, and there is no basis for concluding that the state-owned enterprises signed these agreements acting in a governmental capacity.'[330]

The claimant had also relied on a Presidential Decree in support of his argument. The tribunal did not analyze whether in its view it created an obligation for the State arising as a matter of law. The tribunal simply concluded that even if the decree created an obligation, it had been fulfilled. No breach had thus occurred.[331]

In *Stati v. Kazakhstan*,[332] the parties argued extensively with respect to the umbrella clause. Claimants argued, *inter alia*, that the clause does not differentiate between contractual obligations and legislative, or regulatory, undertakings.[333] In the end the tribunal

[324] Ibid., at para. 448. [325] Ibid., at para. 447.

[326] *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, Partial Award On Jurisdiction and Liability, dated 2 September 2009.

[327] *Mohammad Ammar Al-Bahloul v. The Republic of Tajikistan*, at para. 257.

[328] *CMS Gas Transmission Company v. The Republic of Argentina*, Annulment Decision dated 5 September 2007, at para. 95(a).

[329] Ibid., at para. 268. [330] Ibid., at para. 269. [331] Ibid.

[332] *Anatolie Stati, Gabriel Stati, Ascom Group SA and Terra Raf Trans Traiding Ltd v. Kazakhstan*, Award dated 19 December 2013.

[333] *Stati v. Kazakhstan,* at para. 1289.

did not rule on the various issues concerning the umbrella clause. Since it had already concluded that Kazakhstan had violated the FET standard under Article 10(1), it only needed to rule on the umbrella clause if it constituted a further breach of the FET potentially leading to further damages. The tribunal found that this was not the case.[334]

In *Khan v. Mongolia*[335] the tribunal addressed the question whether breach of any provision of the Foreign Investment Law of Mongolia would constitute a breach of the umbrella clause in Article 10(1). The tribunal said the following:

> The Claimants submit that the terms 'any obligations' [in Article 10(1) of the ECT] encompass the statutory obligations of the host state and in this case, Mongolia's obligations under the Foreign Investment Law. Given the ordinary meaning of the term 'any' and the fact that the Respondents have not submitted any arguments or authorities to the contrary, the Tribunal accepts the Claimants' interpretation of Article 10(1) of the ECT. It follows that a breach by Mongolia of any obligations it may have under the Foreign Investment Law would constitute a breach of the provisions of Part III of the Treaty.[336]

In *Novenergia v. Spain*,[337] claimant relied on the umbrella clause arguing that by adopting and promoting RD 601/2007 Spain expressly undertook to pay a fixed FIT for the lifespan of photovoltaic plants in question. Claimant also contended that Spain had made specific commitments to the claimant.[338]

The tribunal did not agree with claimant. The tribunal took the view that application of the umbrella clause requires 'that the host State either concluded with the investor a specific contract or made to the investor a specific personal promise'.[339] The tribunal noted that the rights on which claimant relied were based on general regulatory acts enacted by Spain for a 'generality of investors in the field of renewable energy'.[340]

Claimants in *Antin v. Spain*,[341] also argued that the umbrella clause in Article 10(1) covered contractual obligations, unilateral obligations, legislations and other legislative and regulatory acts.[342] The tribunal did not specifically address the umbrella clause in its reasons. It simply concluded that Spain had not complied with its obligations under Article 10(1) of the ECT.[343]

In *Greentech v. Spain*,[344] the claimants invoked the umbrella clause relying on RD 661/2007 and the regulatory framework existing at the time when they made their investment. The tribunal took the view that the obligation under the umbrella clause applies to a specific commitment rather than to a general regulatory act. It found that neither the terms of RD 661/2007 nor the registration of the photovoltaic plants in the RAIPRE amounted to an obligation entered into by Spain for purposes of the umbrella clause in the ECT.[345]

The same issue came up in *Greentech v. Italy.*[346] The tribunal did not rule on the umbrella clause, since it had already concluded that respondent had breached the FET standard under Article 10(1), and since no additional damage could result from other breaches of the ECT.[347]

The tribunal noted, *obiter dicta*, that it was inclined to interpret obligations in the umbrella clause as sufficiently broad to cover not only contractual duties but also legislative

[334] Ibid., at paras. 1314–15.
[335] *Khan Resources v. Mongolia*, Final Award dated 2 March 2015.
[336] Ibid., at para. 295.
[337] See note 116, *supra.*
[338] *Novenergia v. Spain*, at para. 707.
[339] Ibid., at para. 715.
[340] Ibid.
[341] *Antin Infrastructure Services Luxembourg S.à.r.l. and Antin Energia Termosolar B.V. v. Kingdom of Spain*, Award dated 15 June 2018.
[342] *Antin v. Spain*, at para. 438.
[343] Ibid., at para. 572.
[344] See note 145, *supra.*
[345] *Greentech v. Spain*, at para. 413.
[346] See note 162, *supra.*
[347] *Greentech v. Italy*, at para. 456.

and regulatory instruments which are specific enough to qualify as commitments to identifiable investments or investors.[348]

It went on to explain its view in the following way:

> Respondent has admitted that the GSE Agreements themselves constitute binding obligations, although they may be unilaterally modified by legislative or regulatory action of the Italian government. However, even to the extent the GSE Agreements may be deemed mere 'accessory contracts' that mirror the underlying regulations set forth in the Conto Energia decrees, the GSE Agreements must not be viewed in isolation from the GSE authorization letters and Conto Energia decrees.
>
> The Tribunal majority instead finds that, taken as a whole, the Conto Energia decrees, the GSE letters, and the GSE Agreements, amounted to obligations 'entered into with' specific PV operators. Those obligations were sufficiently specific, setting forth specific tariff rates for a fixed duration of twenty years. Accordingly, whether any of the Conto Energia decrees, GSE letters, or GSE Agreements would, in isolation, be covered by the ECT's umbrella clause is not the relevant question here, given that each of Claimants' investments received benefits pursuant to all three types of 'obligations'.[349]

VIII. 2) Each Contracting Party shall endeavour to accord to Investors of other Contracting Parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (3).

This provision, the focus of which is on the Making of Investments, again highlights the difference between this concept and that of Investment.[350] Both these concepts are defined in Article 1 of the ECT.[351] It is clear from the text—'shall endeavor to accord'—that the intention is not to create the treatment referred to. This is confirmed in paragraph (4) of Article 10 which refers to a supplementary treaty to be entered into in this respect.[352] This provision cannot be made the subject of arbitration pursuant to Article 26 of the ECT. This requires that a complaint is raised by an Investor relating to an Investment; i.e. to occurrences having taken place once an Investment has been made.[353] It is possible, however, for a Contracting Party to commence arbitration under Article 27 of the ECT alleging violation of Article 10, paragraph (2) of the ECT.[354] Alleged violations of paragraph (2) may also be brought before a tribunal established on the basis of Article 26, if the Investor can convince the tribunal that an Investment has in fact been made, and if the alleged violation relates to that Investment.

Even though the ECT makes a distinction between Investment and the Making of Investments, the language used in Article (10)1 is not clear on this point. The first sentence of Article 10(1) refers to the Making of Investments, whereas the remainder of paragraph (1) deals with Investments and the obligations of Contracting Parties relating thereto. The reference in the third and fourth sentences dealing with the 'Making of Investments' could perhaps lead to an interpretation where the obligations laid down in the third and fourth sentences would apply also to the first sentence. This unfortunate wording was noted during the negotiations. Amendments were suggested, but in the end no change was made.[355]

[348] Ibid., at para. 464. [349] Ibid., at paras. 465–6. [350] See discussion at p. 183, *supra.*
[351] See p. 67 *et seq.* and p. 132 *et seq.*, *supra.* [352] For a commentary, see p. 246 *et seq.*, *infra.*
[353] For a commentary on Article 26, see p. 414 *et seq.*, *infra.* [354] See p. 475 *et seq.*, *supra.*
[355] Cf. e.g. Legal Subgroup Notes/Report 2, 6 October 1994; fax from the Canadian representatives to Craig Bamberger, 13 October 1994.

No ECT tribunal has been called upon to rule on the relationship between the first and second sentence of Article 10(1) from this perspective. In *Blusun v. Italy*[356] the tribunal said the following focusing primarily on the FET standard:

> In the Tribunal's view, little turns on the interpretive argument based on Article 1(8) [the definition of Making Investments], because the second sentence of Article 10(1) goes on to stipulate that the stable conditions to be created under the first sentence 'shall include a commitment to accord *at all times* to Investments of Investors of other Contracting Parties fair and equitable treatment' (emphasis added). In effect, as various tribunals have pointed out, the obligation to create stable conditions is conceived as part of the FET standard which is generally applicable to investments by virtue of the second sentence.[357]

Thus assuming that the first and second sentences of Article 10(1) apply to a legal instability claim said to arise in the course of an existing investment, the tribunal proceeded to analyze the scope of the host State's obligation in this respect.[358]

IX. 3) For the purposes of this Article, 'Treatment' means treatment accorded by a Contracting Party which is no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is the most favourable.

The provision sets forth a definition of 'treatment', to be applied throughout Article 10. At the same time paragraph (7) incorporates almost identical language when referring to the standards of national treatment and most-favoured-nation treatment.[359] Neither paragraph has a cross-reference to the other. The relationship between the two paragraphs is thus unclear, as is the independent meaning of paragraph (3), except as a definition. The national and most-favoured-nation protection standards are set forth in paragraph (7).

It is possible that paragraph (3) was deemed necessary to include against the background of the plans to conclude a separate treaty, referred to in paragraph (4), on the Making of Investments. Paragraph (4) refers back to the definition in paragraph (3) of the 'Treatment' to be accorded with respect to the Making of Investments. As mentioned above, however, no such supplementary treaty has been concluded.[360]

X. 4) A supplementary treaty shall, subject to conditions to be laid down therein, oblige each party thereto to accord to Investors of other parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (3). That treaty shall be open for signature by the states and Regional Economic Integration Organisations which have signed or acceded to this Treaty. Negotiations towards the supplementary treaty shall commence not later than 1 January 1995, with a view to concluding it by 1 January 1998.

As discussed above,[361] during the negotiations of the ECT different opinions were expressed as to the scope of national treatment, particularly at the pre-investments

[356] *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic*, Award dated 27 December 2016.
[357] Ibid., at para. 315 (c). [358] Ibid., at para. 316.
[359] For commentary on paragraph (7), see p. 248 *et seq.*, *infra.* [360] See p. 13 *et seq.*, *supra.*
[361] See p. 13 *et seq.*, *supra.*

stage. During the negotiations the US representatives emphasized the importance of market access, whereas other delegations were not prepared to accept the principle of national treatment at the pre-investment stage. The compromise reached at the initiative of the EU, meant that provisions for non-discrimination at the pre-investment stage were to be dealt with in a separate, supplementary treaty. This ambition was also spelled out in the preamble of the ECT, where the sixth paragraph reads:

> Affirming that Contracting Parties attach the utmost importance to the effective implementation of full national treatment and most favoured nation treatment, and that these commitments will be applied to the Making of Investments pursuant to a supplementary treaty.

As already mentioned, however, despite these ambitions, no supplementary treaty has been concluded.

The planned supplementary treaty gave rise to two Understandings.

Understanding 10 reads:

> The supplementary treaty will specify conditions for applying the Treatment described in Article 10(3). Those conditions will include, inter alia, provisions relating to the sale or other divestment of state assets (privatization) and to the dismantling of monopolies (demonopolization).[362]

The other Understanding, Understanding 11, relates to Article 29(6) of the ECT dealing with certain trade matters.[363]

Understanding 11 reads:

> Contracting Parties may consider any connection between the provisions of Article 10(4) and Article 29(6).[364]

The Russian Federation made the following Declaration concerning Article 10(4):

> The Russian Federation wishes to have reconsidered, in negotiations with regard to the supplementary treaty referred to in Article 10(4), the question of the importance of national legislation with respect to the issue of control as expressed in the Understanding to Article 1(6).[365]

The Russian Federation also expressed the following view via a Chairman's Statement:

> In addition, the Russian Federation has expressed the view that the consideration of appropriate amendments to the Treaty pursuant to Article 30 affecting sectors of services within the scope of this Treaty to which measures of the GATTS apply, and the negotiations towards the supplementary investment treaty provided for in Article 10(4), should be conducted in such a manner as to assure mutual consistency of the Treaty provisions arrived at. Here again, I am sure that all delegations would fully endorse the need to achieve such consistency in the future incorporation in the Treaty of the results of the Uruguay Round, and in negotiation of the second Treaty for the pre-investment stage.[366]

[362] Final Act of the European Energy Charter Conference, Understanding 10.
[363] For commentary on Article 29, see p. 485 *et seq.*, *infra*.
[364] Final Act of the European Energy Charter Conference, Understanding 11.
[365] Ibid., Declaration; for the Understanding of Article 1(6).
[366] Chairman's Statement at Adoption Session on 17 December 1994.

5) Each Contracting Party shall, as regards the Making of Investments in its Area, endeavour to:
(a) limit to the minimum the exceptions to the Treatment described in paragraph (3);
(b) progressively remove existing restrictions affecting Investors of other Contracting Parties.

The provision in paragraph (5) concerns the Making of Investments, i.e. the pre-investment phase. The obligations of the Contracting Parties are limited to endeavouring to limiting and removing exceptions to the national treatment and most-favoured nation treatment standards referred to in paragraph (3). Whilst such obligations cannot be the subject of arbitration on the basis of Article 26 of the ECT, it would be possible to initiate arbitration under Article 27 of the ECT.

6) (a) A Contracting Party may, as regards the Making of Investments in its Area, at any time declare voluntarily to the Charter Conference, through the Secretariat, its intention not to introduce new exceptions to the Treatment described in paragraph (3).
(b) A Contracting Party may, furthermore, at any time make a voluntary commitment to accord to Investors of other Contracting Parties, as regards the Making of Investments in some or all Economic Activities in the Energy Sector in its Area, the Treatment described in paragraph (3). Such commitments shall be notified to the Secretariat and listed in Annex VC and shall be binding under this Treaty.

The provision of paragraph (6) deals with the Making of Investments, inviting the Contracting Parties to make voluntary declarations and commitments. As far as commitments are concerned, they are to be notified to the Energy Charter Secretariat and listed in Annex VC. If so notified and listed, they are binding under the ECT. No such commitments have been entered into Annex VC. Nor have any voluntary declarations been made to the Charter Conference pursuant to paragraph 6(a).

XI. 7) Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any other Contracting Party or any third state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable.

1. General Comments

Paragraph (7) sets forth two additional standards of protection found in most investment protection treaties, *viz.*, (i) national treatment, i.e. that foreign investors must not be treated less favourably than investors of the hosts State's nationality, and (ii) most-favoured-national treatment (MFN), i.e. the principle that investors must not be treated less favourably than investors of any other State. As a matter of general principle, these two standards of protection in the ECT ought to be interpreted in a similar way as in other investment protection treaties. At the same time, however, it must be emphasized that every treaty clause must be interpreted on the basis of the Vienna Convention, in particular its Article 31.[367]

[367] See discussion at p. 27 *et seq.*, *supra*.

The principles of national treatment and MFN treatment both constitute cornerstones of the WTO Agreement regulating international trade.

In GATT the most important statement of the principle of national treatment is found in Article III which in essence requires members of the WTO not to discriminate against imported goods. The principle is also referred to in Article IX:I (Marks of Origin) and in Article XVII (State Trading Enterprises). The ultimate purpose of the principle in the WTO context is to avoid protectionism and to ensure that the competitive conditions are equal between imported products and domestic products.

The MFN principle is laid down in Article I of the GATT. The effects of the principle is perhaps best illustrated with respect to tariffs on imported goods. If a member of the WTO has accepted that a tariff on a specific product cannot exceed a certain level, the tariff in question is said to be bound. This means that the member cannot impose customs in excess of the bound tariff. The MFN principle means that a tariff, which has been bound by a member, is extended to all other members even though the lower tariff has been agreed as a result of negotiations with only one other member. All other members thus enjoy a free ride, since they have not made any concessions with respect to its own tariffs. In the WTO context, however, the ultimate purpose underlying the MFN principle is to create a level playing field for all members of the WTO.

The principles of national treatment and MFN treatment are of central importance both for international investment law and international trade law. This raises the question of the extent to which WTO jurisprudence is, or should be, relevant to the interpretation and application of investment protection treaties. The question has been the subject of some debate.[368] Parties have from time to time relied on WTO jurisprudence in support of their arguments based on BITs. Tribunals seem less and less inclined to afford WTO jurisprudence decisive importance, emphasizing the different objectives and purposes of investment protection treaties compared to the WTO Agreements.[369]

It should be noted that the effects of paragraph (7) are limited by virtue of paragraph 10 of Article 10, in that paragraph (7) does not apply to Intellectual Property. Such rights are rather to be protected pursuant to international agreements dealing with intellectual property rights.[370]

2. National Treatment

a. General Comments[371]

The general purpose underlying the principle of national treatment in investment protection treaties is to provide a level playing for the foreign investors in relation to investors of the host State.[370] It means that the host State cannot take any measures that negatively affect foreign investors as compared to domestic investors. Foreign investors may, however, be treated better than domestic ones.

The national treatment standard referred to in paragraph (7) applies only to the post-investment phase, i.e. once an investment has been made. It does not cover the pre-investment phase, i.e. the Making of Investments.

[368] Dolzer and Schreuer, *op. cit.*, at p. 204–6.
[369] Ibid., at p. 206.
[370] For commentary on paragraph (10), see p. 255, *infra.*
[371] For general comments on national treatment, see e.g. Dolzer and Schreuer, *op. cit.* at pp. 98–206; Newcombe and Paradell, *op. cit.*, at pp. 147–232; McLachlan et al, *op. cit.*, at pp. 254–7.

As is the case with several other standards of protection, the national treatment standard is fact-specific. Consequently, it will depend on the facts and circumstances of the individual case whether this standard has been violated. Generally speaking, there is substantial overlap between the national treatment standard and the protection against unreasonable or discriminatory measures.[372] Also the national treatment requires a three-step analysis.

First, it must be determined whether the foreign investor and the host State investor are in 'like circumstances', or in 'like situations', i.e. whether the circumstances are sufficiently similar to make a comparison meaningful. Does 'like circumstances' require the business of the investors to be exactly the same, or is it sufficient to be in the same sector of the economy? In general, investment treaty jurisprudence seems to indicate that tribunals have taken a flexible approach to the interpretation of 'like circumstances' and 'like situations'.[373] A broad understanding of these concepts also seems to be in compliance with the underlying idea to review in full the consequences of the measures taken and/or treatment provided by the host State.

Secondly, the tribunal in question must determine whether there is a differentiation between the foreign and domestic investors. Is the treatment afforded to the foreign investor at least as favourable as the treatment afforded to the domestic investor? Arbitral jurisprudence seems to confirm that the ultimately decisive factor is the actual effect of the treatment in question. In the *Thunderbird* award, decided under the NAFTA, for example, the tribunal concluded that the fact of less favourable treatment was sufficient.[374] It follows that *intention* to discriminate is not relevant in this context, including intention to discriminate based on nationality.

Thirdly, it must be determined whether the differentiation in treatment was justified. Whilst it seems to be generally accepted that differentiation is justified if there is a rational ground for it,[375] it leaves open the question how to define a 'rational ground'. The answer to this question will very much depend on the facts and circumstances of the individual case. Protection of public interest could perhaps under certain circumstances justify a differentiated treatment. In *GAMI v. Mexico* for example, the tribunal took the view that the solvency of a local producer of sugar was a legitimate policy goal, but underlined that the measures in question were not specifically directed at the foreign investor.[376]

The following DECISION was taken with respect to paragraph (7):

> The Russian Federation may require that companies with foreign participation obtain legislative approval for the leasing of federally-owned property, provided that the Russian Federation shall ensure without exception that this process is not applied in a manner which discriminates among Investments of Investors of other Contracting Parties.[377]

[372] See discussion at p. 230 *et seq.*, *supra.* [373] Dolzer and Schreuer, *op. cit.*, at p. 200.
[374] *Thunderbird v. Mexico*, Award dated 26 January 2006, at para. 177.
[375] Cf. e.g. Dolzer, Generalklauseln in Investitionsschutzvertträgen, in Negotiating for Peace, Liber Amicorum Tono Eifel (2003) 296–305.
[376] *GAMI v. Mexico*, Award dated 15 November 2004, at paras. 114–15.
[377] Decision 2 with respect to the Energy Charter Treaty (Annex 2 to the Final Act of the European Energy Charter Conference).

b. ECT Awards

There are only a few ECT awards dealing specifically with national treatment. This is partially explained by the significant overlap between this standard of protection and the prohibition against discrimination.[378]

In *Bahloul v. Tajikistan*[379] the claimant argued that there had been a breach of the national treatment standard because the Tajik party in two joint ventures was allowed to make in-kind contributions in exchange for shares, while Vivalo could only make cash contributions. In the view of the arbitral tribunal the court decisions, which formed the basis of claimant's argument in this respect, did not amount to any such refusal; the judgments did not deny Vivalo the right to make in-kind contributions.[380]

In *AES v. Hungary*,[381] the tribunal noted that the alleged breach of the national treatment standard was based on the same facts that the claimant relied on with respect to discrimination. Since the tribunal had concluded that there was no discrimination it found that there was no breach of the national treatment standard.[382]

In *Electrabel v. Hungary*,[383] the claimant argued that Hungary had accorded to other Hungarian generators of electricity more favourable treatment than it accorded to Electrabel and Dunamenti with respect to the requirement from the Hungarian government to reduce tariffs. Seemingly referring to discriminatory intent, the tribunal noted that there was no factual evidence that any conduct by the Hungarian government 'was ever motivated by national or other discrimination within the terms of Article 10(7) ECT.'[384] The tribunal concluded that given the lack of any substantiation for claimant's allegations, the claim must fail.[385]

3. *Most-Favoured-Nation Treatment*

a. General Comments[386]

MFN clauses have been included in international trade treaties for a very long time[385]. As mentioned above,[387] the MFN principle is one of the cornerstones of the WTO Agreements.[388] MFN clauses are also found in most investment protection treaties today.

The MFN standard was included in BITs from the very beginning, and is older than the parallel provision for 'national treatment' that found its way into BITs at a later stage. Today, according to the United Nations, 'the MFN standard is at the heart of multilateralism and is a core principle in international investment agreements'.[389]

Professor Schwarzenberger has described the constant character of the MFN standard in international agreements as 'remarkable'. He states:

Its permanent use suggests that there is something basic in this international pattern of conduct. It indicates that the mJ.n. standard answers to constant needs of international society, and it suggests

[378] See discussion at p. 230 *et seq.*, *supra.*

[379] *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, Partial Award On Jurisdiction and Liability, dated 2 September 2009.

[380] *Bahloul v. Tajikistan*, at para. 273.

[381] See note 195, *supra.*

[382] *AES v. Hungary*, at para. 11.3.3.

[383] See note 221, *supra.*

[384] *Electrabel v. Hungary*, at para. 7.163.

[385] Ibid., at para. 7.164.

[386] For general comments on MFN clauses in the context of investment protection treaties, see Dolzer & Schreuer, *op. cit.,* at 206–12; MacLachlan et al, *op. cit.*, at 254–7; Newcombe and Paradell, *op. cit.*, at 147–232.

[387] See p. 19 *et seq.*, *supra.*

[388] See p. 19 *et seq.*, *supra.*

[389] See UNCTAD, *Most-Favoured-Nation Treatment*, Series on Issues in International Investment Agreements (1999) section II A.

that the functions fulfilled by the standard are not essentially affected by the peculiarities of time or place or by differences in social and economic systems.[390]

The function of the MFN standard is stated to be 'the elimination of discrimination, the correction of oversights and the adaptation of treaties to changing circumstances'.[391] It generalizes automatically the advantages granted by one State to any other included in the m.f.n. arrangement'.[392] It forms an 'agency of equality' and 'prevents discrimination and establishes equality of opportunity on the highest possible plane: the minimum of discrimination and the maximum of favours conceded to any third State'.[393]

The general philosophy underlying the MFN principle is that parties to a treaty ought to treat each other in a manner that is not less favourable than the manner in which they treat third parties. Under most MFN clauses a benefit, which is granted to a third party, by a party to a treaty, will automatically be extended to the other party to the treaty. The normal effect of an MFN clause is that the scope of application of the treaty containing the MFN clause is broadened, in the sense that benefits found in another treaty—i.e. with a third party—are imported into it. This usually means that the rights of the investor are broadened too. It must be remembered, however, that MFN clauses may be different. Each clause must therefore be interpreted based on the principles and rules laid down in the Vienna Convention. This means that the scope and effect of MFN clauses may vary. Unless otherwise agreed, the MFN clause will operate in relation to all matters covered by the treaty containing the MFN clause, but only to those matters. This is the so-called principle of sameness.

The MFN clauses in some treaties refer to specific provision, or areas, to which the MFN clause applies, or does not apply. For example, some treaties exclude the application of MFN clauses with respect to free trade areas, customs unions, taxation matters[394] and sometimes to dispute resolution. Most investment protection treaties, however, are worded in a general way, usually referring to 'treatment' of investors and/or investors.

Consequently, in order properly to understand the scope and effect of an MFN clause it must be interpreted on the basis of the rules and principles of the Vienna Convention. There is no basis for interpreting an MFN clause differently than any other treaty clause.

It is probably fair to say that the traditional role and significance of an MFN clause were to be found in economic and trade treaties.[395] They typically related to substantive rights under such treaties. With respect to investment protection treaties, it is widely accepted today that an MFN clause typically grants an investor the right to benefit from more beneficial substantive rights contained in treaties with third parties. As explained by

[390] Schwarzenberger, 'The Most-Favoured-Nation Standard in British State Practice', 223, British Year Book of International Law (1945) 96 at 98.

[391] Ibid., 100. [392] Ibid., 99. [393] Ibid.

[394] Article 21(3) of the ECT sets out exceptions with respect to taxation; for commentary on Article 21, see p. 354 *et seq.*, *infra.*

[395] The first 'modern' trade treaty that included an unconditional MFN clause was the Cobden Treaty dated 23 January 1860 between the United Kingdom and France. Later, in March 1929, the Council of the League of Nations adopted a model MFN clause in respect of tariffs. After the Second World War, the MFN standard was revived in the negotiation of the Havana Charter, where it was made one of the core obligations of commercial policy. See UNCTAD, *Most-Favoured-Nation Treatment,* Series on Issues in International Investment Agreements (1999) section II, A, at 13; OECD, Directorate for Financial and Enterprise Affairs, *Working Papers on International Investment,* No. 2. (2004); ibid., *Most-Favoured-Nation Treatment in International Investment Law,* September 2004, section 2.2, at 3.

the tribunal in *CME v. Czech Republic*, an MFN clause would also cover the standard of compensation in an expropriation case.[396]

As far as investment treaty disputes are concerned, it is interesting to note that the majority of cases dealing with MFN clauses in fact deal with the applicability of such clauses to dispute settlement clauses in investment protection treaties. This raises the general question of how to distinguish between procedure and substantive rights in an investment protection treaty, and perhaps the more fundamental question whether such a distinction is appropriate. The tribunal in *Hochtief v. Argentina* concluded that there was no basis for such a distinction:

> This is clear if one considers the case of a claim to money or to performance having an economic value, both of which are stipulated by Article 1(c) of the Argentina- Germany BIT to be within the definition of an 'investment, or of intellectual property rights, addressed in Article 1(d). The argument that although a State could not cancel such claims or intellectual property rights without violating the BIT, it could cancel the right to pursue the claims or enforce the intellectual property rights through litigation or arbitration without violating the BIT is nonsensical. It is nonsensical because the right to enforcement is an essential component of the property rights themselves, and not a wholly distinct right.[397]

Other tribunals have, however, made this distinction. There are a number of arbitral awards where tribunals have discussed whether an MFN clause in a BIT covers the dispute resolution provision of the treaty.[398]

Decisions rendered so far squarely fall into two categories. One category of case accepts that MFN clauses do extend to dispute settlement provisions. Until the *RosInvest*[399] decision was issued, cases in this category all concerned procedural obstacles, that is, it has been held by tribunals that an MFN clause can be used to overcome such obstacles. The other category of case takes a more sceptical attitude towards MFN clauses in relation to dispute settlement provisions. Generally speaking, cases falling into· this category do not concern procedural obstacles, but rather the scope of application of the dispute settlement clauses,

The *RosInvest* decision is believed to be the first case where an arbitral tribunal has allowed a claimant to use an MFN clause in one treaty to incorporate the dispute settlement clause in another treaty.

b. ECT Awards

There are only a few cases where ECT tribunals have addressed the MFN standard.

[396] *CME v. Czech Republic*, Final Award dated 14 March 2003, at para. 500.

[397] *Hochtief v. Argentina*, Decision on Jurisdiction dated 24 October 2011, at para. 67.

[398] See e.g. *Telenor Mobile Communications AS v. Republic of Hungary*, ICSID Case No. ARB/04/15, Award, 13 September 2006; *Suez and Vivendi v. Argentina*, ICSID Case No. ARB/03/19, Decision on Jurisdiction, 3 August 2006; *National Grid v. Argentina,* UNCITRAL, Decision on Jurisdiction. 20 June 2006; *Suez, Sociedad General de Aguas de Barcelona SA. and InterAguas Servicios Integrales del Agua SA v. The Argentine Republic*, ICSID Case No. ARB/03/17 Decision on Jurisdiction, 16 May 2006; *Berschader v. The Russian Federation,* SCC Case No. 08012004, Award, 21 April 2006; *Gas Natural SDG. SA v. The Argentine Republic*, ICSID Case No. ARB/03/10, Decision on Jurisdiction, 17 June 2005; *Plama Consortium Limited v. Republic of Bulgaria*. ICSID Case No. ARB/03/24, Decision on Jurisdiction. 8 February 2005, 44 *ILM* (2005) 721; *Siemens AG v. The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, 3 August 2004, 44 *ILM* (2005) 138; *MTD Equity Sdn Bhd and MTD Chile SA v. Republic of Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004; *Salini v. Jordan*. ICSID Case No. ARB 00/4 Decision on Jurisdiction dated 23 July 2001; *Emilio Agustin Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7 Decision on Jurisdiction, dated 25 January 2000

[399] *RosInvest v. Russian Federation*, Award on Jurisdiction, October 2007.

In *Kardassopoulos v. The Republic of Georgia*,[400] the claimant did not argue breach of the MFN clause. The tribunal ´, however, addressed the MFN clause as part of its discussion of quantum. The tribunal took the view that claimant could in theory have availed itself of the MFN clause in the ECT to secure preferential tax treatment available to other foreign investors.[401] In the event the tribunal did not apply the MFN clause primarily because, as a matter of municipal law, no taxes would have been paid with respect to the investment in question.[402]

The tribunal in *AES v. Hungary*[403] rejected the investor's claims based on the MFN clause. In doing so, the tribunal referred to its analysis of the alleged discrimination. The MFN claims were based on the same facts as the discrimination claims, which the tribunal rejected. In that context the tribunal found that 'each generator's price was determined based on the application of uniform methodology. This being the case, there can be no suggestion that AES was treated 'less favourably' than any other similarly situated investor.'[404]

In *Mamidoil v. Albania*[405] the investor did not initially rely on the ECT, but rather on the Albania-Greece BIT. The claimant subsequently argued that the ECT was applicable by virtue of the MFN clause in the BIT. Since respondent did not raise any objection in this respect, the tribunal proceeded to try the claims also under the ECT.[406]

XII. 8) The modalities of application of paragraph (7) in relation to programmes under which a Contracting Party provides grants or other financial assistance, or enters into contracts, for energy technology research and development, shall be reserved for the supplementary treaty described in paragraph (4). Each Contracting Party shall through the Secretariat keep the Charter Conference informed of the modalities it applies to the programmes described in this paragraph.

This provision refers to the supplementary treaty described in paragraph (4) of Article 10, but which has not been signed, nor negotiated at all. As a consequence thereof, the Charter Conference has not received the information referred to in the provision.

XIII. 9) Each state or Regional Economic Integration Organization which signs or accedes to this Treaty shall, on the date it signs the Treaty or deposits its instrument of accession, submit to the Secretariat a report summarizing all laws, regulations or other measures relevant to:

(a) exceptions to paragraph (2); or
(b) the programmes referred to in paragraph (8).

[400] *Ioannis Kardassopoulos v. The Republic of Georgia*, ICSID Case No. ARB/05/18, Award on Jurisdiction, 6 July 2007.
[401] Ibid., at para. 622. [402] Ibid., at para. 623. [403] See note 195, *supra.*
[404] *AES v. Hungary*, at para. 12.3.2.
[405] *Mamidoil Jetoil Greek Petroleum Products Société S.A. v. Republic of Albania*, Award dated 30 March 2015.
[406] *Mamidoil v. Albania*, at paras. 277–8.

A Contracting Party shall keep its report up to date by promptly submitting amendments to the Secretariat. The Charter Conference shall review these reports periodically.

In respect of subparagraph (a) the report may designate parts of the energy sector in which a Contracting Party accords to Investors of other Contracting Parties the Treatment described in paragraph (3).

In respect of subparagraph (b) the review by the Charter Conference may consider the effects of such programmes on competition and Investments.

This provision was introduced in anticipation of the supplementary treaty referred to in paragraph (4) of the ECT. In the absence of such a supplementary treaty, the Charter Conference and the Secretariat have not been engaged as foreseen in this provision.

XIV. 10) Notwithstanding any other provision of this Article, the treatment described in paragraphs (3) and (7) shall not apply to the protection of Intellectual Property; instead, the treatment shall be as specified in the corresponding provisions of the applicable international agreements for the protection of Intellectual Property rights to which the respective Contracting Parties are parties.

Intellectual Property is defined in Article 1(6) as an Investment under the ECT.[407] As an Investment, Intellectual Property enjoys protection under Article 10 of the ECT. With respect to national treatment and MFN treatment, however, this provision exempts Intellectual Property from such treatment. Instead, treatment is to be as per the applicable international agreements for the protection of Intellectual Property rights to which the respective Contracting Parties are parties.

XV. 11) For the purposes of Article 26, the application by a Contracting Party of a trade-related investment measure as described in Article 5(1) and (2) to an Investment of an Investor of another Contracting Party existing at the time of such application shall, subject to Article 5(3) and (4), be considered a breach of an obligation of the former Contracting Party under this Part.

As discussed in connection with Article 5,[408] by virtue of this provision, the application by a Contracting Party of a trade-related investment measure, as described in Article 5, is deemed to constitute a breach of an obligation under Part III of the ECT for purpose of Article 26 of the ECT. Such a measures could consequently be made the subject of the dispute settlement mechanism in Article 26.

Australia which did not ratify the Treaty made the following Declaration with respect to Articles 5 and 10(11):

Australia notes that the provisions of Articles 5 and 10(11) do not diminish its rights and obligations under the GATT, including as elaborated in the Uruguay Round Agreement on Trade-Related

[407] See pp. 92–93, *supra.* [408] See p. 147 *et seq.*, *supra.*

Investment Measures, particularly with respect to the list of exceptions in Article 5(3), which it considers incomplete.

Australia further notes that it would not be appropriate for dispute settlement bodies established under the Treaty to give interpretations of GATT articles III and XI in the context of disputes between parties to the GATT or between an Investor of a party to the GATT and another party to the GATT. It considers that with respect to the application of Article 10(11) between an Investor and a party to the GATT, the only issue that can be considered under Article 26 is the issue of the awards of arbitration in the event that a GATT panel or the WTO dispute settlement body first establishes that a trade-related investment measure maintained by the Contracting Party is inconsistent with its obligations under the GATT or the Agreement on Trade-Related Investment Measures.[409]

XVI. 12) Each Contracting Party shall ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to Investments, investment agreements, and investment authorizations.

There is considerable overlap between this provision and the FET standard under Article 10(1),[410] an important element of which is denial of justice. The language of paragraph (12) is, however, more specific. It focuses on the effective means for asserting and enforcing rights of the Investor.

A few ECT tribunals have had reason to address Article 10(12).

In *Petrobart v. Kyrgyzstan*[411] the tribunal found that a letter from the Vice Prime Minister to the Chairman of the Bishkek Court which gave support for a stay of execution of judgments rendered against the state-owned company KGM violated the respondents' obligations under Article 10(12).[412] Petrobart had been awarded 3 million USD. In the letter the Vice Prime Minister had referred to the strategic importance of KGM and its critical financial standing as reasons for deferring enforcement of the court decisions.

This provision was addressed also by the tribunal in *Amto v. Ukraine*.[413] The issue here was the Ukrainian bankruptcy legislation at the time. The Ukrainian company in which the claimant was the controlling shareholder—EYUM-10—had claims against Energoatom. Claimant argued that it could not enforce the claims due to the bankruptcy legislation and the way it was applied by Ukrainian courts. Since the debtor—Energoatom—was put under a more or less constant moratorium, no remedy was available against such debtor. Claimant also argued that no remedy was available when a court does not comply with stipulated deadlines in the legislation. The third complaint was that no remedy was available when the debtor co-operated with the creditor with the purpose of depriving other creditors of the right to enforce their claims.

In the circumstances, the tribunal found that Ukraine had not breached its obligations under Article 10(12). After having observed that the provision is not only a rule of law standard, but also a qualitative standard, it went on to say:

The difficulty is to identify the criteria by which to assess the effectiveness of the legislation and rules called into question under Article 10(12) ECT. Bearing in mind the context and the object and purpose of the ECT, the Tribunal considers that 'effective' is a systematic, comparative, progressive and practical standard. It is systematic in that the State must provide an effective framework or

[409] Final Act of the European Energy Charter Conference, Declaration 2.
[410] See discussion at p. 185 *et seq.*, *supra.*
[411] *Petrobart Limited v. Kyrgiz Republic*, Award of 29 March 2005.
[412] *Petrobart v. Kyrgyzstan,* at p. 77.
[413] *Limited Liability Company AMTO v. Ukraine*, Award, dated 26 March 2008.

system for the enforcement of rights, but does not offer guarantees in individual cases. Individual failures might be evidence of systematic inadequacies, but are not themselves a breach of Article 10(12). It is comparative in that compliance with international standards indicates that imperfections in the law might result from the complexities of the subject matter rather than the inadequacies of the legislation. It is progressive in the sense that legislation ages and needs to be modernized and adapted from time to time, and results might not be immediate. Where a State is taking the appropriate steps to identify and address deficiencies in its legislation—in other words improvement is in progress—then the progress should be recognized in assessing effectiveness. Finally, it is a practical standard in that some areas of law, or the application of legislation in certain circumstances, raise particular difficulties which should not be ignored in assessing effectiveness.

In the present case, the Claimant has not demonstrated that the Bankruptcy Law does not provide an effective means to enforce a creditor's rights in the Ukraine. It is a modern law, which introduced new concepts. Its introduction has been accompanied by training programmes for participants in the bankruptcy process. There are some problems with the law, which have been exploited by both creditors and debtors to their own advantage, and it seems that Ukrainian economic procedure, or the customs of thought of its lawyers and judges, have not succeeded in finding solutions to these problems. Its application to a state entity of strategic importance in the energy sector has not surprisingly caused problems. EYUM-10 has had a frustrating experience in the collection of its debts from Energoatom, but the Claimant has failed to demonstrate that the Bankruptcy Law is not effective for the enforcement of rights within the meaning of Article 10(12) of the ECT, or that its provisions otherwise constitute a denial of justice. Accordingly, the Claimant's claims on this ground are dismissed.[414]

In *Stati et al. v. Kazakhstan*,[415] the claimants contended that several aspects of criminal proceedings brought against members of a group of investors violated Kazakhstan's obligations under Article 10(2) of the ECT. In many respects the claimants' arguments resembled a denial of justice claim.[416] In the end, the tribunal did not rule on this issue, since it had already determined that Kazakhstan had breached the FET standard under Article 10(1) of the ECT.[417]

In *Charanne v. Spain*[418] the claimant argued that Spain had violated Article 10(12) by adopting Royal Decree Law 14/2010. In claimant's view this form of legislation made it impossible to challenge the legislation in Spanish courts and to challenge the measures introduced by the legislation. Spain asserted that a Royal Decree Law may be challenged in ordinary court by any citizen and that the questions of its constitutionality may be brought to the Constitutional Court of Spain.

The tribunal rejected claimant's claims. It explained its conclusion in the following way:

According to the Arbitral Tribunal, these means are sufficient to meet the obligation to provide effective mechanism. The Claimants complain that the question of unconstitutionality may only be submitted incidentally in the ordinary framework, which compels the investor to wait for the administration to issue a development or application norm related to the RDL.420. However, the standard of effective means in international law cannot result in imposing on the State specific requirements for organizing its review system, such as forcing the State to provide a system of direct control of the constitutionality of acts with a legislative character. The Claimants also complain that the claim for damages does not allow the constitutional control of the RDL. The latter complaint, however, does not constitute a violation of the standard to provide effective means in international law from the moment the Respondent proves the existence of means allowing both constitutional control (albeit incidentally) and compensation for damage and losses.

[414] *Amto v. Ukraine*, at paras. 88–9.

[415] *Anatole Stati, Gabriel Stati, Ascom S.A. Terra ref Trans Trading Ltd v. The Republic of Kazakhstan*, Final Award, dated 19 October 2013.

[416] Ibid., at paras. 1209–29. [417] Ibid., at paras. 1231–2.

[418] *Charanne B.V. and Construction Investments S.A.R.L. v the Kingdom of Spain*, Final Award dated 21 January 2016.

Nor may the Claimants argue that these remedies are ineffective, as it has been clearly shown that the Board of Contentious-Administrative Litigation of the Supreme Court was aware of, and indeed it decided, questions concerning the constitutionality of RDL 14/2010.[419]

B. Article 11: Key Personnel

1) A Contracting Party shall, subject to its laws and regulations relating to the entry, stay and work of natural persons, examine in good faith requests by Investors of another Contracting Party, and key personnel who are employed by such Investors or by Investments of such Investors, to enter and remain temporarily in its Area to engage in activities connected with the making or the development, management, maintenance, use, enjoyment or disposal of relevant Investments, including the provision of advice or key technical services.

2) A Contracting Party shall permit Investors of another Contracting Party which have Investments in its Area, and Investments of such Investors, to employ any key person of the Investor's or the Investment's choice regardless of nationality and citizenship provided that such key person has been permitted to enter, stay and work in the Area of the former Contracting Party and that the employment concerned conforms to the terms, conditions and time limits of the permission granted to such key person.

Article 11 obliges Contracting Parties to treat key personnel of Investors in a fair way. Contracting Parties must examine in good faith requests with respect to key personnel to enter and remain temporarily in the host State to perform work related to Investments. This duty to 'examine in good faith' is subject to the laws and regulations of the host State in question. The text of subparagraph (1) seems to mean that once the relevant permits have been issued, and as long as they are complied with, they cannot be withdrawn ('and remain temporarily').

Subparagraph (2) requires Contracting Parties to permit Investors to employ 'any key person' of the Investor's choice, regardless of nationality and citizenship. This obligation of a Contracting Party is conditioned on such key person having been permitted to enter in the Area of the host State, pursuant to subparagraph (1). The obligation laid down in subparagraph (2) raises the question whether it trumps municipal legislation in the host State in question providing for different forms of affirmative action programmes aimed at promoting the employment of nationals—or certain groups of nationals—of the host State.

Article 24(2)(iii) of the ECT dealing with exceptions in the ECT could perhaps be seen as indicating such a possibility, provided that the conditions therein are met.[420]

C. Article 12: Compensation for Losses

1) Except where Article 13 applies, an Investor of any Contracting Party which suffers a loss with respect to any Investment in the Area of another Contracting Party owing to war or other armed conflict, state of national emergency, civil disturbance, or other similar event in that Area, shall be accorded by the latter Contracting Party, as regards restitution, indemnification, compensation or other settlement, treatment which is the most favourable of that

[419] *Charanne and Construction Investments v. Spain*, at paras. 472–3.
[420] For commentary on Article 24, see p. 389 *et seq.*, *infra.*

which that Contracting Party accords to any other Investor, whether its own Investor, the Investor of any other Contracting Party, or the Investor of any third state.

2) Without prejudice to paragraph (1), an Investor of a Contracting Party which, in any of the situations referred to in that paragraph, suffers a loss in the Area of another Contracting Party resulting from

a) requisitioning of its Investment or part thereof by the latter's forces or authorities; or

b) destruction of its Investment or part thereof by the latter's forces or authorities, which was not required by the necessity of the situation,

shall be accorded restitution or compensation which in either case shall be prompt, adequate and effective.

Article 12 deals with loss of and damage to the property of Investors in situations where Article 13 concerning expropriation is not applicable.[421] The situations addressed in the provision are limited to war, armed conflict, national emergency, civil disorder and the like. Three different situations are dealt with in the article.

First, subparagraph (1) stipulates that an Investor suffering a loss, or incurring damage, is entitled to restitution, indemnification, compensation, or other settlement, which is the most favourable of what the Contracting Party offers any other Investors, be they nationals of any other Contracting Party, or of any third State.

Secondly, subparagraph (2)(a) entitles an Investor to compensation if he suffers a loss as a result of requisition by governmental forces and authorities,

Thirdly, subparagraph (2)(b) stipulates that if an Investment is destroyed by unnecessary action of government forces, the Investor is entitled to compensation. No guidelines are provided as to what may constitute unnecessary action.

Compensation under subparagraph (2) must be prompt, adequate, and effective, which is the same compensation standard as for expropriation under Article 13 of the ECT.

D. Article 13: Expropriation

(1) Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalised, expropriated or subjected to a measure or measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as 'Expropriation') except where such Expropriation is:

(a) for a purpose which is in the public interest;

(b) not discriminatory;

(c) carried out under due process of law; and

(d) accompanied by the payment of prompt, adequate and effective compensation.

Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the 'Valuation Date').

Such fair market value shall at the request of the Investor be expressed in a Freely Convertible Currency on the basis of the market rate of exchange existing for that currency on the Valuation Date. Compensation shall also include interest at a commercial rate established on a market basis from the date of Expropriation until the date of payment.

(2) The Investor affected shall have a right to prompt review, under the law of the Contracting Party making the Expropriation, by a judicial or other competent and independent authority

[421] For commentary on Article 13, see p. 260 *et seq.*, *infra.*

of that Contracting Party, of its case, of the valuation of its Investment, and of the payment of compensation, in accordance with the principles set out in paragraph (1).

(3) For the avoidance of doubt, Expropriation shall include 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.

Outline

I. Introduction

Generally speaking, the most serious threat to a foreign investment is expropriation. From the perspective of a foreign investor, the most important provisions in any international treaty for the protection of foreign investment are the provisions dealing with protection against expropriation. These provisions do in fact constitute the heart and soul of every investment protection treaty. The ultimate purpose of every such treaty is to protect against expropriation.

Even though it is generally accepted in international law that States have the right to expropriate property and rights of foreigners, it is equally accepted that they can do so only under certain circumstances. Most international agreements on the protection of foreign investments attempt to spell out such conditions as between the contracting States.

A legal dictionary defines expropriation as '[a] governmental taking or modification of an individual's property rights ...'.[422] This definition makes it clear that expropriation need not necessarily entail an actual taking of property as such. A modification of property rights may also qualify as expropriation. In order for a modification of property rights to be classified as expropriation, the modification must be to the detriment of the original holder of rights. Thus, the concept of expropriation covers measures whereby a State deprives an individual or enterprise of the enjoyment of their property rights.

[422] Black's Law Dictionary (17th edition) 1999, 602.

Systematic expropriation of private property within one or more specific sectors of a nation's economy within the framework of socio-economic or political reform is often referred to as *nationalization.*[423] The difference between expropriation and nationalization is one of scope and extent rather than of legal nature.

Mention must also be made of the term 'confiscation'. This term is mostly used to refer to the seizure of property by a State without compensation. Black's Law Dictionary defines 'confiscation' as 'the seizure of private property by the government without compensation to the owner, often as a consequence of conviction for crime, or because possession or use of the property was contrary to law'.[424]

The term expropriation is not limited to the taking of property rights as such. Also when host States interfere with rights of foreign owners of property without depriving them of the legal title to the property such measures may constitute expropriation. In fact, direct expropriations are rare today. Most investment treaty disputes today concern indirect expropriation.

Examples of measures that may constitute indirect expropriation can be found in the Explanatory Note to the 1961 Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens. These include restriction of physical access to production facilities, labour legislation setting wages at a prohibitively high level, denial of entrance of essential spare parts or machinery or of visa for key foreign employees.[425]

Most international instruments nowadays include provisions on, and sometimes examples of, indirect expropriation as well as measures equivalent, or tantamount, to expropriation. Examples of such instruments include the 1967 OECD Draft Convention on the Protection of Foreign Property,[426] Article 3 of which stipulates that: 'No Party shall take any measures depriving, directly or indirectly, of his property a national of another Party unless the following conditions are complied with ...'. Similar language is to be found in the OECD Draft Negotiating Text for a Multilateral Agreement on Investment.[427]

Most investment protection treaties also have provisions on indirect expropriation and measures having an equal effect.[428]

As mentioned above, today most investment treaty arbitrations concerning alleged expropriations are about indirect expropriation. Nowadays it is unusual—although not unheard of—that a State takes steps and measures, which constitute direct expropriation. Rather, most arbitral tribunals faced with claims arising from alleged expropriations must address the difficult question of determining what state measures are legitimate—for example in pursuit of a national policy on environmental protection—and when such measures constitute, or are tantamount to, indirect expropriation.

Whether measures of a host State result in, or are tantamount to, indirect expropriation is typically a matter of degree rather than of kind. Many regulations and taxes imposed by a State are legitimate and lawful exercises of sovereign power, but may this notwithstanding affect foreign investments. One particular aspect of indirect expropriation is that measures which per se are legitimate may have an effect—cumulative, or

[423] Black's Law Dictionary defines nationalization as '[t]he act of bringing an industry under governmental control or ownership', at 1046.

[424] Ibid., at p. 596. [425] American Journal of International Law (1961) 558–9.

[426] UNCTAD, International Investment Instruments, vol. II, 114 (1996).

[427] UNCTAD, International Investment Instruments, vol. IV, 107, 148 (2001).

[428] Cf. Dolzer and Stevens, Bilateral Investment Treaties, 99 (1995).

otherwise—which *de facto* is of an expropriatory nature. This aspect is potentially particularly relevant in Central and Eastern Europe—and therefore to the ECT—given the fact that all economies in this part of the world were planned/command economies where administrative regulations replaced the market forces and where administrative regulations often continue to play an important role in commercial and economic life.

Generally speaking, the protection of foreign investment under international law forms part of the law of state responsibility. While it is not disputed that under international law the expropriation of foreign property is not unlawful per se, it is equally clear that certain conditions must be fulfilled for an expropriation to be lawful. If that is not the case, the expropriating State is in breach of its international law obligations. Such breach does, as a matter of principle, result in state responsibility. Most cases discussed in this Commentary are based on treaties, either BITs or the Energy Charter Treaty, and sometimes the North America Free Trade Agreement. The signatories to such treaties are under a treaty obligation to expropriate only under certain conditions.

The most difficult issue for arbitral tribunals today, however, is not to determine whether the conditions for a lawful expropriation have been met or not, but rather whether there has been an expropriation *at all*. That notwithstanding, it is necessary, by way of background, to describe, however briefly, the requirements for a lawful expropriation. These requirements are usually summarized in four points:

(i) the measure in question must serve a public purpose;
(ii) the measure must not be arbitrary or discriminatory;
(iii) the expropriation procedure must observe due process; and
(iv) the expropriatory measure must be accompanied by compensation.[429]

One of the pillars of the law of state responsibility is the attribution to the state of acts and omissions of its organs and officials. The State is an abstract legal entity. It cannot, therefore, in reality act itself. The State can only act through authorized officials, representatives and agents. In analysing alleged expropriations, the first step for tribunals is therefore to determine whether the alleged act and/or omissions are at all attributable to the State in question. If the answer is affirmative, the tribunal must determine, as a second step of the analysis, whether the acts and/or omissions constitute expropriation.[430]

It is generally accepted that expropriation of private property within the territory of a State falls within the domestic jurisdiction of that State. Indeed, most—if not all—States have rules providing for the taking of property for certain public purposes. The permissibility of such measures has been reaffirmed, *inter alia*, by the Iran-US Claims Tribunal in the case of *Sedco Inc. v. N.IO.C.*, according to which'[i]t is an accepted principle of international law that a State is not liable for economic injury which is a consequence of bone fide 'regulation' within the accepted police power of states'.[431] Moreover, it is generally accepted that a State is free to impose restrictions upon the acquisition by foreign individuals and enterprises of certain kinds of property. However, the question of the extent to which, and under which conditions, the expropriation of foreign property is permissible under international law has divided nations and commentators into different camps.[432]

[429] See discussion at p. 263 *et seq.*, *infra.*
[430] For a discussion of the rules of attribution, see p. 45 *et seq.*, *supra.*
[431] Interlocutory award, dated 28 October 1985, reprinted in Iran-US Claims Tribunal reporter, 248; see discussion at p. 267 *et seq.*, *infra.*
[432] See discussion at p. 264 *et seq.*, *infra.*

II. Background – General Comments on Expropriation[433]

1. Lawful and Unlawful Expropriation

As mentioned above, expropriation is not unlawful per se under international law[432]. A lawful expropriation must, however, meet certain requirements. Different views have historically been expressed as to what these requirements are, or should be.

Traditionally, capital exporting States have advocated restrictions on the right of States to expropriate foreign property in order to secure the enjoyment of investments of their nationals made abroad. Capital importing countries, on the other hand, have emphasized their right to limit foreign control over their own resources.

The position of the *capital exporting* States has traditionally been that expropriation in order to be lawful must comply with an international minimum standard. This standard is often held to include one or more of the following three requirements:

(i) The expropriation must be made for a public purpose;
(ii) The expropriation must not discriminate foreigners; and
(iii) The expropriation must be accompanied by compensation.

All three conditions are reflected in the 1962 UN General Assembly Resolution on Permanent Sovereignty over Natural Resources. The Western view has traditionally been that expropriation is only lawful under public international law if all three conditions are met. This means that a foreign investor who suffers expropriation is entitled to compensation even if the expropriation is warranted by a public purpose and does not discriminate against foreigners.

[433] For general comments, see Dolzer and Schreuer, *op. cit.*, 98–129; McLachlan *et al, op .cit*, 359–412; Newcombe & Paradell, *op. cit.*, 321–98; Yannaca-Small, *op. cit.*, 562–93; see also Christie, 'What Constitutes a Taking of Property under International Law' (1962) 33 BYIL 307; Weston, ' "Constructive Takings" under International Law: A Modest Foray into the Problem of Creeping Expropriation' (1975) 16 VJIL 103; Vagts, 'Coercion and Foreign Investment Rearrangements' (1978) 72 AJIL 17; Higgins, 'The Taking of Property by the State: Recent Developments in International Law' (1982) 176 RDCADI 259; Been & Beauvais, 'The Global Fifth Amendment: NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine' (2003) 78 NYULR 30; D. Clough, 'Regulatory Expropriations and Compensation under NAFTA' (2005) 6 JWIT 553; Dolzer, 'Indirect Expropriation of Alien Property' (1988) 1 ICSID Rev 41; Dolzer, 'New Foundations of the Law of Expropriation of Alien Property' (1981) 75 AJIL 553; Dolzer, 'Indirect Expropriations: New Developments?' (2003) 11 NYUELJ 64; Dolzer & Bloch, 'Indirect Expropriation: Conceptual Realignments?' (2003) 5 ILF 155; Fortier & Drymer, 'Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor' (2004) 19 ICSID Rev 293; Graham, 'Regulatory Takings, Supernational Treatment, and the Multilateral Agreement on Investment: Issues Raised by Nongovernmental Organizations' (1998) 31 CILQ 599; Hobér, *Investment Arbitration in Eastern Europe: In Search of a Definition of Expropriation* (New York: Juris, 2007); Hoffmann, 'Indirect Expropriation', in Reinisch, (ed.), *Standards of Investment Protection* (Oxford: Oxford University Press, 2008); Kriebaum, 'Partial Expropriation' (2007) 8 JWIT 69; Kriebaum, 'Regulatory Takings: Balancing the Interests of the Investor and the State' (2007) 8 JWIT 717; Lowe, 'Regulation or Expropriation?' (2002) 55 CLP 447; Madalena, 'Foreign Direct Investment and the Protection of the Environment: the Border Between National Environmental Regulation and Expropriation' (Mar. 2003) EELR 70; Newcombe, 'The Boundaries of Regulatory Expropriation' (2005) 20 ICSID Review; Paulsson & Douglas, 'Indirect Expropriation in Investment Treaty Arbitrations,' in Horn & Kroll, (eds.), *Arbitrating Foreign Investment Disputes: Procedural and Substantive Legal Aspects*, (2004)145; Reinisch, 'Expropriation', in P. Muchlinski, F. Ortino, & C. Schreuer, (eds.), *The Oxford Handbook of International Investment Law*, (2008); Reinisch, 'Legality of Expropriation', in Reinisch, (ed.), *Standards of Investment Protection* (2008); Sampliner, 'Arbitration of Expropriation Cases Under US Investment Treaties - A Threat to Democracy or the Dog that Didn't Bark?' (2003) 18 ICSID Rev 1; Sedigh, 'What Level of Host State Interference Amounts to a Taking under Contemporary International Law' (2002) 2 JWI 631; T. Walde & A. Kolo, 'Environmental Regulation, Investment Protection and "Regulatory Taking" in International Law' (2001) 50 ICLQ 811.

The calculation of the compensation may, however, vary depending on whether the first two conditions, public purpose and non-discrimination, have been met.

Capital importing States have traditionally denied the existence of an international minimum standard, reserving a greater discretion for the expropriating State to determine the legality of its own measures.

Restatement (Third) of the Foreign Relations Law of the United States, Section 712, expresses the international minimum standard in the following way:

> A state is responsible under international law for injury resulting from:
>
> (1) A taking by the state of the property of a national of another state that
> (2) is not for a public purpose, or
> (3) is discriminatory, or
> (4) not accompanied by provisions for just compensation.

As mentioned above[434] the most difficult question which arbitral tribunals face today is that of distinguishing between indirect expropriation and legitimate governmental action.

The international minimum standard does not provide much guidance in this respect. It comes into play at the next stage, i.e. when it has been determined that an expropriation has taken place. That determination must be made on the basis of the facts and circumstances of the specific case; thus it cannot be made in the abstract.

Today it would seem to be widely accepted that a lawful expropriation must meet the four requirements mentioned above.[435] These requirements are found in most investment protection treaties, including the ECT. It would also seem to be accepted that they form part of customary international law.

III. The expropriation must serve a public purpose

The criterion that expropriation must be made in pursuance of a public purpose appears in the rulings of international tribunals throughout the twentieth century. This was also manifested in Article 4 of the General Assembly Resolution 1803 on Permanent Sovereignty over Natural Resources, which stipulates that:

> Nationalization, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognized as overriding purely individual or private interests.[436]

In the subsequent Charter of Economic Rights and Duties of States adopted by the General Assembly on 12 December 1974,[437] however, the public purpose criterion does not appear. The Charter of Economic Rights and Duties of States stipulates simply that each State has the right to:

> nationalize, expropriate or transfer ownership of private property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent.[438]

[434] See p. 260 *et seq.*, *supra.* [435] See p. 262, *supra.*
[436] Resolution 1803 (XVII), reprinted in 2 International Legal Materials (1963) p. 223.
[437] Resolution 3281 (XXIX), reprinted in 14 International Legal Materials (1975), p. 251.
[438] Article 2(c).

The Charter of Economic Rights and Duties of States was a result of the efforts of the less developed States to negotiate a 'new deal' in their relations with the industrialized nations. These efforts are also manifested by the adoption of the 1974 Declaration on the Establishment of a New International Economic Order.[439]

The public purpose criterion has not always been upheld in international cases, at least with respect to nationalization. However, the arbitrators in the case of *Amoco International Financial Corp. v. Iran* seem to support the existence of an independent public purpose criterion, but concede that States have an extensive discretion in determining its scope:

> A precise definition of the 'public purpose' for which an expropriation may be lawfully decided has neither been agreed upon in international law nor even suggested. It is clear that, as a result of the modern acceptance of the right to nationalize, this term is broadly interpreted, and the States, in practice, are granted extensive discretion. An expropriation, the only purpose of which would have been to avoid contractual obligations of the State or of an entity controlled by it, could not, nevertheless be considered as lawful under international law.[440]

The quoted passage and the subsequent wording of the decision further suggest that the scope of the public purpose criterion may differ depending on whether the expropriation can be classified as nationalization, in which case the State would typically be granted wider discretion. The argument that a particular expropriation does not serve a public purpose has in practice been only of secondary importance, often coupled e.g. to the argument that the expropriation is discriminatory.

One problem is that 'public purpose' is a broad concept, which is not readily susceptible to objective analysis and examination neither by States nor tribunals. Nevertheless, references to the public purpose criterion are still widely used in treaty texts and legal writing, as well as in the reasoning of arbitral tribunals dealing with expropriation.

IV. The measure must not be arbitrary or discriminatory

Discrimination is widely held as prohibited by customary international law in the field of expropriation. Discrimination in this respect may be manifest in a State's treatment of foreigners, of foreign nationals of a particular nationality, or of particular foreigners in a manner less favourable than the State's treatment of its own nationals. The non-discrimination requirement is sometimes treated as an aspect of the public purpose requirement.

The underlying philosophy of this requirement is that the foreign investor shall enjoy national treatment, i.e. must not be treated less favourable than domestic investors in a similar situation.

V. The expropriatory procedure must observe due process

Due process also forms part of the FET standard.[441] In the final analysis, it is not clear to what extent this requirement is of independent importance to the legality of an expropriation. Generally speaking, the due process requirement means that the investor must be

[439] Adopted by General Assembly Resolution 3201 (5-VI) of 1 May 1974, reprinted in 13 International Legal Materials (1974), p. 715.

[440] *Amoco International Finance Corp. v. Iran, US V. Iran* (1987) 15 Iran-USC.T.R. 189, paragraph 145.

[441] See discussion at p. 187 *et seq.*, *supra.*

given an opportunity to safeguard his interests and to present his case within the framework of the expropriatory procedure.

VI. The expropriatory measure must be accompanied by compensation

This requirement has been by far the most controversial requirement for a lawful expropriation. The duty of a State to compensate its wrongs against a national of another State is, however, deeply rooted in the rules and principles of State responsibility. As to the nature of such compensation, capital exporting States generally adhere to a standard that has become known as the *Hull formula*, according to which expropriation is lawful only if accompanied by compensation that is 'prompt, adequate and effective' which is usually understood to mean that compensation should correspond to fair market value. This formula—albeit with variations—appears in many bilateral investment protection treaties as well as in many multilateral treaties. Capital importing States, on their part, have not always been prepared to accept this formula as reflecting international law, but have argued that compensation should be 'appropriate', with the additional proviso that account must be taken of the expropriating nation's 'relevant laws and regulations and all circumstances that the State considers pertinent'.[442]

This debate was particularly lively and heated during the 1970's and 1980's in connection with debates concerning the sovereignty of States over natural resources.

These debates have by and large faded away. Today most treaty based investment disputes follow the philosophy underlying the Hull formula, i.e. to provide compensation corresponding to the fair market value of the expropriated investment.

Compensation for expropriation was dealt with at length in the judgment of the International Court of Justice in the 1928 *Chorzow Factory* case.[443] The date of this case confirms that compensation for expropriation was an issue in public international law already some time ago. It continues to be an issue. Commenting on this judgment, the arbitrators in the *Amoco* case stated that' [i]n spite of the fact that it is nearly sixty years old, this judgment is widely regarded as the most authoritative exposition of the principles applicable in this field, and is still valid today ... '.[444]

The case concerned the Polish expropriation of a German factory contrary to an international treaty to which both States were parties. The judgment illustrates that payment of compensation can be viewed not only as a prerequisite for the legality of a particular expropriation. It is also suggested that the nature and amount of compensation may be dependent on whether the expropriation itself is lawful.

It is obvious that an expropriation carried out contrary to an international treaty obligation, as in the *Chorzow Factory* case, must be considered contrary to international law. Had the *Chorzow* expropriation itself been lawful (i.e. absent the international treaty prohibiting it), the Court suggests that the right of compensation would have been limited to 'the value of the undertaking at the moment of dispossession, plus interest to the day of payment'.[445] The Court went on to pronounce, however, that an unlawful act

[442] Charter of Economic Rights and Duties of States adopted by the General Assembly on 12 December 1974, Article 2(c).
[443] *Germany v. Poland* (1928) Permanent Court of International Justice Reports, Series A, No. 17, pp. 46–8.
[444] *Amoco International Finance Corp. v. Iran, US v. Iran* (1987) 15 Iran-USC.T.R. 189, paragraph 191.
[445] *Chorzow Factory* case, Judgment of the Court, at 46.

as such shall be treated under the general principles of state responsibility, and that the reparation 'must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed'.[446]

As far as compensation is concerned, it is important, first of all, to emphasize that the right to compensation—on whatever basis—is generally recognized. In other words, compensation in some amount must follow an expropriation.

The generally held view among capital exporting States is that 'compensation' means 'full compensation.¨ This in turn, is usually understood as a reference to the Hull formula, i.e. 'prompt, adequate and effective' compensation, or rather to the' adequate' element of the formula. 'Adequate' compensation means that the investor is paid the full value, i.e. the market value, of the property taken. If an on-going business has been expropriated, 'full value' typically equals the going concern value.

Some commentators have suggested that there are—or at least should be—exceptions to the full compensation rule. Suggestions have been made to the effect that such exceptions ought to include national programmes of agricultural land reform, war and large scale nationalizations.

The fair market value can be determined by using various methods. A commonly used method is the so-called discounted cash flow method (DCF), which means that an estimate is made of the future cash flow adapted to the present value by applying a discount factor to take account of risk and the time value of money.[447]

In arbitral jurisprudence, the vast majority of cases deal with a situation where the host State has not paid any compensation at all to the investor in question. The vast majority of cases thus deal with allegedly unlawful expropriations.

The requirements of lawful expropriation discussed above—which are included in most investment protection treaties—are thus usually not relevant for unlawful expropriations.

By contrast, unlawful expropriations are covered by the general rules of state responsibility. As far as compensation is concerned, this means, as explained in the *Chorzow Factory Case*,[448] and as reflected in the ILC Articles, that damages should, as far as possible, restore the situation that should have existed had the unlawful act not been committed. This approach may result in a different amount of compensation compared to a situation where the expropriation is deemed to be lawful.[449]

VII. Direct and indirect expropriation

As a matter of general principle, the difference between a direct and indirect expropriation is whether the legal title of an owner is affected.

If the owner is deprived of the legal title to the property in question, there is a direct expropriation. If certain types of governmental measures affect foreign property—without depriving the owner of legal title—this may constitute an indirect expropriation and require compensation to be paid.

Whilst most investment disputes today deal with indirect—rather than direct—expropriation, there is no generally accepted or employed definition of the concept.

[446] *Chorzow Factory* case, Judgment of the Court, at 48.
[447] See p. 282 *et seq.*, *infra.*
[448] See note 443, *supra.*
[449] See p. 282 *et seq.*, *infra.*

Two awards rendered on the basis of Article 1110 of the NAFTA encapsulates one approach to indirect expropriation which has become widely accepted. Article 1110 of the NAFTA provides that 'no Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment'.

In *Metalclad v. Mexico*[450] the tribunal said:

> Thus, expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.[451]

Four years later another NAFTA tribunal offered the following explanation:

> An indirect expropriation is still a taking of property. By contrast where a measure tantamount to an expropriation is alleged, there may have been no actual transfer, raking or loss of property by any person or entity, but rather an effect on property which makes formal distinctions of ownership irrelevant ... Evidently the phrase 'take a measure tantamount to nationalization or expropriation of such an investment' in Article 1110(1) was intended to add to the meaning of the prohibition, over and above the reference to indirect expropriation.[452]

The difficulty to find a general definition of indirect expropriation is to a large extent explained by the fact that the analysis to be performed is by necessity very fact specific. The result of the analysis is thus dependent on the facts and circumstances of the individual case.

In recognition of this difficulty, the US Model BITs of 2004 and 2012 have sought to provide more details. Article 6(1) provides protection against direct and indirect expropriation. In a separate annex—Annex B—the following details are added:

(a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors: (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred; (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and (iii) the character of the government action.
(b) Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.[453]

As far as investment protection treaties are concerned, protection against expropriation—direct or indirect—covers all investments to which the treaty in question applies. To determine the scope of the protection it is thus necessary first to find out the definition of 'investment' under the treaty in question. Many investment protection treaties today have broad definitions of 'investment'.[454] Almost all of them include contracts and contractual rights, as a category of investments.[455]

[450] *Metalclad v. Mexico*, Award dated 30 August 2000. [451] Ibid., at para. 103.
[452] *Waste Management Inc. v. Mexico*, Award dated 30 April 2004, at para. 159.
[453] 2004 and 2012 US Model BITs, Annex B, para. 4.
[454] See the commentary on Article 1(6) of the ECT, at p. 67 *et seq.*, *supra.*
[455] Cf. Dolzer and Stevens, *op. cit.*, at p. 25 *et seq.*

Contractual rights are thus protected, as a matter of principle against governmental interference. The degree of interference will determine whether it amounts to an indirect expropriation.

Contractual rights of an investor are also protected when, for example, the government of the host State is the counterparty to the contract in question.

It must be noted, however, that a simple breach of contract in this situation does not automatically constitute an expropriation. To reach that level it is usually required that the government acted in a sovereign capacity. This is a common approach taken by several investment treaty tribunals, as illustrated, for example, in *Siemens v. Argentina.*[456] The tribunal said the following with respect to contractual breaches by a state party:

> … for the State to incur international responsibility it must act as such, it must use its public authority. The actions of the State have to be based on its 'superior governmental power'. It is not a matter of being disappointed in the performance of the State in the execution of a contract but rather of interference in the contract execution through governmental action.[457]

VIII. Some salient features of indirect expropriation

In order better to understand and to outline the contours of the concept of 'indirect expropriation', it is helpful to identify and analyze several elements, some of which—but rarely all of them at the same time—are addressed in arbitral jurisprudence. Such a discussion does indeed facilitate our understanding of 'indirect expropriation'. In the final analysis, however, it is unavoidable that the determination is based on the facts and circumstances of the specific case.

1. Character of Governmental Interference

One important element when determining whether an indirect expropriation has occurred is to assess the impact of the governmental interference in question. This is usually done by measuring the effect of the measure on the economic and financial value of the investment. The greater the negative economic and financial effect, the higher the likelihood that an arbitral tribunal will find that an indirect expropriation has occurred. In *CMS v. Argentina*[458] the tribunal suggested the following test:

> The essential question is therefore to establish whether the enjoyment of the property has been effectively neutralized. The standard that a number of tribunals have applied in recent cases where indirect expropriation has been contended is that of substantial deprivation.[459]

The tribunal in *Metalclad v. Mexico*[460] referred to governmental interference 'which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be- expected economic benefit of the property …'[461]

The focus on the economic and financial effect of a measure usually means that the intention of the government is less important. In other words, the fact that the government did not have the intention to expropriate does not automatically mean that there has been no indirect expropriation.

Sometimes tribunals may find support for the focus on effect in the applicable investment protection treaty. In *Siemens v. Argentina*,[462] for example, the tribunal stated:

[456] *Siemens v. Argentina*, Award dated 6 February 2007.
[457] Ibid., at para. 253.
[458] *CMS v. Argentina*, Award dated 12 May 2005.
[459] Ibid., at para. 262.
[460] *Metalclad Corporation. v. Mexico*, Award dated 30 August 2000.
[461] *Metalclad v. Mexico*, at para. 103.
[462] *Siemens A.G. v. The Argentine Republic*, Award dated 6 February 2007.

The Treaty refers to measures that have the effect of an expropriation; it does not refer to the intent of the State to expropriate.[463]

To a certain degree, the effect of a governmental measure is linked with the question of control of an enterprise, or other investment. If an investor retains title as well as control over the investment—even if there is a significant impact on the economic and financial benefits—some tribunals have found that no indirect expropriation has occurred. In *Azurix v. Argentina*,[464] for example, the tribunal said:

> The impact on the investment attributable to the Province's actions was not to the extent required to find that, in the aggregate, these actions amounted to an expropriation; Azurix did not lose the attributes of ownership, at all times continued to control ABA and its ownership of 90% of the shares was unaffected. No doubt the management of ABA was affected by the Province's actions, but not sufficiently for the Tribunal to find that Azurix's investment was expropriated.[465]

Whilst control is an important element in determining whether an indirect expropriation has occurred, it must be analyzed together with other factors as well. If, for example, the governmental measure in question has resulted in a complete deprivation of the economic and financial benefits of the investment, it matters little that he is still in control of what is in effect an empty shell.

The question of control may arise also in the context of so-called *partial expropriation*. Some tribunals have accepted that particular and separate rights may be expropriated even though the investor retains control over the basic investment. In *Eureko v. Poland*[466] the tribunal found that the rights to acquire further shares under a privatization agreement—subsequently withdrawn by the State—constituted an asset which was capable of expropriation. The original investment, which included, among other things, shares in the same company, remained unaffected.

It would seem that in most cases of so-called partial expropriation, the asset or right that is being expropriated constitutes an 'investment' in its own right for purposes of the investment protection treaty in question.

2. Duration of Governmental Interference

When assessing the effect of a governmental measure, the duration of the measure in question is an important factor. The question arises whether a temporary measures can constitute an indirect expropriation. There would seem to be broad agreement that, as a matter of principle, the deprivation of rights must be permanent. This was the position taken by the tribunal in *S.D. Myers v. Canada*,[467] but it added that 'in some context and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation even if it were partial or temporary'.[468]

Also the tribunal in *LG&E v. Argentina*[469] found that as a rule the governmental interference must be permanent. It said:

[463] *Siemens v. Argentina*, at para. 270.
[464] *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Award dated 14 July 2006.
[465] Ibid., at para. 322.
[466] *Eureko B.V. v. Republic of Poland*, Partial Award dared 19 August 2005, at paras. 239–41.
[467] *.D. Myers, Inc. v. Government of Canada*, First Partial Award dated 13 November 2000.
[468] Ibid., at para. 283.
[469] *LG&E International Inc. v. Argentine Republic*, Decision on Liability dated 3 October 2006.

Thus, the effect of the Argentine State's actions has not been permanent on the value of the Claimants' shares', and Claimants' investment has not ceased to exist. Without a permanent, severe deprivation of LG&E's rights with regard to its investment, or almost complete deprivation of the value of LG&E's investment, the Tribunal concludes that these circumstances do not constitute expropriation.[470]

It is widely accepted that indirect expropriation may also occur as a consequence of several governmental measures taken over a longer period of time, so-called *creeping expropriation*. It is usually the cumulative effect of a series of acts which result in the deprivation of rights which constitutes the expropriation.

The tribunal in *Siemens v. Argentina*[471] described creeping expropriation in the following way:

> By definition, creeping expropriation refers to a process, to steps that eventually have the effect of an expropriation. If the process stops before it reaches that point, then expropriation would not occur. This does not necessarily mean that no adverse effects would have occurred. Obviously, each step must have an adverse effect but by itself may not be significant or considered an illegal act. The last step in a creeping expropriation that tilts the balance is similar to the straw that breaks the camel's back. The preceding straws may not have had a perceptible effect but are part of the process that led to the break.[472]

3. Regulatory Measures

It is generally accepted that States have the power to regulate their own economy and the development in general of their socio-political environment. This power to regulate is simply a reflection of a host State's sovereignty. This does not mean, however, that regulatory measures are per se incapable of constituting indirect expropriation. The difficult task for tribunals dealing with regulatory measures is to draw the line between legitimate governmental measures, on the one hand, and measures which constitute indirect expropriation, on the other hand. In the final analysis, the determination will depend on the facts and circumstances of the individual case.

Some tribunals have emphasized the right of host States to regulate. In *Feldman v. Mexico*[473] for example, the tribunal—after having provided several examples of how governmental authorities can reduce the economic value of a business—stated the following:

> At the same time, governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this.[474]

At the other end of the spectrum—and illustrating the difficult balancing of interests—we find *Santa Elena v. Costa Rica* [475] where the tribunal dealt with measures taken for the purpose of environmental protection. It said:

[470] Ibid., at para. 200.
[471] See note 462, *supra.*
[472] *Siemens A.G. v. The Argentine Republic*, at para. 263.
[473] *Marvin Roy Feldman Karpa v. United Mexican States*, Award dated 16 December 2002.
[474] Ibid., at para. 103.
[475] *Compañia del Desarrollo de Santa Elena, S.A. v. The Republic of Costa Rica*, Award dated 17 February 2000.

Expropriatory environmental measures—no matter how laudable and beneficial to society as a whole—are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains.[476]

Another case where the tribunal did not accept the host State's argument based on its power to regulate is *ADC v. Hungary*[477] involving an airport project. The tribunal said the following:

The Tribunal cannot accept the Respondent's position that the actions taken by it against the Claimants were merely an exercise of its rights under international law to regulate its domestic economic and legal affairs. It is the Tribunal's understanding of the basic international law principles that while a sovereign State possesses the inherent right to regulate its domestic affairs, the exercise of such right is not unlimited and must have its boundaries. As rightly pointed out by the Claimants, the rule of law, which includes treaty obligations, provides such boundaries. Therefore, when a State enters into a bilateral investment treaty like the one in this case, it becomes bound by it and the investment-protection obligations it undertook therein must be honoured rather than be ignored by a later argument of the State's right to regulate.

The related point made by the Respondent that by investing in a host State, the investor assumes the '*risk*' associated with the State's regulatory regime is equally unacceptable to the Tribunal. It is one thing to say that an investor shall conduct its business in compliance with the host State's domestic laws and regulations. It is quite another to imply that the investor must also be ready to accept whatever the host State decides to do to it. In the present case, had the Claimants ever envisaged the risk of any possible depriving measures, the Tribunal believes that they took that risk with the legitimate and reasonable expectation that they would receive fair treatment and just compensation and not otherwise.[478]

As alluded to by the tribunal in *ADC v. Hungary*, the legitimate expectations of the investor may play a role also in the context of indirect expropriation.[479]

Legitimate expectations of an investor are often created by the legal framework provided by the host State existing at the time of the investment. Other potential sources of legitimate expectations include contractual undertakings by the host State, explicit or implicit assurances or representations made by the host State and relied on by the investor when he made his investment.

In *Metalclad v. Mexico*,[480] for example, the tribunal emphasized the expectations created by the government's assurances that all necessary permits had been obtained. The tribunal said:

These measures, taken together with the representations of the Mexican federal government, on which Metalclad relied, and the absence of a timely, orderly or substantive basis for the denial by the Municipality of the local construction permit, amount to an indirect expropriation.[481]

In a subsequent case against Mexico—*Thunderbird v. Mexico*[482] —the tribunal found that the investor could not have had a legitimate expectation to continue his operation

[476] Ibid., at para. 72.

[477] *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary,* Award dated 2 October 2006.

[478] Ibid., at paras. 423–4.

[479] As discussed at p. 193 *et seq.*, *supra*, legitimate expectations play a central role in the interpretation of the fair and equitable treatment standard.

[480] See note 460, *supra.*

[481] *Metalclad v. Mexico*, at para. 107.

[482] *International Thunderbird Gaming Corporation v. The United Mexican States*, Award dated 26 January 2006.

of gaming facilities.[483] Before reaching this conclusion, the tribunal gave the following definition of legitimate expectations:

> Having considered recent investment case law and the good faith principle of international customary law, the concept of 'legitimate expectations' relates, within the context of the NAFTA framework, to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.[484]

The difficulty remains for tribunals to find a reasonable balance between the host States's power to regulate and the protection of the investor's rights, including his legitimate expectation.

Some tribunals have found a way forward by requiring a reasonable relationship of proportionality between the means employed by the host State and the aim sought to be realized in the public interest. In *LG&E v. Argentina*,[485] for example, the tribunal said the following:

> With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed. The proportionality to be used when making use of this right was recognized in Tecmed, which observed that 'whether such actions or measures are proportional to the public interest presumably protected thereby and the protection legally granted to investments, taking into account that the significance of such impact, has a key role upon deciding the proportionality'.[486]

IX. Commentary

1. *(1) Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalised, expropriated . . .*

Article 13(1) defines 'expropriation' to include 'nationalization'. As mentioned above, 'nationalization' is often understood to mean expropriation of private property within the framework of socio-economic or political reform, often concerning one or more specific sectors of a nation's economy. By including 'nationalization' in 'expropriation,' disputes are avoided as to whether the compensation standard is, or should be, different when property is taken as part of 'nationalization'. Article 13 makes clear that the same compensation is required in both situations.

During the debates in the 1960's and 1970's concerning a State's rights over its natural resources and the expropriation thereof, one issue raised was the extent to which States where under an obligation under international law to observe contractual or property rights of foreign investors involving such natural resources.[487] Whilst the State's sovereignty rights over its resources were seldom disputed, some States insisted that foreign investors affirm these rights. A similar affirmation is now found in Article 18(1) of the ECT.[488] Paragraph (2) of Article 18 goes on to say that the ECT shall in no way prejudice

[483] Ibid., at para. 208. [484] Ibid., at para. 147.
[485] *LG&E Energy Corporation v. Argentina*, Decision on Liability dated 3 October 2000.
[486] *LG&E Energy Corp. and LG&E Capital Corp. v. the Argentine Republic*, at para. 195.
[487] See p. 264 *et seq.*, *supra.* [488] For a commentary on Article 18, see p. 347 *et seq.*, *infra.*

the rules in ECT Member States governing the system of property ownership of energy resources.

Paragraph (3) of Article 18 enumerates a number of rights which States 'continue to hold' with respect to the exploration and development of their natural resources. Neither Article 18, nor Article 13, or any other provision of the ECT indicates, or explains, the intended relationship between the affirmation of sovereign rights in Article 18 and the protection against expropriation in Article 13 which by definition limits that sovereignty. This lacuna could perhaps give rise to concern in the sense that a State that is so inclined might rely on Article 18 in an attempt to avoid other obligations under the ECT. It is true, however, that in the Final Act of the European Energy Charter the parties declared that Article 18(2)—but not Article 18(1) and 18(3)—should not be construed so as to allow circumvention of other provisions of the ECT.[489]

Article 13 does not contain a definition of expropriation. As far as direct expropriation is concerned, it usually involves the deprivation of legal title. If an owner is deprived of the legal title to the property in question, there is a direct expropriation. Indirect expropriation occurs when the owner of the property is not deprived of legal title, but when governmental measures otherwise negatively affect his property.[490]

X. … or subjected to a measure or measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as 'Expropriation') …

This language makes it clear that Article 13 covers also indirect expropriation,[491] including so-called creeping expropriation.

The provision explicitly refers to the *effect* of the measures in question, thus emphasizing that the decisive element is the actual impact of the measure(s) in question on the economic and financial value and benefit of the investment.[492]

Questions concerning creeping expropriation may arise particularly in the area of taxation. It is widely accepted that States have legitimate tax powers. The question here is whether there are limits to a State's legitimate powers to tax. Does taxation amount to expropriation when a State introduces a number of taxes, the cumulative effect of which is to deprive the foreign investor of any economic value of its investment? This is not an unrealistic scenario in the energy sector where federal, regional and local/municipal taxes on different elements of petroleum investments may in fact undermine, and even deprive, the foreign investor of the possibility of generating profits.

In this context, it is important to note that taxes are *not* exempted from Article 13. Whilst Article 21 of the ECT is a general tax carve-out provision, paragraph (5) of that article explicitly states that 'Article 13 shall apply to taxes'.[493] Article 21(5)(b) does, however, require the investor to exhaust local remedies when taxes are at issue. If an investor is of the view that a tax constitutes an expropriation under the ECT, the investor, or its home State, must refer the issue to the host State's tax authorities. If the investor first raises the tax issue before an arbitral tribunal, the tribunal is directed by Article 21(5)(b) to refer the issue to the host State's tax authorities which then have six months in which to try to solve the issue.

[489] For a discussion of this declaration, see p. 347 *et seq.*, *infra.*
[490] See discussion at p. 269 *et seq.*, *supra.*
[491] See discussion at p. 267 *et seq.*, *supra.*
[492] See discussion at p. 267 *et seq.*, *supra.*
[493] For a commentary on Article 21, see p. 354 *et seq.*, *infra.*

Neither Article 13 nor Article 21 contains a definition of 'tax' or 'taxation measures'.[494]

In the energy sector questions may arise with respect to the tax character of fees required to obtain access to transit and transport facilities, and fees for the use of natural resources.

Article 13 does not address the question of under what circumstances tax measures constitute expropriation. As a matter of general principle, arbitral tribunals would probably analyze alleged expropriatory taxation in the same manner as other cases of alleged indirect expropriation.[495]

In this context it should be noted that the use of contractual tax stabilization clauses is relatively common. Depending on the circumstances of the individual case, it is possible that the breach of a tax stabilization clause could constitute indirect expropriation. It is also possible that such breach could violate the umbrella clause in Article 10(1), last sentence of the ECT.[496]

XI. … except where such Expropriation is:

(a) for a purpose which is in the public interest;
(b) not discriminatory;
(c) carried out under due process of law; and
(d) accompanied by the payment of prompt, adequate and effective compensation.

Article 13 lists the requirements for a lawful expropriation.[497] The most contentious of the requirements is the one relating to compensation.

Item (d) incorporates the so-called Hull formula *expressis verbis,* i.e. prompt, adequate, and effective compensation.[498]

The ECT is believed to be the first multilateral investment protection treaty explicitly to adopt this formula. At the time when the ECT was being negotiated, the Hull formula was not uncontroversial since it was still viewed as primarily representing the interests of capital-exporting countries. This raises the question why the capital-importing parties to the ECT—including many, if not most, of the former republics of the Soviet Union and many East European countries—accepted the formula.

The answer is probably economic in nature. With the radical economic and political changes in Eastern Europe, including the former Soviet Union, these countries recognized that they had their own interests in providing legal protection to foreign investors with a view to encouraging them to make investments. It is also worthy of note that already at the time of negotiating the ECT, the lines between capital exporting and capital importing States were starting to become blurred. As a consequence thereof, the Hull formula was starting to lose the character of self-interest that it might have had when the lines between capital importing and capital exporting countries were clearer. The

[494] See discussion at p. 274, *infra.* [495] See discussion at p. 269 *et seq.*, *supra.*
[496] For a commentary on the umbrella clause, see p. 273 *et seq.*, *supra.*
[497] For a discussion of lawful and unlawful expropriations, see p. 263 *et seq.*, *supra.*
[498] The former US Secretary of State, Cordell Hull, expressed his view in correspondence with the government of Mexico, following nationalization of US oil companies, such that 'under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose, without provision for prompt, adequate and effective payment thereof'.The correspondence is reprinted in 'Official Documents: Mexico-United States' (1938) 32 AJIL Supp 181.

number of States with an interest in both sides of the compensation issue was already then increasing, and generally speaking continues to increase.

The reference in the Hull formula to 'adequate' compensation is generally understood to be a reference to the fair market value of the expropriated investment.[499]

The reference to 'prompt' payment is usually understood to mean payment without undue delay, or sometimes, as payment within a reasonable period of time, or even as soon as possible. The timing of the actual payment of the compensation will in practice to a large degree be dependent on the facts and circumstances of the individual case.

The requirement for 'effective' compensation means that payment must be offered in freely convertible currency, or at least in such a way that the compensation is transferable.

Determining the fair market value of an investment is often complicated. Expressed in theoretical terms, the fair market value is the amount that a willing buyer would normally pay to a willing seller in a free, arm's length transaction. Oftentimes, however, it may be difficult to identify a relevant market.

Various methods may be used to determine the fair market value of an investment. The most commonly used method is the discounted cash flow method. Other possible methods include liquidation value, comparable transactions and replacement value.[500]

The reference to fair market value would seem to exclude the use of book value as a method of calculating compensation in case of an expropriation. Put in general terms, book value is the difference between an enterprise's assets and liabilities as recorded in its financial statements. Book value thus measures value only as recorded on a balance sheet. This method does not reflect the value that a businessman would attach to a business, or assets, based on its ability to generate profit.

Item (d) does not address compensation in case of an unlawful expropriation.[501] In such cases compensation will be determined on the basis of customary international law. In the case of unlawful expropriation, damages should, as far as possible, restore the situation that would have existed, had the unlawful act not been committed.

The ultimate objective of compensation in case of unlawful expropriation is to wipe out all consequences of the unlawful act. The principles of customary international law in this respect are laid down in the ILC Articles.[502]

The basic principle is enshrined in Article 31 of the ILC Articles, which reads:

1. The responsible state is under an obligation to make full reparation for the injury caused by the international wrongful act.
2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act.

Article 34 goes on to describe the forms of reparation. Article 35 explains that restitution is the primary remedy for internationally wrongful acts. In case of expropriations, it is unusual that restitution will be a realistic remedy. In practice, therefore, the focus is almost always on monetary compensation. This is addressed in Article 36 of the ILC Articles which reads:

[499] Cf. e.g. The World Bank Guidelines on the Treatment of Foreign Direct Investment, Guideline IV(3) (1993) 161.

[500] See discussion at p. 277 *et seq.*, *infra.*

[501] Cf. discussion at p. 263 *et seq.*, *supra.*

[502] See discussion at p. 45 *et seq.*, *supra.*

1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.
2. The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.

XII. Such compensation shall amount to the fair market value of the Investment expropriated …

Put in general terms, compensation for expropriated property should typically correspond to the economic value of the property in question. The value of an asset depends on many factors, the importance of which may vary depending on the nature and function of the asset.

The quoted language makes clear that it is the market value which is to be used to determine the compensation. It is further defined as the *fair* market value. The fact that the *standard* of compensation—i.e. fair market value—has been laid down does not automatically mandate a specific *valuation method*.

A market value based compensation is an estimated amount for which an asset should change hands between a willing buyer and a willing seller in an arm's length transaction where the parties have acted knowledgeably and without pressure.

This is a hypothetical test, i.e. reflecting the amount that a hypothetical seller is prepared to pay to a hypothetical buyer. It is widely accepted that the value of an asset is usually equal to its capability to generate financial benefits to its owner. The new owner—the hypothetical buyer—will, for valuation purposes, typically be looking at the expected future financial benefits generated by the asset and discount those benefits to present day value. The market value thus looks to the future.

There are several ways to determine the market value of an asset.

One approach is to focus on the future *income* of the asset in question, and to discount such income to present day value. One well-known and commonly used valuation method focusing on income is the discounted cash flow (DCF) method. In summary, the philosophy underlying the DCF method is that the market value of an asset will, at any given point in time, depend primarily on the net cash flows it is expected to generate in the future, i.e. cash receipts realistically expected from the asset in each future year of its economic life, minus expected cash expenditure. The net cash flows will be discounted (reduced) to a present day value at a percentage rate (discount rate) reflecting the time value, as well as all relevant risks.[503]

The *first step* in the DCF method is to determine how to *identify and measure* the income stream which is to form the basis of the valuation. Nowadays reference is usually made to cash flow rather than to net earnings or future profit. Using cash flow is viewed as better indicating the value than profit and earnings which often depend on the accounting principles used in a particular jurisdiction, making the concept less suitable for international companies.[504]

[503] For a detailed discussion, see Kantor, Valuation for Arbitration: Compensation Standards, Valuation Methods and Expert Evidence (2008); Marboe, Calculation of Compensation and Damages in International Investment Law (2nd edn. 2017) 189–201, 234–78; Ripinsky and Williams, Damages in International Investments Law (2008).

[504] Marboe, *op. cit.*, at 190.

The *next step* is to *forecast* the future cash flow for the DCF method. This requires the collection of vast amounts of information, so as to be able to analyze the past, the present and the future of the asset in question.

One important element in making a forecast is the past performance of the asset. This does not mean, however, that past performance can be extrapolated into the future. Factors to take into account in this context include the economic and political situation in the past, as well as uncertainties relating to pricing of products produced by the asset.

Another crucial aspect of projecting the future cash flow is to identify the so-called value drivers in relation to the asset, i.e. the most important factors determining the value of the company.[505] Value drivers could include the price of commodities, market shares (e.g. monopoly) and the importance to the company of a country as a market.

Business plans and the impact of long-term contracts are other factors to take into account.[506]

Professional valuers have developed a number of techniques of a mathematical and/or statistical nature which are sometimes used to decrease the inherent uncertainties involved in forecasting future cash flows.

The *third step*, and usually last step, in the DCF method is to *calculate the present day value* of the expected total amount of income. For that purpose a discount factor is used to calculate the present day value of an amount of money expected in the future. The longer the creditor has to wait for the money, the lower its present day value and therefore the higher the discount factor.

In essence the discount rate is intended to reflect the rate of return of alternative investment opportunities, which could have been made, had payment not been delayed. The greatest difficulty in this context is to compare alternative investments, particularly in terms of risk.

There are different approaches to determine the discount rate and to deal with the risks. One approach is to use the Weighted Average Cost of Capital (WACC), or the closely related Capital Asset Pricing Model (CAPM).[507]

These two categories of discount rates, generally speaking, rely on the market's perception of risk with respect to a particular enterprise.

Another approach consists in combining various components, essentially different risk elements, to add up to a discount rate.[508]

In *addition* to these steps, it may be necessary to address country risk. There is, however, no generally accepted method to measure country risk. Sometimes default risk measures—e.g. country debt ratings performed by rating agencies—are used rather than equity risk measures. One method is to add a country risk premium to the discount rate.[509]

The reference to fair market value in Article 13 deals with compensation in case of a *lawful* expropriation. The provision does not address compensation in cases of *unlawful* expropriation.

In a case of an unlawful expropriation, the standard of compensation is *full compensation* or as put by the court in the *Chorzow Factory* case[510] the compensation shall wipe out

[505] Marboe, *op. cit.*, at 245–8.
[506] Marboe, *op. cit.*, at 248–56.
[507] Kantor, *op. cit.*, at 205 *et seq.*
[508] Marboe, *op. cit.*, at 195–7.
[509] Marboe, *op. cit.*, at 199–201.
[510] See note 443, *supra.*

all the consequences of the unlawful act and restore, as far as possible, the situation that would have existed, had the unlawful act not been committed. It follows that this involves the comparison of two scenarios: the future income after the breach, and the future income without—'but for'—the breach. Generally speaking, the difference between these two scenarios constitutes the damage caused by the unlawful act. The projection of the future income in the two situations may be done using the DCF method.

In addition to the *income approach*—of which the DCF method is an example—there are other approaches to determine the value of an asset.

One such approach is the so-called *market approach* which seeks to establish the value based on *actual prices* used in the market. It should be noted that this approach differs from determining the fair market value, since the latter involves assumptions about *hypothetical* buyers and sellers.[511]

As part of the market based approach, one may look at *stock prices*, due account taken of the fact that they fluctuate on a regular basis. It is not unusual, however, that stock prices are used as one among several factors in determining the market value of an asset.

Another method included in the market based approach is to look at *prior transactions* and prices actually paid in such transactions. Prices actually paid would generally seem to be reliable evidence of the value of an asset. On the other hand, it is a price paid by a specific buyer, in a specific situation, having perhaps specific plans. That *price* is not necessarily representative of the *value* of the asset in a more general sense.[512]

A similar benchmark used in the market based approach is to look at prices actually paid for corporate assets. Like prior transactions, *corporate sales* would seem to be a reasonably reliable method of determining the market value. For this method to serve its purpose, it is important to make sure that the sales and transactions are truly comparable.

The *comparable companies* method is another possibility under the market based approach. The idea, is simply put, to value a company with reference to other similar companies. One of the challenges with this method—as with comparable sales—is to identify truly comparable companies.[513]

A third approach to determine the value of an asset is the so-called *asset based approach*. The essence of this approach is that it is based on the value of various component parts, as reflected in a company's balance sheet, which together determine the overall value. It is thus dependent on how assets are reflected on the balance sheet of a company. This means that it is subjected to the varying bookkeeping and depreciation rules being applied with respect to the company in question. The asset based approach looks to the past rather than to the future.

One method falling into this category is to use the *book value* as determined on the basis of the balance sheet of the company. It would seem to be widely accepted that using the book value for determining the value of an asset is generally not appropriate.[514] At the same time various methods of adjusting the book value (*adjusted book value*) has been advocated as an appropriate way of valuating assets, particularly

[511] Cf. Kantor, *op. cit.*, 13 *et seq.*

[512] As pointed out by Marboe, *op. cit.*, at 221, the difference between 'price' and 'value' should not be forgotten.

[513] See discussion at p. 304 *et seq.*, *infra*, dealing with the *Yukos* cases, where the tribunal applied the comparable companies method.

[514] Cf. Marboe, *op. cit.*, at 202–3; 278–9.

within the framework of legal disputes.[515] Sometimes the repayment of investments made—so-called sunk investments—is characterized as a variant of the book value method.[516]

Another method under the asset based approach is to use the *replacement value* of an asset. Generally speaking, the replacement value corresponds to the current cost of an asset with similar characteristics. Using the replacement value means that the focus is on actual prices in the market, rather than on historical costs, as reflected on the balance sheet. On the other hand, this method does not take into account any future prospects, such as loss of future income.

An additional method under the asset-based approach is to use the *liquidation value*. This method is based on the assumption of an asset-by-asset sale and not a sale of the entire business. The liquidation value is mostly used when the assets to be valued are deemed not to have any prospects of generating future profit. Generally speaking, the liquidation value is the price that could be generated for the individual assets in a liquidation sale. Important factors to take into account when determining the liquidation value include the timing and marketing of the sale, as well as whether the sale is a consequence of a forced liquidation.[517]

XIII. … at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the 'Valuation Date').

Put in general terms, it would seem obvious that the value of an expropriated asset should be determined as of the date of the expropriation. It is possible, however, that information about the impeding expropriation before this date could significantly reduce the value of the asset. This risk explains why the Valuation Date has been moved forward to 'the time immediately before the Expropriation', or the time immediately before 'the impending Expropriation became known'. This helps to avoid the situation where a State can diminish the value of an asset before expropriation and benefit from the lower value.

In order to determine the valuation date, it is necessary first to determine the expropriation date. In case of *direct expropriation*, in the form of governmental decrees, parliamentary acts, court judgments or confiscatory measures, it is usually not complicated to determine the expropriation date. It may, however, be complicated to ascertain the expropriation date when the impending expropriation became known, so as to affect the value of an investment.

It is necessary to distinguish negative influences on the value of an investment following from general political, economic and social developments in the host State. Generally speaking, the investor would have been affected by the consequences of such general developments also without the expropriation having taken place. Such general developments should as a rule not be excluded from the calculation of compensation. Negative consequences caused by measures taken by the State must, on the other hand,

[515] Stauffer, 'Valuation of Assets in International Takings', 17 Energy Law Journal (1996) 17.
[516] Cf. Kantor, *op. cit.*, 49 *et seq.* [517] Marboe, *op. cit.*, 206–7.

be included. Needless to say, in practice it may prove very difficult to make this distinction with any degree of precision.

As a rule of thumb, it is probably correct to say that when a government publishes a decree or a law which will result in an expropriation, such publication will have a negative impact on the value of an investment.

In case of *indirect expropriation*, it is usually more difficult to determine the date of expropriation and also the proper date of valuation. This is particularly true in cases of creeping expropriation.[518] In such cases the value of the property may become gradually reduced, such that the value of the property in question may be much lower than it would have been, had expropriation taken place by one decree and/or by one governmental act.

One way to avoid the consequences of a host State gradually interfering with an investment, and thereby reducing its value, would be to separate the expropriation and valuation dates. When there is a creeping expropriation, for example, the date of expropriation could be determined as being at the very beginning of this chain of measures.[519]

When an alleged breach of treaty consists of a series of acts, it is necessary to decide which action, or omission, is sufficient to constitute a breach.

Article 15 of the ILC Articles provides some guidance in this respect. The provision stipulates:

> Breach consisting of a composite act
>
> 1. The breach of an international obligation by a State through a series of actions or omissions defined in aggregate as wrongful occurs when the action or omission occurs which, taken with the other actions or omissions, is sufficient to constitute the wrongful act.
> 2. In such a case, the breach extends over the entire period starting with the first of the actions or omissions of the series and lasts for as long as these actions or omissions are repeated and remain not in conformity with the international obligation.

This seems to indicate that the wrongful act will be deemed to take place at the time of the first action, or omission, which in combination with other actions, constitutes a breach.

Some tribunals have relied on the last date of the actions, which combined amounted to an indirect expropriation.

In *Yukos v. Russia*, the tribunal concluded that the expropriation took place on 19 December 2004 when Yuganskneftegaz, the main production entity of Yukos, was sold at an auction, rather than in November 2007 when Yukos was removed from the Russian register of legal entities.[520]

Article 13 does not address the valuation date of *unlawful expropriations*. In such cases, the host State has the responsibility fully to repair financial harm inflicted on the investor; he must be put in the same situation as if the expropriation had not occurred.[521] An arbitral tribunal must thus compare the actual financial situation of the investor with the

[518] See discussion at p. 267 *et seq.*, *supra.*

[519] Cf. e.g. *Rumeli Telekom v. Kazakstan*, Award dated 28 July 2008, at para. 708.

[520] See *Yukos v. Russian Federation*, Award dated 18 July 2014, at para. 1962; see discussion at p. 304 *et seq.*, *infra.*

[521] Cf. discussion at p. 266 *et seq.*, *supra.*

financial situation that the investor would be in, if the expropriation had not taken place. This comparison can only be made as per the date of the award.

The comparison means that the value of the expropriated property must be determined as of two dates: the date of the expropriation and the date of the award. The difference between the two values constitutes the compensation due. If this is done, the practical consequence is that a decrease in value subsequent to the expropriation will not be to the detriment of the investor, but an increase in value would be to his benefit.

In most cases, however, there is no increase in value, rather the opposite.

In *ADC v. Hungary*,[522] the tribunal addressed the question of an increase in value subsequent to the expropriation. The tribunal decided to use the date of the award as the valuation date. It explained that:

> … the application of the *Chorzów Factory* standard requires that the date of valuation should be the date of the Award and not the date of expropriation, since this is what is necessary to put the Claimants in the same position as if the expropriation had not been committed.[523]

Several other tribunals have taken the same approach. In *Quiborax v. Bolivia*,[524] for example the tribunal said:

> Had the expropriation not occurred, the Claimants would still be in possession of their investment. Consequently, they would have collected cash flows for their mining activities until today, and would have had the right to continue collecting them until the depletion of the concessions.[525]

Also, the tribunals in the *Yukos* cases decided to use the date of the award as the valuation date.[526]

XIV. Such fair market value shall at the request of the Investor be expressed in a Freely Convertible Currency on the basis of the market rate of exchange existing for that currency on the Valuation Date.

The text corresponds to the 'effective' element of the Hull formula.[527]

Freely Convertible Currency is defined in Article 1(14) of the ECT.[528]

If a currency is designated as freely usable by the International Monetary Fund, such currency would in all likelihood be regarded as Freely Convertible under the ECT.

Guideline IV(7) of the World Bank Guidelines on the Treatment of Foreign Direct Investment defines 'effective compensation' in the following way:

> Compensation will be deemed 'effective' if it is paid in the currency brought in by the investor where it remains convertible, in another currency designated as freely usable by the International Monetary Fund or in any other currency accepted by the investor.[529]

[522] *ADC v. Hungary*, Award dated 2 October 2006. [523] Ibid. at para. 497.
[524] *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia*, Award dated 13 March 2015; cf. e.g. also *Siemens v. Argentina*, Award dated 6 February 2007, at para. 353 and *Unglaube v. Costa Rica*, Award dated 16 September 2012, at paras. 306–7, 318.
[525] *Quilborax v. Bolivia*, at para. 385. [526] See discussions at p. 302 *et seq.*, *infra.*
[527] See discussions at p. 275 *et seq.*, *supra.* [528] See commentary on Article 1(14) at p. 142, *supra.*
[529] World Bank Guidelines, at 163.

XV. Compensation shall also include interest at a commercial rate established on a market basis from the date of Expropriation until the date of payment.

1. General Comments

Nowadays interest is an important aspect of international arbitration from an economic and financial point of view. Interest can often constitute a significant portion of the award, sometimes exceeding the principal amount.

Stated in general terms, the idea underlying interest is that payment of interest should compensate for the delay with which the payment to a winning party is made. Interest could also be seen as the prevention of unjust enrichment which the debtor would otherwise have obtained.

In the context of lawful expropriations, the compensation must be prompt, adequate, and effective. Prompt payment means payment without delay. To compensate for delayed payments, interest must be paid. Viewed in this way, interest is part of the compensation to be paid in cases of lawful expropriation.

Also in cases of unlawful expropriations, the duty to pay interest is related to compensation, in particular to the obligation to ensure full reparation.[530] In other words, to the extent it is necessary fully to compensate for a violation of an international obligation, interest must be paid.

There are usually three main issues which must be addressed when deciding matters concerning interest: the rate of interest; the period during which interest is to be paid; and whether interest should be simple or calculated on a compounded basis.

The ECT explicitly addresses one of these issues, in that it identifies the period of interest, i.e. 'from the date of Expropriation until the date of payment'.[531] The ECT also addresses the interest rate by referring to 'a commercial rate on a market basis'. Whilst this is a helpful guideline, the language does not automatically result in a specific interest rate. In the final analysis, the determination of the specific interest rate is left to the discretion of the arbitrators.

The question of whether interest should be calculated on a compounded or simple basis is also ultimately left to the discretion of the arbitrators.

Since interest constitutes an element of compensation due to the injured party, a distinction should be made between pre-award interest—i.e. interest accrued up to the date of the award—and post-award interest. The latter form of interest should perhaps be characterized as a default interest charged for the non-payment of an identified debt, i.e. the amount of compensation determined in the award, whereas pre-award interest is usually viewed as forming part of the compensation for the actual injury suffered.

It is widely accepted that international arbitral tribunals have jurisdiction to award interest to an injured claimant. This is confirmed by Article 26(8) of the ECT, which refers to 'awards of arbitration, which may include an award on interest, shall be final and binding.'[532]

[530] See Article 38 of the ILC Articles, and the discussions at p. 276 *et seq.*, *supra.*
[531] For a discussion of 'date of Expropriation', see p. 280 *et seq.*, *supra.*
[532] For a commentary on Article 26, see p. 414 *et seq.*, *infra.*

2. Pre-Award Interest

a. The Rate of Interest

The text makes clear that the interest rate must be a 'commercial rate established on a market basis'.

There are several methods of determining a market-related interest rate. The ultimate approach chosen by arbitrators, will depend on the facts and circumstances of the individual case, and will, in the final analysis, be subject to the discretion of the arbitrators, unless the relevant investment protection treaty provides for a specific rate of interest and assuming that the parties do not agree on an interest rate.

If the parties to the arbitration have agreed on a specific rate of interest, based on the principle of party autonomy in international arbitration, such agreement must be respected by the arbitrators. Limitations on party autonomy in this context, may perhaps be appropriate if interest rates are of a usurious character.

Most jurisdictions have provisions on legal interest. Generally speaking, legal interest would seem to be of limited relevance in the context of compensation for expropriation. One reason is that legal interest often refers to fixed rates which are not necessarily related to interest rates offered on the market. Even if the legal interest rate refers to a market related benchmark rate, it may be too inflexible to suit the needs of determining compensation for expropriation.

One way of determining a market-based interest rate is to focus on the *borrowing interest rate.* Reference is sometimes made to the *prime interest rate*, which corresponds to the interest rate that commercial banks charge their most creditworthy customers. This leaves open the question of which currency the prime rate should be expressed in. Possibilities include the currency of the home State of the investor, as well as the currency of the country in which the business is carried out, i.e. the host State.

As an alternative to the prime rate, it might be appropriate to use the *actual borrowing rate* of the investor, if it can be established. This may be more appropriate, since the prime interest rate is usually referred to as a more abstract concept when calculating damages.

Theoretically it is possible that some form of *average borrowing rate* could be used. A major obstacle, however, seems to be the lack of reliable and relevant information.

A second possibility to determine a market-based pre-award interest rate could be to refer to the interest that the investor would have earned, had it been paid in time. The underlying theory here is that the investor would have had funds available for *alternative investments*. Using this approach, the central question is which investments represent a relevant alternative for the investor. Put differently: what would the investor have done with the money, had he received it in time.

At the end of the day, it will be in the discretion of tribunals—based on the facts and circumstances of the individual case—to determine which alternative investment vehicle is to be used for purposes of determining the applicable interest rate. Possible alternative investments include government bonds, treasury bills and various forms of certificates of deposit. In *Yukos v. Russia*, for example, the tribunal referred to US Treasury bond rates.[533]

A third possibility is to refer to *interbank interest rates*. One of the more significant interbank interest rates is LIBOR (London Interbank Offered Rate). This is an average

[533] See discussion at p. 306, *infra.*

interest rate at which banks offer to lend funds to each other on the international interbank market. In general, interbank interest rates are typically relevant because they reflect actual economic and financial markets. Also, it could be said that they are objective in the sense that they neither reflect the position of the claimant/investor, nor that of the respondent State in the investment dispute in question. On the other hand, interbank interest rates seem to fluctuate significantly over time. This particular disadvantage could, however, be counterbalanced by using an average value over a longer period of time.

It is not unusual that tribunals using interbank interest rates add a surcharge of several percentage points. In *Kardassopoulos v. Georgia*, for example, the tribunal added four percentage points to LIBOR.[534]

b. Simple or Compound Interest?

From an economic point of view, the difference between simple and compound interest, can be significant. The financial impact of compound interest varies with the compounding intervals used. Interest is usually compounded annually, quarterly or monthly, or even at shorter intervals. The shorter the period used for compounding is, the higher the amount of additional interest.

In economic and financial life, compounding of interest is used on a regular basis. Today most financing and investment activities on a transnational basis involve compound interest.

Historically, the traditional approach in international arbitral jurisprudence has shown reluctance to award compound interest. One reason for this reluctance has probably been the potentially dramatic effect of compounding the interest which could quickly lead to the amount of interest exceeding the principal.

Article 38 of the ILC Articles provides for the payment of interest when necessary to ensure full reparation.[535]

In the commentary to Article 38 it is suggested that interest should be simple, not compound.[536] This is the traditional position of public international law, based primarily on state-to-state disputes.

In recent investment treaty arbitrations, there is a developing trend to award compound interest as opposed to simple interest.[537] Whilst there is as of yet no unanimity, the predominant pattern among arbitral tribunals in investment treaty disputes is to accept compound interest.

Generally speaking, compound interest is viewed as better reflecting actual economic and financial realities, thereby ensuring that the loss actually incurred is compensated.

The intervals used for compounding interest mostly seem to vary between twelve months (compounded annually) and six months (compounded semi-annually).[538]

[534] See discussion at p. 305 *et seq.*, *infra.* [535] See discussion at p. 276 *et seq.*, *supra.*

[536] ILC Responsibility of States for Internationally Wrongful Acts: Draft articles with Commentaries (2002).

[537] Cf. e.g. *Compania del Desarollo de Santa Elena v. Costa Rica*, Award dated 17 February 2000, at paras. 97 *et seq.*: *Metalclad Corporation. v. Mexico*, Award dated 30 August 2000, at para. 128; *Middle East Cement v. Egypt*, Award dated 12 April 2002, at para. 175; *Lenure v. Ukraine*, Award dated 28 March 2011, at para. 360; *Quilborax v. Bolivia*, Award dated 16 September 2015, at paras. 520–1; and *Tenaris v. Venezuela*, Award dated 29 January 2016, at para. 594.

[538] Cf. e.g. *Occidental v. Equador*, Award dated 5 October 2012, at para. 845; *Gold Reserve v. Venezuela*, Award dated 22 September 2014, at para. 855; *Khan Resources v. Mongolia*, Award dated 2 March 2015, at para, 425; *Kardassopoulus v. Georgia*, Award dated 3 March 2010, at para. 667; and *Anatolie and Gabriel Stati v. Kazakhstan*, Award dated 18 December 2013, at para. 1855.

In a recent study of forty-two ICSID awards between 2000 and 2014 it was found that only ten tribunals awarded simple interest.[539]

c. Post-Award Interest

If one accepts the idea that pre-award interest constitutes part of the compensation due to an investor, it could be argued that post-award interest ought to be fixed at a different rate, since the purpose of post-award interest is at least arguably different, i.e. to serve as an incentive to comply with the payment terms of the award.[540]

In municipal legal systems this kind of interest is usually referred to as default interest. The payment obligation is determined in the award and the respondent is in default if he does not pay as ordered in the award.

Arbitral jurisprudence is divided with respect to post-award interest, in the meaning that some tribunals do not distinguish between pre- and post-award interest. Sometimes this means that the pre-award interest will continue until payment is made.

If a distinction is made, post-award interest will usually start to run as of the date of the award, unless a grace period is given to the respondent. In such a situation the post-award interest will start to rum only at the expiry of the grace period. Such an arrangement may thus serve as an encouragement to pay the amount in question.

If a distinction is made between pre- and post-award interest, the arbitral tribunal must determine a rate with respect to the latter. The practice of tribunals varies widely. Sometimes tribunals determine higher rates for post-award interest presumably in the hope that this will serve as an incentive to make prompt payment. As far as the actual rates are concerned, they include interbank rates, as well as interest rates on various forms of government bonds and treasury bills, or certificates.[541]

Given the increased acceptance of compound interest as regards pre-award interest, compound interest is also used sometimes in the context of post-award interest.[542]

If the purpose of post-award interest is viewed as a way to encourage prompt payment, this could perhaps be achieved by using short compounding periods which increases the interest to be paid. For example, interest could be compounded on an annual basis prior to the award but on a three-month basis for the post-award interest. In *Yukos v. Russia*,[543] the tribunal awarded simple pre-award interest, but post-award interest compounded annually.

XVI. (2) The Investor affected shall have a right to prompt review, under the law of the Contracting Party making the Expropriation, by a judicial or other competent and independent authority of that Contracting Party, of its case, of the valuation of its Investment, and of the payment of compensation, in accordance with the principles set out in paragraph (1).

This provision gives the investor the *right*, but not the obligation, to seek prompt review by local courts and authorities of the legality of the expropriation, as well as of the

[539] Uchkunova and Temnikov, 'A Procrustean Bed: Pre-and Post-Award Interest, in ICSID Arbitration', 2nd ICSID Rev. (2014) 659.

[540] For a different view, see McLachlan, Short and Weiniger, *op. cit.*, at 453–4.

[541] See discussion at p. 284 *et seq.*, *supra.*

[542] See discussion at p. 284 *et seq.*, *supra.*

[543] See discussion at p. 306, *infra.*

valuation and compensation paid. The investor is thus not required to exhaust local remedies prior to seeking redress under the ECT,

The situation is different, however, with respect to taxes. Whilst Article 21(5) (a) of the ECT makes clear that Article 13 applies also to taxes, subparagraph (b) of that article, requires that the investor, or its government, refer the question of the alleged expropriation to the tax authorities of the host State.[544]

If the investor nevertheless first commences arbitration under the ECT, the arbitrators must refer the tax issue to the tax authorities of the host State. They then have six months to resolve the issue.

No cases are known where an investor has availed itself of the right first to go to local courts or authorities to have an expropriation issue tried.

XVII. (3) For the avoidance of doubt, Expropriation shall include 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.

This provision was introduced to address the situation dealt with in the Barcelona Traction Case.[545] The Barcelona Traction Light and Power Company was incorporated in Canada, but the majority of its shareholders were Belgian nationals. The ICJ ruled that under customary international law, the State of nationality of the majority shareholders had no legal standing in the dispute against Spain for damages caused to the company which was active in Spain.

This subparagraph provides that expropriation of an investor's interests in the shares or assets of a company is covered by the ECT, also if the company is locally incorporated.[546]

XVIII. ECT Awards

I. Introduction

In almost every ECT arbitration, the claimant has requested compensation based on an alleged expropriation.[547] So far, ECT tribunals have granted such claims in two arbitrations: *Kardassopoulos v. Georgia*, in 2010,[548] and in the *Yukos* cases in 2014.[549]

In other cases, the claimant has relied on Article 13, but the tribunal in question has not tried the issue, explaining that it did not have to do this, since it decided the dispute on the basis of another legal ground, oftentimes on the basis of fair and equitable treatment standard. This category of cases includes: *Stati et al v. Kazakhstan*;[550]

[544] For a commentary on Article 21, see p. 355 *et seq.*, *infra.*
[545] *Barcelona Traction Light & Power Co.* (*Belgium v. Spain*) ICJ Reports (1970) 3.
[546] For a discussion of shareholders as Investors under the ECT, see p. 274, *supra.*
[547] A notable exception is *Amto v. Ukraine* decided in 2005, where the claimant did not rely on Article 13.
[548] See discussion at p. 300 *et seq.*, *infra.*
[549] See discussion at p. 300 *et seq.*, *infra.*
[550] See note 332, *supra.*

Khan v. Mongolia;[551] *Energoallians v. Moldova*;[552] and *Eiser v. Spain*[553] and other arbitrations concerning renewable energy.

In those cases where tribunals have denied the expropriation claim, the tribunals have, to varying degrees, analyzed and discussed the different aspects of expropriation under Article 13 of the ECT.

The focus has primarily been on determining whether an expropriation has taken place.

a. Direct and Indirect Expropriation

In *Nykomb v. Latvia*, the claimant argued that non-payment of the double tariff constituted indirect expropriation.[554] The tribunal noted that regulatory takings could under certain circumstances amount to direct or indirect expropriation. The decisive factor was the degree of taking or control of the enterprise in question.[555] The tribunal found that there was no taking of Windau—the locally incorporated entity owned by the claimant—nor of its assets; there was no interference with shareholders rights or with the management control of Windau. Against this background the tribunal concluded that withholding payment of the double tariff did not qualify as an expropriation, or as the equivalent thereof, under the ECT.[556]

In *Petrobart v. Kyrgyzstan*,[557] the claimant argued that it had been subjected to expropriation or measures equivalent thereto. The tribunal noted that it was clear that no formal expropriation of claimant's investment had taken place. Nor did the tribunal find that an indirect expropriation had occurred.

In explaining this conclusion the tribunal referred to the intent underlying the measures[558] and said:

> Nor does it appear that the measures taken by the Kyrgyz Government and state authorities, although they had negative effects for Petrobart, were directed specifically against Petrobart's investment or had the aim of transferring economic values from Petrobart to the Kyrgyz Republic. Petrobart's claims against KGM remained and gave rise to demands in KGM's bankruptcy.[559]

The claimant in *Plama v. Bulgaria*[560] argued that an indirect expropriation had occurred, or in the words of the tribunal:

> … its claims do not relate to the physical taking of the property but to the impact that the state's conduct had on the enjoyment and value of its investment.[561]

In the circumstances, the tribunal found that the claimant had not been able to establish that there was any harm or loss to the investment or any limitation in the right to use or enjoy the investment.[562]

In reaching this conclusion, the tribunal applied the following criteria:

> (i) substantially complete deprivation of the economic use and employment of the rights to the investment, or of identifiable distinct parts thereof, (i.e. approaching total impairment); (ii) the

[551] See note 335, *supra.* [552] See discussion at note 54, *supra.* [553] See note 100, *supra.*
[554] *Nykomb v. Latvia*, Award dated 16 December 2003. [555] *Nykomb v. Latvia* at para. 4.3.1.
[556] Ibid. [557] *Petrobart v. Kyrgyzstan,* Award dated 29 March 2005.
[558] See discussion at p. 261 *et seq.*, *supra*, as to the relevance of intent in the context of expropriation.
[559] *Petrobart v. Kyrgyzstan*, at p. 77.
[560] *Plama Consortium Limited v. Republic of Bulgaria*, Award dated 27 August 2008.
[561] *Plama Consortium Limited v. Republic of Bulgaria,* at para. 190. [562] Ibid., at para. 227.

irreversibility and permanence of the contested measures (i.e. not ephemeral or temporary); and (iii) the extent of the loss of economic value experienced by the investor.[563]

The first ECT arbitration in which a tribunal found that a breach of Article 13 had been established was *Kardassopoulos v. Georgia*.[564]

On 3 March 1992 Tramex (owned and controlled by Messrs. Fuchs and Kardassopoulos) and the Georgian state-owned oil company SakNavtobi signed a Joint Venture Agreement creating GTI Ltd.

Following a restructuring of the Georgian fuel and energy sector, which among other things, resulted in SakNavtobi becoming a department in the Ministry of Fuel and Energy, GTI obtained a 30 year concession over Georgia's pipelines, essentially intended for the transport of oil from oil fields in Azerbaijan on the Caspian Sea. The deed of concession was signed by Transneft—the entity in charge of the main pipelines in Georgia and constituting a unit of SakNavtobi—and ratified by the Ministry of Fuel and Energy. The deed of concession was executed on 28 April 1993.

A few years after the initial investment had been made by the claimant, the Azerbaijan International Oil Company (AIOC), a consortium of multinational oil companies, became active in the region when big quantities of crude oil in the Caspian Sea were confirmed.

On 11 November 1995. President Shevardnadze adopted Decree No. 477, which established the State-owned Company Georgian International Oil Corporation ('GIOC').

Decree No. 477 provided, in part, as follows:

> As agreed upon within the International Oil Consortium, the founding companies thereof, international, financial, banking and investment structures, as well as the governmental authorities and non-governmental of Georgia, the establishment of Georgian Oil Corporation is deemed as expedient
>
> The aim of the Georgian International Oil Corporation shall include:
>
> Rehabilitation of the oil pipeline and other oil transportation, oil facilities available in the territory of Georgia, including construction works, oil transportation, processing and sale thereof, as well as formation of relevant infrastructure, and coordination and management of financial banking investment, insurance and other activities related to the aforesaid issues.

Decree No. 477 also indicated that other companies would be invited to participate in GIOC:

> The following be also invited to participate in the Georgian International Oil Corporation: the Stale Oil Company of Azerbaijan, LUKOIL, the Russian Oil Company, INTERSYSTEM company jointly held by Azerbaijan and Georgia and other international oil companies, banks, financial, investment and insurance companies.

A few months later, on 20 February 1996, the Cabinet of Ministers adopted Decree No. 178 'for the purposes of creating essential favourable conditions for the transportation of oil and gas within the territory Georgia'.

[563] Ibid., at para. 193.

[564] *Ioannis Kardassopoulos v. The Republic of Georgia*, Award dated 3 March 2010. The factual account of the dispute is based in paras. 68–208 of the award.

The Decree included the following provision:

3. To assign a shareholder partnership to [GIOC) in order to manage the government-owned state property, without rights to transfer of joint-stock company [GIOC] to provide the rights on ownership, use, management, exploitation, reconstruction of the herein provided state property, including all other rights, necessary for the specified company as to the party, which signed the contract of construction and exploitation of the pipeline and also the right to receive all kinds of profit from the specified property. To give the mentioned rights to [GIOC] for the term not less than fixed by the contract of construction and exploitation of pipeline, in view of possible prolongation of this contract, or for thirty years:

On Samgori-Batumi pipeline with all external diameter of 530 mm;

On all kinds of the equipment, necessary for reception, storage, measure, check, control, pumping over, reduction of oil pressure and all other means and equipment, functionally connected with the specified pipeline;

On the land, intended for construction and exploitation of oil pipeline, including any plots of land through the whole extent of the pipeline, and also other territories, the use of which is essential for realization of rights on ownership, use, management, exploitation and reconstruction of the specified property.

Decree No. 178 further provided that GIOC would represent Georgia in a contract with the AIOC, among other entities, for the construction and exploitation of the Samgori-Batumi pipeline:

Joint-stock company [GIOC] to represent the Georgian party (instead of Industrial Association of Main Oil Pipelines of Georgia) in the contract on construction and exploitation of the pipeline, which according to the Protocol, signed on August 31, 1995, will be concluded between the Government of Georgia, the Government of Azerbaijan, Industrial Association of Main Oil Pipelines of Georgia, State Oil company of Azerbaijan and International Operating Company of Azerbaijan.

The final provision of the decree cancelled 'all rights (given earlier by the Georgian government to any of the parties) contradicting the present Decree'.

The tribunal noted that this 'brought to an abrupt end to Tramex/GTI's rights in Georgia'.[565]

In analysing these facts, the tribunal found that:

… the circumstances of Mr. Kardassopoulos' claim present a classic case of direct expropriation, Decree No. 178 having deprived GTI of its rights in the early oil pipeline and Mr. Kardassopoulos' interest therein. The Tribunal also finds that this deprivation was not an exercise of the State's *bona fide* police powers.[566]

The tribunal also noted that the groundwork for the expropriation had been laid by the adoption of Decree No. 477, which established GIOC, the company to whom GTI's rights were eventually transferred.[567]

In *Liman Caspian Oil v. Kazakhstan*,[568] the claimants argued that the invalidation by Kazakh courts of the transfer of a licence, and its re-transfer to an entity, by the Ministry of Energy, constituted expropriation.

[565] Ibid., at para. 157. [566] Ibid., at para. 387. [567] Ibid., at para. 388.
[568] *Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan*, Award dated 22 June 2010.

The tribunal did not agree. It said that the:

> … mere fact that decisions of the Kazakh courts declared that Claimants did not prevail and were not holders of rights they claimed to have, therefore, is not sufficient to find an expropriatory measure falling under ECT Article 13.[569]

The tribunal noted that earlier in the award, when analyzing ECT Article 10(1) it had found that:

> the Kazakh court decisions were not arbitrary, grossly unfair, unjust idiosyncratic, discriminatory or lacking due process, even if they might have been incorrect as a matter of Kazakh law, and that correspondingly they have to be accepted from the perspective of international law and particularly that of the ECT. Consequently, the invalidation of the transfer of the license by the Kazakh courts has to be accepted under international law and under the ECT.[570]

In *Al-Bahloul v. The Republic of Tajikistan*,[571] the claimant argued that his investment in the Baldjuvon and Petroleum SUGD joint ventures had been expropriated by virtue of i) the State's failure to issue exploration licences with respect to the four December 2000 Agreements; ii) the State's failure to issue licences to Baldjuvon followed by the company's dissolution by the Supreme Court of Tajikistan on application of the Ministry of Finance; iii) the State's failure to issues licences to Petroleum SUGD and the subsequent forced reduction of Vivalo's share interest in the joint venture; and iv) the failure of the State to offer to pay dividends from Petroleum SUGD's activities since 14 March 2003.

With respect to respondent's failure to issue licences under the four December 2000 Agreements, the tribunal had already ruled that it constituted a violation of the umbrella clause of Article 10(1) of the ECT. The tribunal found, however, that this failure did not constitute a violation of Article 13. The tribunal said:

> The December 2000 Agreements, were of unlimited duration. There is no evidence in the record that they were terminated by either party. Indeed, as one of his claims for relief in this arbitration, Claimant bas sought specific performance of the State's obligations under those Agreements. Thus, while it is true that the failure to issue licenses within a reasonable time period after signature of the Agreements was a breach of the obligations of the State under those Agreements, and might have adversely influenced until now Claimant's opportunity to exploit what he believes to be highly valuable assets, no permanent taking of Claimant's contractual rights has been shown, such that this Tribunal could consider Claimant's rights to have been destroyed.[572]

As regards the dissolution by the courts of the Baldjuvon joint venture and the reduction of the share interest in the Petroleum SUGD joint venture, the tribunal concluded that those decisions were the result of the application of Tajik laws essentially to the effect that obligations under relevant company legislation had not been complied with. Also, the tribunal noted that there was no evidence of respondent having prevented the exercise of claimant's shareholder rights. Consequently, the tribunal found that no expropriation had occurred.[573]

In *AES v. Hungary*[574] the claimants took the position that respondent had expropriated revenues which they had been entitled to receive under the 2001 Power Purchase

[569] Ibid., at para. 430.
[570] Ibid., at para. 431.
[571] *Mohammad Ammar Al-Bahloul v. The Republic of Tajikistan*, Partial Award dated 2 September 2009.
[572] Ibid., at para. 282.
[573] Ibid., at paras. 284–8.
[574] *AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary*, Award dated 23 August 2010.

Agreement (PPA), by amending the 2001 Electricity Act and by issuing the Price Decree. These acts were characterized by claimants as equivalent to nationalization or expropriation.

The tribunal did not agree. It noted that the acts complained of did not interfere with the ownership or use of claimants' property, and that they retained control of the relevant plant; there was thus no deprivation of claimants' ownership or control.[575]

The tribunal also found that the claimants continued to receive substantial revenues from their investments, showing that the value of the investments was not substantially diminished and that the claimants were not deprived of a significant part of the value of their investments.[576]

The tribunal in *Electrabel S.A. v. Republic of Hungary*[577] was faced with similar facts to those in *AES v. Hungary*. The tribunal came to the same conclusion with respect to expropriation, and essentially for the same reasons.

With respect to direct expropriation, the tribunal concluded that there was no taking of Electrabel's investment in Dunamenti, nor was there a taking concerning the PPA, and it was not transferred by Hungary to a third party.[578]

As regards the alleged indirect expropriation the tribunal found that Hungary had not deprived Dunamenti of the use of its power plant, and that Dunamenti's business was not rendered financially worthless by the early termination of the PPA, but had continued to operate in Hungary's electricity market.[579]

In the *Yukos* cases,[580] the claimants essentially relied on five categories of measure in support of their expropriation claim under Article 13 of the ECT:

1. Seizure in October 1993 of 99 per cent of the shares held by Hulley Enterprises Limited and Yukos Universal Limited in Yukos, preventing claimants from disposing of the shares;
2. Causing the unwinding of the merger between Yukos and Sibneft, at the time the fifth largest oil company in Russia, thereby allowing Sibneft to be acquired by the state-owned company Gazprom;
3. Fabricating massive tax debts against Yukos and simultaneously freezing or seizing the company's assets and interfering with its day-to-day management such that it was not possible for Yukos to pay the tax debts;
4. Selling Yuganskneftgaz—the main producing entity of Yukos—in a sham auction that allowed state-owned company Rosneft to acquire Yuganskneftgaz for a price well below the market price;
5. Initiating and controlling the bankruptcy of Yukos, thereby obtaining directly, or indirectly, or through Rosneft, Yukos' main production assets and practically all of the bankruptcy proceeds; the bankruptcy eventually led to the liquidation of Yukos on 21 November 2007.

In brief summary, the background to the dispute was the following.[581]

[575] *AES v. Hungary*, at para. 14.3.2. [576] Ibid., at para. 14.3.3.
[577] *Electrabel S.A. v. Republic of Hungary*, Award dated 30 November 2012.
[578] Ibid., at para. 6.52. [579] Ibid., at para. 6.53.
[580] *Yukos Universal Limited (Isle of Man) v. The Russian Federation; Hulley Enterprises Limited (Cyprus) v. The Russian Federation; Veteran Petroleum Limited (Cyprus) v. The Russian Federation*. All these arbitrations were tried by the same tribunal. The three awards were rendered on the same date—18 July 2014—and are for all practical purposes identical. All the awards were challenged by the court of first instance in the Hague, which set aside the award; the case is now pending before the Court of Appeal in the Hague.
[581] See paras. 71–109; 1548–74 of the *Yukos* cases.

Yukos was established as part of the Russian privatization programme. It was fully privatized in 1995–6. As a vertically integrated energy company it was engaged in the exploration, production, refining, marketing and distribution of crude oil, natural gas and petroleum products. In May 2002, Yukos was the first Russian company to be ranked among the top ten largest oil and gas companies in the world.

At its peak in 2003, it had approximately 100,000 employees, six main refineries and a market capitalization of more than USD 33 billion. In the summer of 2003, Yukos was engaged in negotiations with ExxonMobil and Chevron Texaco for some form of merger.

Claimants contended that Yukos' success and the increasing social and economic influence gained by its management—including financial support given by Mr. Khodorkovsky to political opposition parties—were perceived as a political threat by the Russian authorities. Respondent, however, argued that Yukos was an enterprise engaged in criminal tax evasion schemes and fraudulent activities.

The dispute focused on Russian tax legislation, particularly on a low-tax region programme launched by the Russian government in the 1990s. The essence of the programme was the following.

The Russian low-tax regions were permitted to exempt taxpayers from federal corporate profit tax for the purpose of fostering taxpayers' investments in the low-tax regions, provided the taxpayer complied with certain requirements.

The Russian low-tax regions that were relevant to Yukos' 'tax optimization' scheme included: a) Closed Administrative Territorial Units (known as 'ZATOs'), Lesnoy and Trekhgorniy; and b) other low-tax regions: Mordovia. Kalmykia, and Evenkia.

With respect to the tax benefits available in the ZATOs (Lesnoy and Trekhgorniy), in 1999, the ZATOs were permitted to exempt taxpayers fully from federal corporate profit tax. In 2000, most ZATOs were permitted to exempt taxpayers from the portion of the federal corporate profit tax that was payable to their budget. In 2001, *all* ZATOs were permitted to exempt taxpayers from the portion of the federal corporate profit tax that was payable to their budget. In 2002, these exemptions were revoked.

With respect to the tax benefits available in other low-tax regions, in 2000 and 2001, Mordovia, Kalmykia, and Evenkia were permitted to exempt taxpayers fully from the portion of the federal corporate profit tax that was payable to their budget. From 1 July 2002 until 31 December 2003, low-tax regions were permitted to exempt taxpayers from the portion of the federal corporate profit tax payable to their budget, but only up to four percent. An exception existed for 'grandfathered' tax investment agreements entered into prior to 1 July 2001, such that these taxpayers could still receive a zero percent profit tax rate if they fulfilled certain other conditions. As of 1 January 2004, the existing tax investment agreements were terminated, but the Tax Code of the Russian Federation still allowed low-tax regions to reduce the federal corporate profit tax payable to their budget up to four percent.

In response to the expropriation claims, the respondent first of all took the position that the claimants had failed to establish that respondent's conduct had caused the liquidation of Yukos; the actions leading thereto were not attributable to the respondent, nor did they constitute an exercise of its sovereign power. In respondent's view, Yukos' problems were the result of Yukos' own actions.

Respondent further argued that the claimants had failed to establish that the challenged measures interfered with claimants' legitimate expectations. The claimant—respondent

argued—had no legitimate expectations that the Russian tax authorities would not apply the tax legislation, and assess taxes, the way they did. The enforcement measures were foreseeable consequences of the fact that Yukos did not pay taxes.

The respondent also argued that the measures taken with respect to the assessment and enforcement of taxes were well within the range of generally accepted regulatory powers of a State, which were confirmed, *inter alia*, by the fact that the measures were upheld by the Russian courts.

The tribunal found that respondent had not explicitly expropriated Yukos or the holdings of its shareholders. It did find, however, that the measures taken by the respondent had an effect equivalent to nationalization or expropriation. The facts and circumstances leading to this finding were in brief summary the following.

Respondent contended that Yukos' restructuring of its trading operations from high-tax jurisdictions, such as Moscow and Nefteyugansk, to trading companies incorporated in low-tax jurisdictions of Lesnoy, Trekhgorny, Mordovia, Kalmykia, and Evenkia was aimed at evading taxes, rather than to achieve any genuine economic result.

Respondent argued that Yukos interposed between Yukos and its customer's its 'sham' trading shells registered in Russian low-tax regions. Yukos' oil producing subsidiaries sold the extracted oil to the trading companies at a fraction of the market price. The trading companies then sold the oil either abroad at a market price or to Yukos' refineries, and subsequently re-bought it at a reduced price and re-sold it at a market price.

Respondent asserted that prices increased step by step from shell company to shell company, generating artificially inflated profits through non-arm's length transactions. Those profits were then taxed at reduced rates in the low-tax regions, where the sham trading shells were registered. Respondent contended that the tax authorities identified abuses by the Lesnoy trading shells, which resulted in further investigations and ultimately, in the tax assessment against Yukos and related proceedings.

Claimants argued that Yukos, like other Russian companies at that time, was merely taking advantage of the legislation in place in the low-tax regions. Claimants asserted that any findings of 'abuse' by the Russian tax authorities was a function of the arbitrary and unpredictable interpretations of the law in Russia.

Starting in July 2003, a series of criminal investigations were initiated by the Russian Federation against Yukos management and activities. According to claimants, these actions included the "targeting" of Yukos' employees, Yukos's auditor PwC, in-house counsel, and lawyers, involved in various Yukos-related cases, as well as searches and seizures, threats to revoke its oil licences, and mutual legal assistance requests and extradition proceedings against Yukos management.

Claimants characterized these actions as harassment, motivated by Mr. Khodorkovsky's participation in Russian opposition politics, that were intended—together with tax reassessments—to lead to the expropriation of Yukos' assets.

Respondent argued that its actions were in response to illegal acts committed by Yukos and its officers and shareholders.

Between July and October 2003, three key Yukos officers were arrested. In July 2003, Mr. Platon Lebedev, Director of Hulley and Yukos Universal Limited, was arrested on charges of embezzlement and fraud; he was sentenced to nine years in prison in May 2005. In October 2003, Mr. Vasily Shakhovsky, President of Yukos-Moscow, was charged with and later convicted of tax evasion. In October 2003, Mr. Khodorkovsky was arrested

and charged with crimes including forgery, fraud, and tax evasion; he was also sentenced to a nine-year prison term in May 2005.

As a result of these arrests, a number of high-ranking Yukos executives fled Russia.

Claimants contended that by April 2006, no fewer than 35 top managers and employees of Yukos had been interrogated, arrested or sentenced, and that lawyers acting for Yukos had been obstructed in their work. During the same period, Russian authorities conducted searches, seizures, and interrogations of Yukos property and personnel. Claimants argued that all of these actions amounted to harassment and intimidation, that they deprived Yukos' management of the ability to manage and control Yukos as a business, and that the underlying motive was to expropriate Yukos' assets.

Respondent asserted that in addition to participation in tax fraud schemes, Yukos participated in a massive transfer pricing scheme by which hundreds of millions of dollars from the sales of oil and other products were illegally siphoned off to offshore entities for the benefit of Messrs. Khodorkovsky and Lebedev.

Respondent also argued that Yukos officials had been engaged in violent crimes, such as murder, attempted murder and assault of persons seeking to enforce Russian tax laws or otherwise perceived to threaten Yukos interests. Claimants denied Respondent's allegations of criminal acts as well as acts, of tax evasion.

Respondent denied that Yukos and its officers were targeted in a discriminatory way, contending that Russian taxation measures have also been applied to other offenders and that the searches and seizures were taken as part of legitimate taxation measures and conducted in accordance with normal Russian practice and the appropriate procedural protections available under Russian law.

In the period between October 2003 and December 2004, claimants stated that Yukos and its subsidiaries faced a series of major setbacks, including the alleged frustration of its merger with Sibneft, significant tax reassessments, fines, VAT exactions, the freezing of shares and assets, the threatened revocation of licences, and the forced sale of Yukos' main oil production subsidiary, Yuganskneftegaz.

These measures were followed by the bankruptcy of Yukos in August 2006.

As to the merger with Sibneft, the claimants stated that in October 2003, a merger was about to be completed between Yukos and Sibneft, Russia's fifth largest oil company. According to claimants, the resulting entity, YukosSibneft, would have become the world's fourth largest oil company. In November 2003, however, after Yukos had already acquired 92% of Sibneft's shares as part of the merger and after the arrest of Mr. Khodorkovsky, Sibneft's controlling shareholder, Mr. Roman Abramovich, called off the merger process and the transactions were then unwound by a series of court decisions.

On 28 April 2003, the Tax Ministry issued a Tax Audit Report for the years 2000 and 2001 that raised no questions concerning Yukos' tax optimization structure. On 1 September, 1 October, and 1 November 2003, the Tax Ministry issued certificates confirming that Yukos had no outstanding debts.

On 8 December 2003, the Tax Ministry ordered a tax re-audit of Yukos for the year 2000. On 29 December 2003, the tax authorities of the Russian Federation issued the first of five tax assessments against Yukos that were based on the alleged abuse by Yukos of its tax optimization scheme.

The Tax Ministry demanded payment from Yukos for approximately USD 3.5 billion for 2000. Similarly, large tax reassessments were issued in the period between 2004 and

2006 for subsequent tax years. 2001 taxes were re-assessed in the amount of approximately USD 4.1 billion, 2002 taxes in the amount of approximately USD 6.8 billion, 2003 taxes in the amount of approximately USD 6.1 billion, and 2004 taxes in the amount of approximately USD 3.7 billion.

By the time the Tax Ministry issued the last of these demands for payment, Yukos faced a tax bill of more than USD 24 billion, of which approximately USD 10.6 billion constituted allegedly evaded revenue-based taxes (including interest and fines), and the remainder (approximately USD 13.6 billion) consisted of VAT and related interest and fines.

Respondent argued that the reassessments were a consequence of Yukos' activities relating to the tax fraud scheme of the claimants. In the view of the claimants, however, the reassessments were so excessive so as to make plain respondent's strategy to destroy Yukos.

At the same time that tax reassessments were being filed against Yukos and its subsidiaries, Russian authorities began freezing shares and other assets belonging to Yukos and related entities. In October 2003, Russian prosecutors froze shares held by Yukos Universal Limited and Hulley in Yukos. Orders issued by the Moscow Arbitrazh Court in April and June 2004 prevented Yukos from disposing of its assets.

An application by Yukos in July 2004 to have sufficient assets released to meet its tax liabilities was ignored and a surcharge of approximately USD 240 million was applied for late payment of taxes.

Claimants further maintained that Yukos' numerous proposals throughout this period to settle the tax claims were ignored or rejected by the Russian authorities, despite the fact that the government settled with taxpayers in several other areas.

In July 2004 Russian authorities began seizing Yukos' shares in Yuganskneftegaz, Samaraneftegaz, and Tomskneft. Bank accounts of Yuganskneftegaz were frozen. The Russian authorities also used mutual legal assistance treaties to affect Yukos' interests abroad.

Respondent did not dispute the freezing of Yukos' assets but contended that freezing assets of a debtor, including shares owned by it, is a standard enforcement measure for tax levies and judgments. Respondent maintained that its freezing orders did not cover all of the assets of Yukos in Russia and that Yukos remained in possession of large assets abroad.

In July 2004 the Russian Federation indicated that it intended to appraise and sell Yuganskneftegaz to pay off Yukos' back taxes. A valuation carried out by the investment bank ZAO Dresdner Bank at the request of the Russian Federation valued Yuganskneftegaz at between USD 15.7 billion and USD 18.3 billion. A valuation carried out by JP Morgan, at the request of Yukos, valued Yuganskneftegaz at between USD 16 billion and USD 22 billion. The Russian Ministry of Justice announced that Yuganskneftegaz was worth USD 10.4 billion.

After Yukos' attempt to enjoin the sale of Yuganskneftegaz by legal recourse in the United States failed, the company was sold at auction on 19 December 2004 for USD 9.37 billion to a sole bidder and newly incorporated entity called Baikal Finance Group, which was subsequently bought by Russian State-owned company Rosneft.

Claimants alleged that the Russian Federation first reported in March 2005 that it intended to 'push Yukos into bankruptcy in order to redistribute its remaining assets.' On 6 March 2006, a syndicate of foreign bank creditors of Yukos filed a bankruptcy petition before the Moscow Arbitrazh Court, pursuant to a confidential agreement with Rosneft. Yuganskneftegaz—then owned by Rosneft—filed a separate bankruptcy petition against

Yukos, which was subsequently joined to that of the bank syndicate. On 28 March 2006, bankruptcy proceedings were commenced against Yukos, placing it under so-called external supervision, and on 4 August 2006, Yukos was declared bankrupt.

Yukos' remaining assets were nearly all acquired by State-owned companies Gazprom and Rosneft, with the bankruptcy auctions raising a total of USD 31.5 billion. In November 2007, Yukos was liquidated and struck off the register of legal entities.

A central element of respondent's arguments was that claimants should have expected that the Russian Federation would react as it did to what it claimed to be violations of Russian tax law and jurisprudence in that field. The tribunal addressed this argument in the following way:

> In the view of the Tribunal, the expectations of Claimants may have been, and certainly should have been, that Yukos' tax avoidance operations risked adverse reaction from Russian authorities. It is common ground between the Parties that Yukos and its competitors viewed positions taken by the tax authorities on issues of tax liability to be exigent, erratic and unpredictable. The Tribunal however is unable to accept that the expectations of Yukos should have included the extremity of the actions which in the event were imposed upon it. Not only did Mikhail Khodorkovsky not appear to expect to be arrested even after the arrest of Platon Lebedev, he and his colleagues surely could not have been expected to anticipate the rationale and immensity of the tax assessments and fines. They could not have been expected to anticipate that their legal counsel would labor under the disabilities imposed upon them. They could not have been expected to anticipate the sale of YNG for so low a price under such questionable circumstances. They could not have been expected to anticipate that more than thirteen billion dollars in unpaid taxes and fines would be imposed on Yukos for unpaid VAT on oil exports when that oil had in fact been exported. They could not have been expected to anticipate that they risked the evisceration of their investments and the destruction of Yukos.[582]

Earlier in the award, the tribunal had found that the primary objective of the respondent had not been to collect taxes, but rather to bankrupt Yukos and appropriate its valuable assets.[583]

The tribunal further explained that:

> if the true objective were no more than tax collection, Yukos, its officers and employees, and its properties and facilities, would not have been treated, and mistreated, as in fact they were. Among the many incidents in this train of mistreatment that are within the remit of this Tribunal, two stand out: finding Yukos liable for the payment of more than 13 billion dollars in VAT in respect of oil that had been exported by the trading companies and should have been free of VAT and free of fines in respect of VAT; and the auction of YNG at a price that was far less than its value. But for these actions, for which the Russian Federation for reasons set out above and in preceding chapters was responsible, Yukos would have been able to pay the tax claims of the Russian Federation justified or not; it would not have been bankrupted and liquidated (unless the Russian Federation were intent on its liquidation and found still additional grounds for achieving that end, as the second criminal trial of Messrs. Khodorkovsky and Lebedev indeed suggests).[584]

In *Mamidoil v. Albania*,[585] the claimant argued that an indirect expropriation under Article 13 of the ECT had occurred as a result of four measures taken by the respondent: (i) regulatory changes introduced in 2000 in the form of a new Land Use Plan; (ii) pressure to relocate its newly built tank farm in 2000; (iii) adoption of a decree dated 25 July 2007

[582] Award, at para. 1578. [583] Award, at para. 756. [584] Award, at para. 1579.
[585] *Mamidoil Jetoil Greek PetroleumProducts Societe S.A. v. The Republic of Albania*, Award dated 30 March 2015.

prohibiting the discharge of fuel tanks in the port of Durres which entered into force in July 2009; and (iv) refusal to renew a trading licence at the end of 2010.

The tribunal did not agree with claimant.

As to the new Land Use Plan, the tribunal noted that its execution was part of an overall transport sector policy of which the claimant was aware when it started to build the tank form.[586]

Concerning the pressure referred to by the claimant, the tribunal found that the order to stop the construction was rather a starting point for negotiations between the parties.[587]

Neither of the two measures mentioned above thus formed part of an indirect expropriation in the view of the tribunal. Nor did the closing down of the port of Durres. The tribunal was convinced that this measure formed part of respondent's policy of re-orientation and re-zoning of the port of Durres of which the claimant was aware when it started to invest in the tank farm.[588]

With respect to the application for renewal of claimant's trading licence, the tribunal noted that the claimant itself had decided not to apply for a new licence. Therefore, this circumstance could not form part of an indirect expropriation.[589]

The tribunal concluded that the measures complained of did not result in claimant losing 'any of the attributes of its property over the investment. Claimant remained entitled to continue to use, posses, control and dispose of the property.'[590]

In *Charanne v. Spain*,[591] the claimants argued that the new regulatory scheme introduced by Spain had a substantial negative impact on the profitability of the business of T-Solar, the locally incorporated entity, such that the impact on the economic value of the investment constituted indirect expropriation. The claimants remained shareholders of the company T-Solar Group which continued to operate and to make a profit after the new regulatory scheme had been introduced. Against this background, the tribunal concluded:

> The Arbitral Tribunal is of the opinion that, although the profitability of T-Solar could have been seriously affected, such impact is not in itself sufficient to amount to an expropriation. The Claimants' reasoning would lead to the conclusion that any measure affecting profitability of a company could be considered an expropriation by the mere fact that it entails a decrease in profits and, therefore, in value. This, of course, cannot be the case. For a measure to be considered as equivalent to an expropriation, its effects must be of such a significance that it could be considered that the investor has been deprived, in whole or in part, of its investment. A simple decrease in the value of the shares constituting the investment cannot constitute an indirect expropriation, unless the loss of value is such that it can be considered equivalent to a deprivation of property.[592]

The tribunal noted that, according to the calculations presented by the claimant, profitability had decreased and that such reduction in profitability had serious economic and financial consequences. In the view of the tribunal, the reduction was not of such

[586] Ibid., at para. 574. [587] Ibid., at paras. 544, 575. [588] Ibid., at para. 578.
[589] Ibid., at paras. 555–6. [590] Ibid., at para. 579.
[591] *Charanne B.V. and Construction Investments S.A.R.L. v. Spain*, Award dated 21 June 2016.
[592] Ibid., at para. 465.

significance, however, so as to destroy the value of the investment. Therefore, the tribunal concluded, the disputed measures did not have effect tantamount to an expropriation.[593]

In *Isolux v. Spain*[594] the facts were similar to those in *Charanne v. Spain*. Also the claimant's argument were similar. The tribunal concluded that no expropriation had occurred, since the profitability of the plants as per the valuation date, using the internal rate of return as the benchmark, was higher—7.19%—than the calculated internal rate of return as per the date of the investment which was 6.19%. In reaching this conclusion the tribunal relied on calculations made by respondent's experts using the calculation methods of claimant's experts.[595]

In *Blusun v. Italy*[596] concerning photovoltaic plants in Italy, the tribunal found that measures taken by respondent did not amount to expropriation. The measures affected rights which locally incorporated companies had acquired for the development of the project in question which essentially consisted in joining approximately 120 photovoltaic plants to each other and to two stations for connection to the national grid. The rights concerned ownership of land, construction permits, and permits for connecting the plants to the local grid. Subsequent to regulatory changes and commercial and financial complications the project was abandoned.

The tribunal explained its conclusion in the following way:

> In the circumstances, the Claimants have not established that any part of the investment was subject to expropriation or a situation tantamount thereto, contrary to Article 13 of the ECT. The Claimants never lost title to the land which was qua agricultural land an asset of Eskosol's insolvency. The premium paid for the land was at the Claimants' risk and was not opposable to Italy. In a context in which Blusun's failure to construct the plants or to connect them to the grid was due to its own investment decisions, notably its failure to attract adequate finance, Italy should not be required to pick up the tab for Blusun's failures. To put it in other terms, Blusun had no right or legitimate expectation to the enhanced value of the land on the footing that the Project would succeed. This conclusion makes it unnecessary to determine whether changes in planning regulations involving the use to which agricultural land can be put are merely regulatory in any event.
>
> The point can be made in another way. Blusun acquired agricultural land at a substantial overprice. At all times it was aware of what it had to do to unlock the extra value in the land, i.e. to construct the plants and connect them to the grid within applicable time limits. It failed to comply with those conditions. Even if one were to hold, hypothetically, that the reduction of land available for power generation from a ratio of 50% to one of 10% did amount to an indirect expropriation of that fraction of the land thereby rendered useless for the Project, the value to be attributed to the land is the value it continued to have - i.e. the value of unimproved agricultural land as at the date of the Romani Decree. That value did not change: since any additional losses were at the claimants' own risk they are not recoverable under Article 13.[597]

[593] Ibid., at para. 466. In the reduced version of the award which is publicly available, the profit levels are left out.

[594] *Isolux Infrastructure Netherlands B.V. v. Kingdom of Spain*, Award dated 12 July 2016.

[595] Ibid., at paras. 850–2.

[596] *Blusun S.A. and others v. Italy*, Award dated 27 December 2016.

[597] Ibid., at paras. 407–8 (footnote omitted). The dissenting arbitrator found that the land and use restriction amounted to an indirect expropriation. In his view the restriction may have had a significant impact on the failure of the project. Damages should therefore be awarded corresponding—at a minimum—to the lost incremental value of the land.

In *Novenergia v. Spain*,[598] the claimant argued that respondent breached Article 13 of the ECT. The tribunal denied the expropriation claim. It took the view that the measures complained of did not have an expropriatory intent, nor effect and that the measures 'left unaffected the claimant's proprietary rights'.[599] It noted that while the challenged measures affected the value of the investments, the measures did not have the effect equivalent to an expropriation.[600]

Also in *Greentech v. Spain*,[601] claimants raised an expropriation clause. The tribunal denied the claim noting initially that the case did not concern a nationalization or direct expropriation since the claimants were not deprived of the legal title to the photovoltaic facilitates in question.[602]

The tribunal confirmed that the standard for indirect expropriation requires a substantial deprivation of the use, benefit or value of the investment.[603] Whilst recognizing that the claimants had suffered serious financial losses as a consequence of the challenged measures, this was not enough to constitute indirect expropriation.[604]

b. Lawful and Unlawful Expropriation

In *Kardassopoulos v. Georgia*,[605] the claimants contended that the expropriation was unlawful, since Georgia had breached all the criteria for a lawful expropriation listed in Article 13(1) of the ECT.[606]

It was undisputed that Georgia had not paid any compensation to the claimants. Respondent argued that this fact alone did not make the expropriation unlawful. The tribunal did not squarely address this argument, since it found that the respondent had breached one of the other criteria for a lawful expropriation, *viz.*, due process.[607]

With respect to the public purpose criterion, the tribunal found—after having listened to both fact and expert industry witnesses—that the expropriation had been carried out for a public purpose. It noted that 'the development of Georgia's oil pipeline infrastructure was of crucial national importance to the country's political independence in the region and its economic development'.[608]

The tribunal also found that the expropriation had not been discriminatory. In the view of the tribunal, the Georgian government had not discriminated against Tramex and Mr. Kardassopoulos as foreign investors, but rather struck a better deal with another foreign investor, when GIOC—having obtained GTIs rights—signed an agreement with AIOC.[609]

As regard to the due process requirement, the tribunal concluded that respondent had failed to ensure that there was a procedure in place which allowed Mr. Kardassopoulos to have his claims heard within a reasonable period of time. The tribunal continued:

> Rather, contrary to several elements which may be considered to form part of the due process obligation, such as reasonable advance notice and a fair hearing, the expropriation of Mr. Kardassopoulos' rights was carried out in a manner that can at best be described as opaque. This is best illustrated by the documentary and oral evidence discussed as part of the factual matrix above, which underscores the Georgian Government's role in the events that led to squeezing the Claimants out of the investment picture once AIOC bad entered the region. While the evidence indicates that AIOC had some reservations about embracing the Claimants within their corporate structure or ceding control to them on a long-term basis, the evidence is equally clear that if the Georgian Government

[598] See note 116, *supra.* [599] Ibid., at para. 761. [600] Ibid., at para. 762.
[601] See note 145, *supra.* [602] Ibid., at para. 427. [603] Ibid., at para. 429.
[604] Ibid., at para. 480. [605] See note 564, *supra.* [606] See p. 275 *et seq.*, *infra.*
[607] *Kardassopoulos v. Georgia*, Award dated 3 March 2010, at para. 390.
[608] Ibid., at para. 390. [609] Ibid., at para. 393.

had confirmed the existence and validity of the Claimants' rights in the early oil pipeline, AIOC would have taken the Claimants' presence seriously. Although AIOC repeatedly sought clarification from Georgia of the Claimants' status in Georgia they were assured that no conflict existed.[610]

The tribunal then went on to describe the process by which Georgia expropriated the investment, and concluded:

Viewed in its totality, the process by which the Respondent took GTI's rights, and thereby expropriated Mr. Kardassopoulos' investment, cannot by any definition be considered to have been carried out under due process of law. Moreover, the Respondent's failure to grant Mr. Kardassopoulos a reasonable chance within a reasonable time to have his claims heard following the expropriation of his investment unquestionably, in the eyes of the Tribunal, falls short of what is required by this criterion. Accordingly, the Tribunal determines that the expropriation of Mr. Kardassopoulos' investment was carried out in breach of Article 13(1) of the ECT.[611]

In the *Yukos* cases, claimants took the view that respondent had not fulfilled any of the requirements for a lawful expropriation under Article 13(1) of the ECT. With respect to public purpose, the claimants argued that the facts 'unmistakably show that the actions of the Russian Federation had nothing to do with the legitimate exercise of sovereign power, whether taxation, law enforcement or otherwise, but were rather a blatant confiscation of strategic assets and the elimination of a potential political opponent.'[612]

Respondent, on the other hand, argued that no lack of public interest had been established. It contended that the taxation measures were legitimate 'and firmly recognized in international law.'[613]

Respondent also argued that claimants had failed to establish discrimination under Article 13(1)(b) of the ECT, since they had not argued discrimination based on foreign ownership or residence which is the proper test. The selective tax enforcement was not discriminatory under the ECT, in the view of respondent.

Respondent went on to say that Yukos 'was a visible and logical candidate for tax assessments, penalties, and enforcement actions' as its abuses of the low-tax region policy were particularly egregious and the amounts of taxes it evaded unprecedented. Other Russian oil companies, argued Respondent, cannot be compared. Some companies, such as Rosneft, Tatneft, and Surgutneftegaz did not resort to tax minimization schemes involving the use of low-tax regions. While some other companies, such as Lukoil, did use such schemes, they abandoned them much earlier than Yukos. Other companies, which continued to rely on the low-tax regions programme, for example Sibneft, satisfied the 'proportionality of investments requirement of the Russian anti-avoidance rules'. Finally, respondent said, tax arrears, default interest and fines were in fact assessed against some companies, including TNK-BP, Sibneft, and Lukoil.[614]

Respondent also denied any violation of due process.

The arbitral tribunal found that the requirements under Article 13(1) had not been met by the Russian Federation. The tribunal gave the following explanations:

As to condition (a), whether the destruction of Russia's leading oil company and largest taxpayer was in the public interest is profoundly questionable. It was in the interest of the largest State-owned oil company, Rosneft, which took over the principal assets of Yukos virtually cost-free, but that is not the same as saying that it was in the public interest of the economy, polity and population of the Russian Federation.

[610] Ibid., at para. 397. [611] Ibid., at para. 404. [612] Ibid., at para. 1565.
[613] Ibid., at para. 1569. [614] Award at para. 1571 (footnotes omitted).

As to condition (b), the treatment of Yukos and the appropriation of its assets by Rosneft (and to a much lesser extent, another State-owned corporation, Gazprom, when compared to the treatment of other Russian oil companies that also took advantage of investments in low-tax jurisdictions, may well have been discriminatory, a question that was inconclusively argued between the Parties and need not be and has not been decided by this Tribunal.

As to condition (c), Yukos was subjected to processes of law, but the Tribunal does not accept that the effective expropriation of Yukos was 'carried out under due process of law' for multiple reasons set out above, notably in Section VIII.C.3. The harsh treatment accorded to Messrs. Khodorkovsky and Lebedev remotely jailed and caged in court, the mistreatment of counsel of Yukos and the difficulties counsel encountered in reading the record and conferring with Messrs. Khodorkovsky and Lebedev, the very pace of the legal proceedings, do not comport with the due process of law. Rather, the Russian court proceedings, and most egregiously, the second trial and second sentencing of Messrs. Khodorkovsky and Lebedev on the creative legal theory of their theft or Yukos' oil production, indicate that Russian courts bent to the will of Russian executive authorities to bankrupt Yukos, assign its assets to a State controlled company, and incarcerate a man who gave signs of becoming a political competitor.

As to condition (d), what in any event is incontestable is Respondent's failure to meet its prescription, because the effective expropriation of Yukos was not 'accompanied by the payment of prompt, adequate and effective compensation', or, in point of fact, any compensation whatsoever. In order for the Russian Federation to be found in breach of its treaty obligations under Article 13 of the ECT, the foregoing violations of the conditions of Article 13 more than suffice.[615]

c. Compensation

aa. Valuation Date

In *Kardassopoulus v. Georgia*[616] the tribunal, referring to the principles laid down in the *Chorzow Factory* case, noted that in certain circumstances when an unlawful expropriation has occurred, it is necessary to award damages as per the date of the arbitral award.[617] This would, for example, be the case if the investment had gained in value between the date of expropriation and the date of the award, and if the investor would have retained the investment, but for the expropriation.[618]

The tribunal concluded however, that, in the circumstances, the valuation date was the date of the expropriation. The tribunal said the following:

The evidence on the record indicates that the Claimants would likely have sold their shares in GTI to AIOC (or a member of AIOC) in 1995 had Georgia affirmed the Claimants' rights. The Claimants appear to concede this proposition, although they argue that it is a conservative scenario [see Kaczmarek I, para. 127]. This is precisely the outcome they sought, however, in entering into negotiations with Velt Energie and United Perlite. While the Claimants may have preferred to remain in the game in some capacity, the record confirms that selling their shares in the GTI project would have been an entirely acceptable outcome, assuming a fair price for those shares could be obtained.

Moreover, regardless of the Claimants' preference to retain some interest in the Gachiani-Supsa pipeline, the oral evidence of Mr. Adams suggests that AIOC's shareholders would have viewed their presence as an irritant, being a very small company on the scale of the consortium and not having any technical expertise, and sought to negotiate the purchase of their shares in the pipeline rather than work together [Tr. D9:97–101]. This is confirmed by both industry experts, Mr. Beazley [Tr. D10:7 1] and Mr. Effimoff [Tr. D10: 127], who expressed the view that had the Georgian Government confirmed GTI's rights AIOC would likely have sought to negotiate with Tramex and purchase its interest in GTI outright.[619]

[615] Ibid., at paras. 1581–4.
[616] *Kardassopoulus v. Georgia*, Award dated 3 March 2010.
[617] Ibid., at para. 514. [618] Ibid. [619] Ibid., at paras. 515–16.

The valuation date chosen by the tribunal was 10 November 1995, i.e. one day before the adoption of Decree No. 477 which had preceded Decree No. 178 which in turn had effected the expropriation, so as to avoid any diminution of value of the investment due to the conduct of the State.[620]

In the *Yukos* cases[621] the situation was more complicated. Initially the tribunal had to determine the date of expropriation of the investment and also whether the claimants had the right to choose between the date of expropriation and the date of the award as the basis for the valuation.

With respect to the date of expropriation, claimants had suggested 21 November 2007, which was the date on which Yukos was deleted from the Russian register of companies. The tribunal was of the view, however, that the expropriation occurred earlier. It found that a substantial and irreversible deprivation of claimants' assets had occurred on 19 December 2004 when Yuganskneftegaz was sold at an auction.[622]

As regards the right of the claimants to choose the valuation date, the tribunal concluded that in the case of unlawful expropriations, as in the case before it, claimants are entitled to choose between the expropriation date and the date of the award. The tribunal gave the following explanation:

> In the view of the Tribunal, and in exercise of the latitude that the terms of Article 13 of the ECT afford it in this regard, the question of whether an expropriated investor is entitled to choose between a valuation as of the expropriation date and the date of an award is one best answered by considering which party should bear the risk and enjoy the benefits of unanticipated events leading to a change in the value of the expropriated asset between the time of the expropriatory actions and the rendering of an award. The Tribunal finds that the principles on the reparation for injury as expressed in the ILC Articles on Stale Responsibility are relevant in this regard. According to Article 35 of the ILC Articles, a State responsible for an illegal expropriation is in the first place obliged to make restitution by putting the injured party into the position that it would be in if the wrongful act had not taken place. This obligation of restitution applies as of the date when a decision is rendered. Only to the extent where it is not possible to make good the damage caused by restitution is the State under an obligation to compensate pursuant to Article 36 of the ILC Articles on State Responsibility.
>
> The consequences of the application of these principles (restitution as of the date of the decision, compensation for any damage not made good by restitution) for the calculation of damages in the event of illegal expropriation are twofold. First, investors must enjoy the benefits of unanticipated events that increase the value of an expropriated asset up to the date of the decision, because they have a right to compensation in lieu of their right to restitution of the expropriated asset *as of that date*. If the value of the asset increases, this also increases the value of the right to restitution and, accordingly, the right to compensation where restitution is not possible.
>
> Second, investors do not bear the risk of unanticipated events decreasing the value of an expropriated asset over that time period. While such events decrease the value of the right to restitution (and accordingly the right to compensation in lieu of restitution), they do not affect an investor's entitlement to compensation of the damage 'not made good by restitution' within the meaning of Article 36(1) of tile ILC Articles on State Responsibility. If the asset could be returned to the investor on the date where a decision is rendered, but its value had decreased since the expropriation, the investor would be entitled to the difference in value, the reason being that in the absence of the expropriation the investor could have sold the asset at an earlier date at its previous higher value. The same analysis must also apply where the asset

[620] Ibid., at para. 517. [621] See note 580, *supra.* [622] *Yukos*, at para. 1762.

cannot be returned, allowing the investor to claim compensation in the amount of the asset's higher value.[623]

ab. Valuation Methodology

In *Kardassopoulus v. Georgia*, the tribunal was dealing with an unlawful expropriation and was thus required to determine compensation which would, as far as possible, wipe out all consequences of the unlawful act and re-establish the situation which would in all probability have existed if that act had not been committed.

In valuing the claimants' 50% interest in GTI's rights, the tribunal accepted the income and market approaches suggested by the claimants.[624]

The tribunal had the benefit of having available to it three arm's length contemporaneous transactions, or potential transactions ,all of which indicated a value in more or less, the same range—USD 28.1 million—USD 30.6 million.[625] The first comparable was a leasing transaction concerning the rights and assets associated with the pipeline to AIOC.[626] The second comparable was an offer extended by an oil service company to buy a 25% stake in GTI.[627] The third comparable was an offer from two companies to buy claimants' interest in GTI.[628] Based on these three comparables, weighted and adjusted, the tribunal concluded that each of the claimants was entitled to damages in the amount of USD 15.1 million.[629]

In the *Yukos* cases[630] the tribunal decided that claimants had the right to choose between the valuation as per the date of expropriation, 19 December 2014, and the date of the award. The tribunal decided that the date of the award was to be 30 June 2014, for calculation purposes.[631]

The tribunal thus had to determine the amount of damages as per each valuation date.

The tribunal noted that the claimants were entitled to damages with respect to the value of their shares in Yukos; the value of the dividends that would have been paid to the claimants up to the valuation date, but for the expropriation; and pre-award simple interest on those amounts.[632]

The tribunal initially noted that it was going to exclude two factors on which the claimants had relied in their calculation, i.e. a potential listing of Yukos on the New York Stock Exchange and the potential effects of a completed merger between Yukos and Sibneft. These two factors were viewed as too uncertain and speculative.[633]

With respect to the *valuation of Yukos*, the tribunal decided to use a corrected version of the comparable companies' method. The claimants had also relied on DCF calculations as well as on comparable transactions. In the view of the tribunal, claimants' DCF calculations were not reliable, and the parties agreed that there were in fact no comparable transactions.[634]

Using the comparable companies' method, with adjustment based on respondent's expert's comments, the tribunal found that the equity value of Yukos as per 21 November 2007 was approximately, USD 61, 076 billion.[635]

[623] Ibid., at paras. 1766–8.
[624] For a discussion of the income and market approaches, see p. 277 *et seq.*, *supra.*
[625] Ibid., at para. 598.
[626] Ibid., at para. 544–52.
[627] Ibid., at para. 553–61.
[628] Ibid., at para. 562–6.
[629] Ibid., at para. 645.
[630] See note 580, *supra.*
[631] Ibid., at para. 1777.
[632] Ibid., at para. 1778.
[633] Ibid., at paras. 1779–80.
[634] Ibid., at para. 1785.
[635] Ibid., at para. 1783.

The next step for the tribunal was to adjust the value as per 21 November 2007 (the expropriation date suggested by the claimants) to the value as per 19 December 2004, which was the expropriation date determined by the tribunal. To make this adjustment the tribunal used the RTS Oil and Gas index. It multiplied the value as per November 2007 (USD 61,076 billion) by a factor reflecting changes in the RTS Oil and Gas index between 21 November 2007 and the two valuation dates.[636] By applying this adjustment factor, the tribunal found that the equity value of Yukos as per 19 December 2004 was USD 21, 176 billion[637] and as per 30 June 2014, USD 42,625 billion.[638]

As regards the *valuation of lost dividends*, the tribunal explained that it had to determine the value of lost dividends as per each valuation date, 'since the value of Yukos as of that date, while it captures the expectations of future profit, does not capture any of the past profit the company would likely have generated.'[639]

In calculating lost dividends, the tribunal used claimants' calculations of the lost cash flows of Yukos. It did, however, adjust and supplement the numbers provided by the claimants. Applying the model used by the claimants' expert to these numbers resulted in a total amount of lost dividends of USD 67.213 billion.[640]

The tribunal came to the conclusion that it had to modify the calculation made by the claimants, due account taken primarily of comments and criticisms presented by respondent's expert. For example, adjustments were made to take adequate account of the real risk of substantially higher taxes which would negatively affect Yukos' cash flows.[641] Adjustments were also made referring to the 'risks associated with the complex and opaque structure set up by claimants, or by others on their behalf, in order to transfer money earned by Yukos out of Russian Federation through a vast offshore structure.'[642]

Taking all these factors into account, and exercising its discretion, the tribunal concluded that Yukos dividends in 2004 would have been USD 2.5 billion, and from 2004 through the first half of 2014 USD 45 billion.[643]

As per the valuation date of 19 December 2004, the total amount of lost dividends was USD 2.418 billion[644] and as per 30 June 2014, USD 45 billion.[645]

With respect to *interest*, the tribunal used a 3.389% annual rate which resulted in a total amount of interest payable on the equity value of Yukos between 1 January 2005–30 June 2014 of USD 7.596 billion.[646]

Calculation of interest on dividends as per 30 June 2014 resulted in a total interest amount of USD 6.981 billion.[647]

It follows from the foregoing that damages based on a valuation date of 30 June 2014 were higher than calculations as per 19 December 2004. The higher amount was thus awarded to the claimants.

ac. Interest

In *Kardassopoulus v. Georgia*,[648] the tribunal awarded pre-award interest at the rate of LIBOR + 4%.

In doing so, the tribunal referred to the interest rate referred to in the Pipeline Construction and Operating Agreement as the best indicator of a fair commercial rate.[649]

[636] Ibid., at para. 1788–9.
[637] Ibid., at para. 1815.
[638] Ibid., at para. 1821.
[639] Ibid., at para. 1791.
[640] Ibid., at para. 1797.
[641] Ibid., at paras. 1805–7.
[642] Ibid., at paras. 1808–10.
[643] Ibid., at para. 1812.
[644] Ibid., at para. 1817.
[645] Ibid., at para. 1823.
[646] Ibid., at para. 1818.
[647] Ibid., at para. 1823.
[648] See note 564, *supra.*
[649] Ibid., at para. 661.

The tribunal also awarded compound interest. It explained its decision in the following way:

> Simple interest has the great advantage of simplicity; but it is often a simplicity combined with arbitrariness. When the question is, what amount has the Claimant lost by being wrongly denied payment of a sum on a certain date in the past, in circumstances where the Claimant could have invested an equivalent sum, or could only have borrowed an equivalent sum, on terms of compound interest, the award of compound interest is appropriate. The Tribunal takes the view that an award of compound interest is appropriate in this case. In so finding, it takes comfort in the principles articulated in Santa Elena, which apply equally here:
>
> '[W]hile simple interest tends to be awarded more frequently than compound, compound interest certainly is not unknown or excluded in international law. No uniform rule of law has emerged from the practice in international arbitration as regards the determination of whether compound or simple interest is appropriate in any given case. Rather, the determination of interest is a product of the exercise of judgment, taking into account all of the circumstances of the case at hand and especially considerations of fairness which must form part of the law to be applied by the Tribunal.'[650]

The parties were in agreement as to the starting date for calculating interest, *viz.*, 20 February 1996, which was the date when the expropriation of Mr. Kardassopoulos' investment crystallized.[651]

Presumably exercising its discretion, the tribunal decided to compound the interest on a semi-annual basis using the six-month term LIBOR rate for US dollars deposits published by the Wall Street Journal.[652]

As regards post-award interest, the tribunal did not see any reason to depart from its decision concerning pre-award interest. It thus ordered the same post-award interest, as from the date of the award until full payment of the award.[653]

In the *Yukos* cases[654] the tribunal initially noted that it had a wide margin of discretion in determining the rate of interest as well as whether interest should be simple or compound.[655]

After having rejected several possible interest rates, the tribunal 'in the exercise of its discretion' decided that it would be appropriate to use a rate based on ten year U.S. treasury rates.[656]

It used the average yield of ten-year U.S. Treasury bonds during the period 1 January 2005–30 May 2014 which it had calculated to be 3.389%.[657]

With respect to the question whether interest should be simple or compounded, the tribunal found that 'in the circumstances of this case, it would be just and reasonable' to award simple pre-award interest and compound post-award interest, compounded on an annual basis.[658]

Respondent was granted a grace period of 180 days following the date of the award before any post-award interest would start to accrue.[659]

No pre-award interest was granted on the value of the shares in Yukos, since they were to be valued as per the date of the award.

ad. Causation, Contributory Negligence and Mitigation

The question of *causation* was addressed by the tribunal in *Kardassopoulos v. Georgia*.[660]

[650] Ibid., at para. 664 (footnotes omitted). [651] Ibid., at para. 663.
[652] Ibid., at para. 668. [653] Ibid., at paras. 677–8. [654] See note 580, *supra.*
[655] Ibid., at para. 1678. [656] Ibid., at para. 1685. [657] Ibid., at para. 1687.
[658] Ibid., at para. 1689. [659] Ibid., at para. 1691. [660] See note 564, *supra.*

The respondent argued that claimants had failed to prove that the conduct of the State had caused the losses of claimants. In particular respondent argued that claimants had failed to establish that, but for Georgia's conduct, (i) Tramex/GTI would have been able to construct and/or operate the Gachiani-Supra Pipeline or the Future Pipelines and to derive profits therefrom; (ii) Tramex/GTI would have been able to stand in GOGC's shoes and receive all of the transit fees that the claimants seek; or (iii) the claimants would have recovered unspecified damages by pursuing claims against AIOC, SakNavtobi, and Transneft through either litigation or arbitration.[661]

The tribunal noted that Article 31 of the ILC Articles on State Responsibility requires a State to make full reparation for injury caused by an internationally wrongful act, and that this requirement means that there must be a sufficient causal link between the wrongful act and its consequences.

Turning to the case before it, the tribunal said:

> In this case, the failure to provide adequate compensation following adoption of Decree No. 178, which had directly and deliberately caused the loss of GTI's rights and, at the same time, the loss of the Claimants' entire investment in Georgia, is a clear violation of the Respondent's duties towards the Claimants. There is no question of remoteness or foreseeability of damage here—the loss that Mr. Kardassopoulos suffered was a direct and foreseeable consequence of the process that began with the establishment of GIOC, through Decree No, 477, and culminated in the cancellation of GTI's rights in favour of GIOC, pursuant Decree No. 178. As a matter of international law, this should have been followed by the payment of compensation, but it was not. Similarly, the loss that Mr. Fuchs sustained through breach of the FET provision in the Georgia/Israel BIT was a direct and foreseeable consequence of the Georgian Government's conduct throughout the compensation commission process, culminating in the denial of any relief in 2004.[662]

In the *Yukos* cases[663] with respect to *causation*, the respondent argued that the claimant had to prove that all acts complained of constituted treaty violations. The tribunal did not agree.

It concluded that the claimants had in fact shown that a series of actions of the Russian Federation—in particular the 2000–4 tax assessments against Yukos and the enforcement measures, including the sale of Yuganskneftegaz—constituted an expropriation of claimants' investment and that the expropriation caused claimants damage. Against this background, it was not necessary to establish that other actions may, or may not, have contributed to a treaty violation.[664]

The respondent also argued that the concurrent conduct by it, or a third party, which is not wrongful and which has caused damage should exclude any responsibility of respondent. Again, the tribunal did not agree. Referring to Article 31 of the ILC Articles on State Responsibility, and its commentary, the tribunal said:

> As the commentary makes clear, the mere fact that damage was caused not only by a breach, but also by a concurrent action that is not a breach does not, as such, interrupt the relationship of causation that otherwise exists between the breach and the damage. Rather, it falls to the Respondent to establish that a particular consequence of its actions is severable in causal terms (due to the intervening actions of Claimants or a third party) or too remote to give rise to Respondent's duty to compensate.[665]

This the respondent had failed to do.

[661] Ibid., at para. 454.
[662] Ibid., at para. 469.
[663] See note 580, *supra.*
[664] Ibid., at para. 1772.
[665] Ibid., at para. 1775.

The *Yukos* tribunal also addressed the question of *contributory negligence*. The respondent referred to twenty-eight instances where it alleged that claimants conducted themselves in an illegal and bad faith manner and which contributed to Yukos's situation. The tribunal rejected most of them, but there remained four instances of alleged willful and negligent conduct by claimants which potentially constituted contributory negligence:

1) Yukos' conduct in some of the low-tax regions;
2) Yukos' use of the Cyprus-Russia double taxation treaty;
3) Yukos' conduct in connection with the auction of Yuganskneftegaz, notably the procuring of a Temporary Restraining Order by a Texas court and the published threat of a 'lifetime of litigation'; and
4) Yukos' conduct in connection with its bankruptcy, notably the non-payment of a certain Loan.[666]

In dealing with the issue of contributory negligence, the tribunal referred to Article 39 of the ILC Articles on State Responsibility, which reads:

> In the determination of reparation, account shall be taken of the contribution to the injury by willful or negligent action or omission of the injured State or any person or entity in relation to whom reparation is sought.

The tribunal also reviewed decisions of other investor-state tribunals having addressed the issue of contributory negligence. On the basis of this review, the tribunal came to three conclusions:

> Firstly, the legal concept of contributory fault must not be confused with the investor's duty to mitigate its losses. There are cases where the claimant's damages were reduced because the tribunal found that it failed to take some reasonable steps to minimize its losses. In such cases, 'the injured Party must be held responsible for its own contribution to the loss.
>
> Secondly, there are cases where the contributory fault of the investor, while it may have increased the loss which it sustained, was unrelated to the wrongdoing of the State. The fault of the investor in those cases contributed to the losses which flowed from the wrongful act of the State.
>
> Finally, the Tribunal identified certain decisions where the tribunals found that the victim contributed to the State's wrongful conduct. The contributory' fault of the investor in those cases provoked the wrongful conduct of the State.'[667]

Based on its review of the four instances mentioned above, the tribunal concluded that Yukos had abused some of the low-tax regions and engaged in questionable use of the Cyprus-Russia double taxation agreement and that this contributed in a material way to the injury suffered by the claimants.[668]

In determining the extent to which the conduct of the claimants had contributed to their injury, the tribunal said:

> Having considered and weighed all the arguments which the Parties have presented to it in respect of this issue the Tribunal, in the exercise of its wide discretion, finds that, as a result of the material and significant mis-conduct by Claimants and by Yukos (which they controlled), Claimants have contributed to the extent of 25 percent to the prejudice which they suffered as a result of Respondent's destruction of Yukos. The resulting apportionment of responsibility as

[666] Ibid., at para.1608. [667] Ibid., at paras. 1603–5. [668] Ibid., at para.1634.

between Claimants and respondent, namely 25 percent and 75 percent, is fair and reasonable in the circumstances of the present case.[669]

The Yukos tribunal also dealt with *mitigation*. Respondent argued that claimants could have mitigated their damages by taking the following measures in the first quarter of 2004: paying the taxes assessed against it; filing amended tax returns for the years 2000–2; and filing a tax return for 2003 recognizing all of Yukos' income without assigning it to its trading entities.[670]

The tribunal concluded, however, that the suggested measures would not have made a difference at the end of the day since 'the measures taken by the Russian Federation demonstrate that its primary objective was to bankrupt Yukos and appropriate its assets and that it was determined to do whatever was necessary to achieve this purpose.'[671]

d. Compensation in Non-Expropriation ECT Awards

Article 10 of the ECT—as opposed to Article 13—does not have any express provisions regarding remedies or reparations for breaches of Article 10. In this situation tribunals will apply customary international law. Article 26(6) of the ECT[672] instructs tribunals to apply—in addition to the provisions of the Treaty—'applicable rules and principles of international law'.

It is generally accepted that a State is under an obligation to make full reparation for the damage caused by its internationally wrongly acts. This principle has been enshrined in the *Chorzow Factory* case,[673] and subsequently codified in the ILC Articles On State Responsibility, particularly in Article 31.[674]

It follows from Article 36 of the ILC Articles that the principle of full compensation includes historical losses as well as lost profits; the provision refers to 'any financially assessable damage including loss of profit insofar as it is established'. This wording clearly places the burden of proof on the party asking for compensation.

In all cases where ECT tribunals have found breaches of Article 10, they have relied on the *Chorzow Factory* case and/or on the ILC Articles when determining compensation.[675]

In *Nykomb v. Latvia*, the tribunal explained that it lacked information needed to make a proper analysis of Nykomb's damage. In the end it concluded that 'in the circumstances a discretionary award of one third of the estimated loss in purchase prices of electricity up to the time of this award' was a reasonable basis for calculating claimant's losses.[676]

In *Petrobart v. Kyrgyzstan*, the tribunal concluded that claimant was entitled to 75% of the damage it suffered by not being able to receive from KGM the amount awarded to Petrobart by the Bishkek Court.[677] Petrobart also claimed lost profits. The tribunal found, however, that there were too many uncertainties relating to the claim and consequently denied it.[678]

[669] Ibid., at para.1637. [670] Ibid., at para. 1776. [671] Ibid.
[672] For commentary on Article 26, see p. 414 *et seq.*, *infra.* [673] See p. 266 *et seq.*, *supra.*
[674] See p. 266 *et seq.*, *supra.*
[675] *Nykomb v. Latvia, supra* at note 554, pp. 38–42; *Petrobart v. Kyrgyzstan, supra* at note 557, pp. 77–88; *Al Bahloul v. Tajikistan, supra* at note 571, paras. 40–105; *Stati et al v. Kazakstan, supra* at note 56, paras. 1460–854; *Eiser v. Spain, supra* at note 100, paras. 441-478; *Novenergia v. Spain, supra* at note 116, paras. 803–43; *Masdar v. Spain, supra* at note 129, paras. 547–665; *Antin v. Spain, supra* at note 137, paras. 631–734; *Greentech v. Spain, supra* at note 145, paras. 433–546; *Greentech v. Italy, supra* at note 162, paras. 539–77.
[676] *Nykomb v. Latvia*, at pp. 40–1. [677] *Petrobart v. Kirgizistan*, at p. 85.
[678] Ibid., at pp. 86–7.

In *Bahloul v. Tajikistan*, the claimant asked for compensation for lost profits based on the DCF-method. The tribunal found that there were 'simply too many unsubstantialized assumptions to justify the application of the DCF-method.'[679] Whilst the tribunal found that respondent had breached Article 10 of the ECT, claimant was not awarded any compensation.

In *Stati et al v. Kazakhstan*, the tribunal noted initially that whilst it had found a breach of Article 10 of the ECT; but not of Article 13, the measures taken by respondent did eventually result in a taking of claimants' investment. Against this background the tribunal found that it could seek guidance from Article 13 concerning determination of compensation to the effect that damages to be awarded should not be lower than what the ECT prescribes with respect to lawful expropriation.[680]

The valuation date chosen by the tribunal—30 April 2009—was when the respondent's sequestration of claimants' shares in the locally incorporated companies occurred. It was only at that point that 'actual and permanent damage could be identified for the investments'.[681]

With respect to the valuation of the two oil fields in question, the parties and the tribunal were in agreement that the DCF-method was an appropriate method for calculating damages.[682]the tribunal was not entirely satisfied with the expert reports submitted by the parties. In the end, the tribunal relied on asset value based on a comparable transactions analysis performed by one of the financial experts.[683]

Claimants also asked for damages with respect to an oil exploration contract that Kazakhstan did not extend. The tribunal found that the expenses incurred by claimants were compensable, but that its claim for lost profit was not. In the view of the tribunal, claimants had not met their burden of proof.[684]

Claimants had been involved in building and developing an LPG plant. The project had been delayed end eventually discontinued by claimants. When it came to determine the damages for the plant, the tribunal relied on contemporaneous bids for the plant, rather than on calculations in expert reports nominated by the parties.[685]

In all the cases against Spain and Italy concerning renewable energy,[686] the arbitral tribunals have applied the principles of full compensation as laid down in the ILC Articles. Full compensation has been explained as compensation for the reduction of the fair market value of the investment by establishing the present value of cash flows lost because of the challenged measures.[687]

The principle of full compensation also covers historical losses. In most cases referred to above, the tribunal have rejected claims for compensation for such losses. These historical losses are alleged declines in revenues resulting from Spain's changes in the RD 661/2007 regulatory scheme introduced prior to June 2014 when that scheme was definitively replaced by the new so-called Specific Regime.

In one of the cases—*Masdar v. Spain*—the tribunal granted compensation for historical losses, the tribunal said this:

As set out above, Claimant's Lost Historical Cash Flows, which its damages expert quantifies in EUR 20 million, are undiscounted cash flows between January 2013 and 20 June 2014, calculated

[679] *Bahloull v. Tajikistan*, at para. 96. [680] *Stati et al v. Kazakhstan*, at paras. 1460–1.
[681] Ibid., at paras. 1496–7. [682] Ibid., at para. 1617. [683] Ibid., at paras. 1624–5.
[684] Ibid., at paras. 1686, 1690–2. [685] Ibid., at paras. 1746–8. [686] See note 680, *supra.*
[687] See e.g. *Eiser v. Spain*, at para. 441.

on the basis of both actual data and assumptions. In its written submissions, Respondent did not substantively engage with Claimant's claim for Lost Historical Cash Flows. Respondent's objections to Brattle's calculation of Claimant's Lost Historical Cash Flows were limited to general criticisms of Brattle's valuation method. A majority of the Tribunal has discussed—and rejected these objections—above.

More importantly, the economic regime established by Respondent between 6 and 20 June 2014 in RD413/2014 and Ministerial Order IET/1045/2014 had retroactive effect. In order to compensate Claimant for losses that it incurred, as a consequence of the retroactive application of RD413/2014 prior to the valuation date, the lost profits resulting from RD413/2014's regime must be taken into account.603 Not doing so would ignore a significant consequence of Respondent's wrongful conduct and fail to provide Claimant full compensation. [688]

When establishing the fair market value of the investments by calculating the present day value of future cash flows, the tribunals in the cases concerning renewable energy referred to above have used the DCF-method. Respondent's in these cases have usually argued that the DCF-method is generally an inappropriate valuation method, among other things because it is too speculative. Tribunals have nevertheless concluded that the DCF-method is appropriate in the circumstances of the case in question. In the words of the tribunal in *Novenergia v. Spain*:

However, the DCF-valuation is based on fundamental principles of economic and finance and is regarded by many as the preferred method for valuation of income-earning assets. The DCF-method is widely supported in professional literature, but more importantly, the method has been broadly accepted by numerous arbitral tribunals as 'the only method which can accurately track value through time' and 'the preferred method of calculating damages in cases involving the appropriation of or fundamental impairment of going concerns'. In the words of the *CMS v. Argentina* tribunal:

DCF techniques have been universally adopted, including by numerous arbitral tribunals, as an appropriate method for valuing business assets.[689]

When applying the DCF-method most tribunals in the Spanish cases have used 2014 as the valuation date, since that was the point in time at which Spain abolished the Special Regime and introduced the Specific Regime.[690]

In Greentech *v. Italy*, the tribunal found that the appropriate valuation date was 1 January 2015, which was the effective date of the Spalma-incentivi Decree which modified the incentive tariffs.[691]

Another critical element of the DCF-method in the renewable energy cases has been the operational life of the plants in question. Experts retained by the claimants have usually argued that the plants have an operational life of forty years. Experts retained by respondent have usually argued that the plants had design lives for twenty-five years, or less.[692] Most tribunals have used an operational life of twenty-five or thirty years when making their DCF-calculations.[693]

[688] *Masdar v. Spain, supra* note 100, at paras. 650–1 (footnotes omitted).

[689] *Novenergia v. Spain*, note 116, *supra*, at para. 818 (footnotes omitted); this approach was explicitly endorsed by the tribunal in *Greentech v. Spain*, note 145, *supra* , at para. 477.

[690] See p. 195 *et seq.*, *supra*, for a discussion of the Spanish regulatory scheme.

[691] *Greentech v. Italy*, note 162, *supra*, at para. 565; for a discussion of the Italian regulatory scheme, see p. 213 *et seq.*, *supra.*

[692] Cf. *Eiser v. Spain*, note 100, *supra*, at paras. 443–50.

[693] See e.g. *Eiser v. Spain*, at paras. 451–2; *Masdar v. Spain*, note 129, *supra*, at para. 618; *Antin v. Spain*, note 137, *supra*, at para. 714; *Greentech v. Spain*, at para. 517.

Yet another central aspect of the DCF-method is the discount rate to be used. Claimants have used varying discount rates. Spain has often argued that the risk would have been higher in the so-called 'but for' scenario and that therefore a higher discount rate should be used.[694] No tribunals seem to have accepted this argument. The tribunal in *Novenergia v. Spain* explained its position in the following way:

> However, it cannot be correct to assume a higher risk in a scenario where the regulatory framework of the RE sector would have remained stable and RD 661/2007 would have continued to remain in force as originally implemented. The facts of the case show that under the Special Regime, the Respondent managed to attract numerous investors to the tune of billions of euros, indicating that the risk was considered low. Conversely, under the Specific Regime, it is not reasonable to conclude that the risk is lower, especially considering that the current remuneration system is subject to periodic reviews and the turmoil that they have caused.[695]

As far as interest is concerned, rates have varied between 0.8% to 2.5%, mostly compounded on a monthly basis. Post-award interest has usually been slightly higher than pre-award interest.

E. Article 14: Transfers Related to Investments

(1) Each Contracting Party shall with respect to Investments in its Area of Investors of any other Contracting Party guarantee the freedom of transfer into and out of its Area, including the transfer of:
- **a) the initial capital plus any additional capital for the maintenance and development of an Investment;**
- **b) Returns;**
- **c) payments under a contract, including amortization of principal and accrued interest payments pursuant to a loan agreement;**
- **d) unspent earnings and other remuneration of personnel engaged from abroad in connection with that Investment;**
- **e) proceeds from the sale or liquidation of all or any part of an Investment; (f) payments arising out of the settlement of a dispute;**
- **f) payments of compensation pursuant to Articles 12 and 13.**

(2) Transfers under paragraph (1) shall be effected without delay and (except in case of a Return in kind) in a Freely Convertible Currency.

(3) Transfers shall be made at the market rate of exchange existing on the date of transfer with respect to spot transactions in the currency to be transferred. In the absence of a market for foreign exchange, the rate to be used will be the most recent rate applied to inward investments or the most recent exchange rate for conversion of currencies into Special Drawing Rights, whichever is more favourable to the Investor.

(4) Notwithstanding paragraphs (1) to (3), a Contracting Party may protect the rights of creditors, or ensure compliance with laws on the issuing, trading and dealing in securities and the satisfaction of judgements in civil, administrative and criminal adjudicatory proceedings, through the equitable, non-discriminatory, and good faith application of its laws and regulations.

(5) Notwithstanding paragraph (2), Contracting Parties which are states that were constituent parts of the former Union of Soviet Socialist Republics may provide in agreements concluded between them that transfers of payments shall be made in the currencies of such Contracting

[694] Cf. *Eiser v. Spain*, at para. 470. [695] *Novenergia v. Spain*, at para. 832.

Parties, provided that such agreements do not treat Investments in their Areas of Investors of other Contracting Parties less favourably than either Investments of Investors of the Contracting Parties which have entered into such agreements or Investments of Investors of any third state.

(6) Notwithstanding subparagraph (1)(b), a Contracting Party may restrict the transfer of a Return in kind in circumstances where the Contracting Party is permitted under Article 29(2)(a) or the WTO Agreement56 to restrict or prohibit the exportation or the sale for export of the product constituting the Return in kind; provided that a Contracting Party shall permit transfers of Returns in kind to be effected as authorised or specified in an investment agreement, investment authorisation, or other written agreement between the Contracting Party and either an Investor of another Contracting Party or its Investment

Transfer of payments—of dividends, earnings, capital and revenues—is an important feature of any foreign investment arrangement.

The risk of not being able to transfer funds connected with an investment is a significant disincentive for most foreign investors. Article 14 in essence creates a right for Investors to repatriate capital and earnings in a prompt and effective way.

The exchange rate applied must be market-based and if no market rate exists, an inward investment rate, or the rate used for IMF special drawing rights, must be used.

The guarantees set out in Article 14(1) must be read against the background of Decision 3 with respect to the Energy Charter Treaty. This decision grants CIS countries the right to apply restrictions on the movement of capital by its own investors. Such restrictions may not, however, impair the rights granted to foreign investors with respect to their investments. Whilst transfer restrictions could be applied in relation to a foreign subsidiary established in a CIS country, this is not allowed if the parent company of this subsidiary requests the transfer. Any such restrictions must not affect current transactions.

Decision 3 reads:

DECISION With respect to Article 14

(1) The term 'freedom of transfer' in Article 14(1) does not preclude a Contracting Party (hereinafter referred to as the 'Limiting Party') from applying restrictions on movement of capital by its own Investors, provided that:
   (a) such restrictions shall not impair the rights granted under Article 14(1) to Investors of other Contracting Parties with respect to their Investments;
   (b) such restrictions do not affect Current Transactions; and
   (c) the Contracting Party ensures that Investments in its Area of the Investors of all other Contracting Parties are accorded, with respect to transfers, treatment no less favourable than that which it accords to Investments of Investors of any other Contracting Party or of any third state, whichever is the most favourable.

(2) This Decision shall be subject to examination by the Charter Conference five years after entry into force of the Treaty, but not later than the date envisaged in Article 32(3).

(3) No Contracting Party shall be eligible to apply such restrictions unless it is a Contracting Party which is a state that was a constituent part of the former Union of Soviet Socialist Republics, which has notified the provisional Secretariat in writing no later than 1 July 1995 that it elects to be eligible to apply restrictions in accordance with this Decision.

(4) For the avoidance of doubt, nothing in this Decision shall derogate, as concerns Article 16, from the rights hereunder of a Contracting Party, its Investors or their Investments, or from the obligations of a Contracting Party.

(5) For the purposes of this Decision:

'Current Transactions' are current payments connected with the movement of goods, services or persons that are made in accordance with normal international practice, and do not include arrangements which materially constitute a combination of a current payment and a capital transaction, such as deferrals of payments and advances which is meant to circumvent respective legislation of the Limiting Party in the field.

Within the timeframe indicated in item (3) only the Russian Federation made the necessary notification on 29 June 1995.

Decision No. 3 caused the Chairman of the European Energy Charter Conference to make the following statement:

CHAIRMAN'S STATEMENT Having followed the long and difficult discussions on the Freedom of Transfers, I note that certain countries in transition have drawn attention to their interpretation of Decision No 3 which I think to be correct: the rights granted to Investors of other Contracting Parties under paragraph 1(a) of Decision No 3 do not preclude these countries from applying, without derogating from paragraphs 1(b) and (c), (2), (3) and (4) of that Decision, restrictions on movement of capital made by their Investors.[696]

Decision No. 3 gave rise to the following exchange of letters between the European Communities and the Russian Federation.

Letter from the European Communities to Russia:

The purpose of this letter is to confirm that with regard to Decision No 3 of the Energy Charter Treaty (ECT) concerning transfer of payments and especially to the footnote to this Decision, Article 105 in our Partnership and Co-operation Agreement (PCA), signed at Corfu, 24 June 1994, shall not have the effect of disapplying Article 16 of the ECT in relation to Decision No 3.

I propose that this letter and your reply will establish a formal agreement between us.

Letter from the Russian Federation:

I took note of your letter of 17 December 1994, the purpose of which is the confirmation that with regard to Decision N° 3 of the Energy Charter Treaty (ECT) concerning transfer of payments, and especially to the footnote to this Decision, Article 105 of the Agreement on Partnership and Co -operation establishing a partnership between the Russian Federation, of the one part, and the European Communities and their Member States, of the other part (PCA), signed at Corfu on 24 June 1994, shall not have the effect of disapplying Article 16 of the ECT in relation to Decision N° 3.

I agree that your letter and this reply will establish a formal agreement between us.

The footnote to which reference is made, and which was deleted from the final text reads:

This Decision has been drafted on the understanding that Contracting Parties which intend to avail themselves of it and which have also entered into Partnership and Co-operation Agreements with the European Union and its member states containing an article disapplying those Agreements in favour of this Treaty will exchange letters of understanding which have the legal effect of making Article 16 of this Treaty applicable between them in relation to this Decision. The exchange of letters shall be completed in good time prior to signature.

Article 14(2) obliges Contracting Parties to proceed with transfers without delay, in a Treaty Convertible Currency, except in case of return in kind.[697]

[696] Chairman's Statement at the Adoption Session on 17 December 1994.

[697] Freely Convertible Currency is defined in Article 1(14); for commentary, see p. 142, *supra.*

Decision 4 with respect to the Energy Charter Treaty dealt with Article 14(2) and Romania. It reads:

> Without prejudice to the requirements of Article 14 and its other international obligations, Romania shall endeavour during the transition to full convertibility of its national currency to take appropriate steps to improve the efficiency of its procedures for the transfers of Investment Returns and shall in any case guarantee such transfers in a Freely Convertible Currency without restriction or a delay exceeding six months. Romania shall ensure that Investments in its Area of the Investors of all other Contracting Parties are accorded, with respect to transfers, treatment no less favourable than that which it accords to Investments of Investors of any other Contracting Party or of any third state, whichever is the most favourable.

Since Romania has introduced full convertibility of its currency, this Decision is no longer applicable.

Under Article 14(3) transfers are to be made at the market rate of exchange in a freely convertible currency. Such transfers include initial and additional capital, returns, remuneration to personnel, proceeds from the sale or liquidation of the investment, payments arising out of the settlement of an investment dispute and compensation for loss or expropriation.

It follows from Article 14(4) that a Contracting Party, being the host State, may protect the rights of creditors, ensure compliance with laws on securities and the satisfaction of payments in proceedings, through equitable, non-discriminatory application of its law.

Article 14(5) stipulates that countries belonging to the Commonwealth of Independent States may, with respect to transfers among themselves, conclude agreements to the effect that transfers of payments shall be made in the currencies of such parties, provided that such agreements ensure that Contracting Parties are not treated less favourable than Investments of Investors of Contracting Parties which have entered into such agreements, or Investments of Investors of nay third State. This provision is clarified by Understanding No. 12. It reads:

> It is intended that a Contracting Party which enters into an agreement referred to in article 14(5) ensure that the conditions of such an agreement are not in contradiction with that Party's obligation under the Articles of Agreement of the International Monetary Fund. [698]

Under Article 14(6) transfers of returns in kind may be restricted in circumstances where the WTO agreements allow export restrictions, except that such transfers must be allowed in accordance with the provisions of any written agreement with a Contracting Party.

F. Article 15: Subrogation

(1) If a Contracting Party or its designated agency (hereinafter referred to as the 'Indemnifying Party') makes a payment under an indemnity or guarantee given in respect of an Investment of an Investor (hereinafter referred to as the 'Party Indemnified') in the Area of another Contracting Party (hereinafter referred to as the 'Host Party'), the Host Party shall recognize:
(a) the assignment to the Indemnifying Party of all the rights and claims in respect of such Investment; and

[698] Understanding No. 12, Final Act of the European Energy Charter Conference.

(b) the right of the Indemnifying Party to exercise all such rights and enforce such claims by virtue of subrogation.

(2) The Indemnifying Party shall be entitled in all circumstances to:

(a) the same treatment in respect of the rights and claims acquired by it by virtue of the assignment referred to in paragraph (1); and

(b) the same payments due pursuant to those rights and claims, as the Party Indemnified was entitled to receive by virtue of this Treaty in respect of the Investment concerned.

(3) In any proceeding under Article 26, a Contracting Party shall not assert as a defence, counterclaim, right of set-off or for any other reason, that indemnification or other compensation for all or part of the alleged damages has been received or will be received pursuant to an insurance or guarantee contract.

There are several ways for investors to protect themselves against political risks. At the international level investors enjoy protection under customary international law and under investment protection treaties.

Another simple, direct and efficient method of obtaining protection against political risks is for the investor to purchase political risk insurance. In many respects political risk insurance is similar to ordinary business risk insurance. It is available from a number of sources, including private insurers, State-sponsored insurance agencies and international agencies.

National State-sponsored insurance programmes are usually tied to the promotion of the national economy of the investor. This means that protection is typically granted only to national companies and usually only to their investments in countries which are friendly with the host State.

As a rule, private insurers have more flexibility than government-sponsored agencies. Private insurers can thus adapt their products to the specific needs of the individual investor. This means that both coverage and price can vary considerably from one private insurer to another. On the other hand, the private sector seems to be less willing to provide coverage for longer periods of time. It is not unusual for governmental sponsored agencies to offer protection for up to 20 years, and beyond, whereas this seems to be unusual in the private sector.

While political risk insurance does provide certain coverage for investors, it does not always cover investments existing at the time of the entry into force of the insurance, or all risks that are commonly protected in investment protection treaties. However, unlike in some investment arbitrations, political risk insurance does not present the jurisdictional hurdles sometimes faced by investors, or factors such as challenges to party-appointed arbitrators and annulment procedures that may significantly prolong the arbitral process. Similar to bilateral and multilateral investment treaties, political risk insurance not only benefits the investor by securing protection for his investment, but also benefits the host State by encouraging foreign direct investment from potential investors.

There are several actors providing political risk insurance. At the international level, the Multilateral Investment Guarantee Agency (MIGA) is the most important actor. At the national level, OPIC (Overseas Private Investment Corporation) in the US plays an important role, as does the German equivalent PricewaterhouseCoopers—Euler Hermes. Both OPIC and Hermes are backed by their respective governments. In addition there is nowadays multitude of private sector providers of political insurance.[699]

[699] One estimate indicates that as per 2016 there were approximately 70 private political risk insurers; see Peinhardt and Allee, 'Political Risk Insurance as Dispute Resolution', 7 Journal of International Dispute Resolution (2016) 208.

MIGA was created to promote foreign investment by establishing a method to provide political risk insurance to companies whose government did not have national programmes affording such coverage and to complement those who did the provide coverage.[700] The draft convention establishing the Agency was submitted to the Board of Governors of the International Bank for Reconstruction and Development on 11 October 1985, and went into effect on 12 April 1988 (the 'MIGA Convention' or the 'Convention').

It entered into force upon ratification by five industrialized countries (referred to in the MIGA Convention as Category 1 countries) and fifteen developing countries (Category 2 countries), which were required to subscribe to one third of MIGA's capital (approximately USD 360 million).[701] Pursuant to Article 4(a), membership is open to all members of the World Bank and to Switzerland.

The MIGA Convention was amended by the Council of Governors of MIGA effective 14 November 2010. Under its amended provisions, Article 12(v) now enables the Agency to cover existing investments 'where there is an improvement or enhancement of the underlying project or the investor otherwise demonstrates medium- or long-term commitment to the project and the Agency is satisfied that the project continues to have a high developmental impact in the host, country.'

The object and purpose of MIGA is to support the flow of investments for productive purposes among its member countries, and in particular to *developing member countries*.[702] To reach this objective, the founding fathers provided MIGA with the authority to issue guarantees against political risks in respect of investments between member countries.[703]

Subrogation is an accepted principle of insurance law. A subrogation clause provides for the assignment of an existing claim from the guaranteed investor to a third party and that the third party as subrogate acquires the same rights as the investor had.

This ensures that the insurer/guarantor has a legal basis for recovering payments made under the insurance policy. Subrogation is thus a central element in most investment guarantee programmes.

For such programmes to work it is also important that the host country in question agrees to recognize subrogation. Otherwise the assignment of the investors rights and claims to the insurer might not be accepted under applicable national law. When such recognition is affected in a treaty—as in the ECT—it also becomes an international obligation on the host State/Contracting Party in question.

Article 15 is a so-called subrogation clause. It provides for the transfer of rights that a foreign investor may have in relation to the host State, if it has received compensation from its home state under an investment insurance or guarantee. In this case, the host State shall recognize the assignment to the indemnifying party of all rights and claims with regard to the investment. It shall also acknowledge the right of the indemnifying party to exercise all such rights and enforce such claims.

[700] R. Doak Bishop, James Crawford and Michael Reisman (eds), Foreign Investment Disputes: Cases, Materials and Commentary (Kluwer Law International, 2005) 491–2.

[701] See Article 61 of MIGA's Convention; S. Linn Wiliams, 'Political and Other Risk Insurance: OPIC, MIGA, EXIMBANK and Other Providers' (1993) 5 Pace Int'l L. Rev. 59–114, 82.

[702] The Convention Establishing the Multilateral Investment Guarantee Agency, 11 October 1985, 1508 UNTS 99, Article 2 (MIGA Convention) (emphasis added).

[703] MIGA Convention, Preamble, Article 2(a).

The obligation for Contracting Parties to accept rights does not affect their rights to invoke the provision on state-to-state arbitration Article 27 of the ECT.[704]

As a matter of principle, the subrogee will succeed to any rights and claims that the Investor may have had with respect to the Investment in question. In the case of ICSID arbitrations, the situation may be more complicated. The explanation is the following.

Many political risk insurance arrangements are administrated by States or by State agencies. When they are subrogated into the rights of the investor, the dispute is thus transformed into a dispute between two States, or State agencies. Under the ICSID Convention States, State, agencies and international organizations are excluded from access to ICSID arbitration on the investor's side. They can thus not appear as parties in ICSID arbitrations once they have made payments to the investor under the insurance arrangement in question.[705]

As far as the question of legal standing is concerned the situation can be solved through various contractual arrangements.[706]

Paragraph (3) of Article 15 stipulates that payment under an insurance or guarantee contract cannot be argued as a defence in arbitration proceedings under Article 26 of the ECT, which includes the possibility to resort to ICSID arbitration.[707]

G. Article 16: Relation to Other Agreements

Where two or more Contracting Parties have entered into a prior international agreement, or enter into a subsequent international agreement, whose terms in either case concern the subject matter of Part III or V of this Treaty,

(1) nothing in Part III or V of this Treaty shall be construed to derogate from any provision of such terms of the other agreement or from any right to dispute resolution with respect thereto under that agreement; and
(2) nothing in such terms of the other agreement shall be construed to derogate from any provision of Part III or V of this Treaty or from any right to dispute resolution with respect thereto under this Treaty,

where any such provision is more favourable to the Investor or Investment.

I. Introduction

Article 16 addresses the situation when the ECT overlaps with other treaties. In simplified terms, it could be said that Article 16 of the ECT replaces Article 30 of the Vienna Convention in so far as successive treaties ae concerned.[708]

Article 16 refers to prior, as well as subsequent, treaties entered into by two or more Contracting Parties. It does not cover all provisions of the ECT, but is limited to 'the subject matter of Part III or V' of the treaty. Stated in general terms, the effect of Article 16 is that any provision in either treaty—the ECT or the other treaty, prior as well as subsequent—which is more favourable to the Investor or Investment may be applied.

[704] For commentary on Article 27, see p. 475 *et seq.*, *infra.* [705] Cf. Schreuer, *op. cit.*, at page 186.
[706] Ibid., at pp. 187–9. [707] For commentary on Article 26, see p. 414 *et seq.*, *infra.*
[708] Cf. the discussion relating to the so-called intra-EU issue at p. 401 *et seq.*, *infra.*

The wording of Article 16 indicates that there is no need to determine whether there is a *conflict* between provisions in overlapping treaties. The test is to determine which provisions are more *favourable* to the Investor or Investment.

Article 16 must be read against the background of Article 46 of the ECT, which states that no reservations may be made to the ECT.[709] It is also important to note that the ECT does not have a so-called disconnection clause, i.e. a treaty clause which regulates differences from, or conflicts with, other treaties by establishing a hierarchy between overlapping treaties.

During the negotiations, it was proposed to include a disconnection clause in the treaty text. This proposal was, however, rejected.[710]

At the adoption of the ECT, the Contracting Parties, did, however, regulate the relation between the ECT and the treaty concerning Spitsbergen by issuing Decision No. 1, which reads:

> In the event of a conflict between the treaty concerning Spitsbergen of 9 February 1920 (the Svalbard Treaty) and the Energy Charter Treaty, the treaty concerning Spitsbergen shall prevail to the extent of the conflict, without prejudice to the positions of the Contracting Parties in respect of the Svalbard Treaty. In the event of such conflict or a dispute as to whether there is such conflict or as to its extent, Article 16 and Part V of the Energy Charter Treaty shall not apply.[711]

Another form of carve-out is found in Article 29(2)(b) dealing with trade between former members of the Soviet Union.

The provision reads:

> Such trade of a Contracting Party which is a state that was a constituent part of the former Union of Soviet Socialist Republics may instead be governed, subject to the provisions of Annex TFU, by an agreement between two or more such states, until 1 December 1999 or the admission of that Contracting Party to the WTO, whichever is the earlier.

Whilst this provision has now lost its relevance, it represented an agreed carve-out at the time when the ECT was signed.

Another limitation on the scope of the ECT is the agreement between the European Communities and the Russian Federation to the effect that trade in nuclear materials was to be regulated by separate bilateral agreements. The agreement in the form of a joint memorandum reads:

> The delegations of the Russian Federation and of the European Communities have examined the situation of the nuclear trade between both Parties and they acknowledged the following:
>
> – The statement of the European Commission in the Joint Committee held on 1 and 2 December 1994 clearly indicates that 'the European Commission and the Euratom Supply Agency have never made it their policy to apply quotas on imports of nuclear materials from Russia and do not intend to do so in the future unless a situation should arise requiring safeguard measures in accordance with Article 15 of the Agreement between the European Economic Community, the European Atomic Energy Community and the Union of Soviet Socialist Republics on Trade and Economic and Commercial Co-operation signed in Brussels on 18 December 1989. This means, a fortiori, that no quotas have been or will be applied on a utility by utility basis.'

[709] For commentary on Article 46, see p. 530 *et seq.*, *infra.*

[710] Draft Basic Agreement for the European Energy Charter, 12 August 1992; Draft Ministerial Declaration to the Energy Charter Treaty, version 2–7 (version 7).

[711] Decision I with respect to the Energy Charter Treaty; Annex 2 to the Final Act of the European Energy Charter Conference.

– The relevant provisions of the Agreement on Partnership and Co-operation establishing a partnership between the European Communities and their Member States on the one part, and the Russian Federation on the other part, signed in Corfu on 24 June 1994, on national treatment with respect to nuclear materials imported from Russia are fully applicable.
– They acknowledge the intention expressed by the European Commission to look at the way the Euratom Supply Agency is implementing its supply policy, with a view to take full account of both Parties' legitimate interests, including inter alia the interest expressed by Russia in increasing the volume of trade.

Representatives of the Commission and of the Russian Government will meet in the near future in order to examine the difficulties encountered by Russian exporters of nuclear materials.[712]

II. ECT Awards

Several ECT tribunals have discussed Article 16, usually in connection with jurisdictional objections raised by respondent States to the effect that tribunals sitting under the ECT lack jurisdiction in intra-EU disputes.[713]

The first tribunal to discuss Article 16 was the tribunal in *Electroabel v. Hungary*[714] in its decision on jurisdiction, applicable law and liability. With respect to the substantive protection, in Part III of the ECT, the tribunal did not consider that the ECT and EU law shared the same subject matter. It therefore found that Article 16 was not applicable in this respect.[715]

Concerning arbitration under Part V of the ECT, the tribunal noted that EU law was not incompatible with the ECT and that the two legal orders could be applied together as far as arbitration was concerned.[716] The tribunal concluded that 'nothing in EU law can be interpreted as precluding investor-state arbitration under the ECT and the ICSID Convention'.[717]

In *RREEF v. Spain*[718] Article 16 of the ECT was discussed again. The respondent argued that the ECT was not applicable to disputes concerning intra-EU investments.

On the issue of the lack of a disconnection clause in the ECT, the respondent noted that it would be meaningless and that no such clause was needed. The reason was, the respondent continued, that 'the ECT was a multilateral treaty signed by the ECT, together with the Member States, and obviously the latter could not subscribe to a treaty that was incompatible with EU law.'[719]

The claimant pointed to the fact that the EU had used disconnection clauses in other treaties where they had been intended to apply, but that no such clause was intended with respect to investor-state arbitration.[720]

With respect to the interpretation of Article 16, the claimant, *inter alia*, said the following:

Article 16 of the ECT provides that other norms can prevail when they are more favourable to the Investor or Investment. In this respect, the substantive protection afforded by the ECT to

[712] Joint memorandum of the Delegations of the Russian Federation and the European Communities on Nuclear Trade, Annex II to document CONF 115, 6 January 1995.
[713] For a further discussion of this issue, see p. 401 *et seq.*, *infra.* [714] See note 211, *supra.*
[715] *Electrabel v. Hungary*, at para. 4176. [716] Ibid., at para. 4175. [717] Ibid.
[718] *RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.a.r.l. v. Kingdom of Spain*, Decision on Jurisdiction dated 6 June 2016.
[719] *RREEF v. Spain*, at para. 51, quoting from respondents Memorial on Jurisdiction.
[720] Ibid., at para. 65.

investors and their investment is broader compared to the one afforded by the EU law, notably in the post-establishment phase. This is also evident in the dispute settlement stage, where the ECT allows investors to bring direct claims against the Contracting Parties before an arbitral tribunal, in contrast to EU law, where the investor has to go through the domestic courts of the State where the investment has been made. Therefore, if the ECT and EU treaties were found to have the same-subject matter, the ECT's more favourable provisions, including the right of investors to initiate arbitral proceedings against a Contracting Party, would take precedence over any conflicting provision of the EU treaties.[721]

In addressing the issue of its jurisdiction, the tribunal observed that it had been established by a specific treaty—i.e. the ECT—and that the ECT was its constitution. The tribunal went on:

Therefore, in case of any contradiction between the ECT and the EU law, the tribunal would have to insure the full application of its '*constitutional*' instrument, upon which its jurisdiction is founded. This conclusion is all the more compelling given that Article 16 of the ECT expressly stipulates the relationship between the ECT and other agreements—from which there is no reason to distinguish EU law. It follows from this that, if there must be a '*hierarchy*' between the norms to be applied by the Tribunal, it must be determined from the perspective of public international law, not of EU law. Therefore, the ECT prevails over any other norm (part from those of *ius cogens*—but this is not an issue in the present case). In this respect, the Tribunal fully agrees with the position of the tribunal in *Electroabel*.[722]

The tribunal also addressed the question of an implicit disconnection clause in Article 26 of the ECT[723] as argued by Respondent. The tribunal was not convinced by the argument. It said:

The purpose of a disconnection clause is to make clear that EU Member States will apply EU law in their relations inter se rather than the convention in which it is inserted. Absent such a clause in a multilateral treaty, it is intended to be integrally applied by the EU and its Member States. It has not been challenged that no such clause has been included in the ECT. According to the Respondent, the inclusion of such a clause would be meaningless when 'the envisaged agreement covers areas in which there has been total harmonisation'.In the Tribunal's view, given that there is no disharmony or conflict between the ECT and EU, as noted above, there was simply no need for a disconnection clause, implicit or explicit.[724]

In *Charanne v. Spain*,[725] the respondent again argued that the ECT contained an implicit disconnection clause for intra-EU relations. The purpose of this clause was said to be to exclude relations between EU Member States from the ECT. The tribunal did not find this argument convincing. It interpreted the ECT on the basis of the Vienna Convention, and concluded that 'the terms of the treaty are clear and do not justify any additional interpretation that could lead to reading into the ECT an implicit disconnection clause for intra-EU disputes'.[726]

The tribunal went on to say that in its view, there was no need to agree on a disconnection clause. The tribunal explained:

[721] Ibid., at para. 60 (footnotes omitted).
[722] Ibid., at para. 75 (footnotes omitted).
[723] For a commentary on Article 26, see p. 414 *et seq. infra.*
[724] Ibid. at para. 82 (footnotes omitted).
[725] *Charanne B.V. and Construction Investments S.A.R.L. v the Kingdom of Spain*, Final Award dated 21 January 2016.
[726] *Charanne v. Spain*, at par. 437.

In reality, the Tribunal considers that the Contracting Parties to the ECT had no need to agree on a disconnection clause, be either implicitly or explicitly. The role of a disconnection clause would be, in effect, to resolve a conflict between the ECT and the TFEU. However, there is no conflict between the two treaties. As stated in previous sections of the present award, the competence of the Arbitral Tribunal to decide on a claim filed by an investor of an EU Member State against another EU Member State on the basis of the alleged illegal nature of the actions carried out in the exercise of its national sovereignty, is perfectly compatible with the participation of the EU as a REIO in the ECT. And, as we shall see in subsequent sections of the present award, there is no rule of EU law which prevents EU Member States to resolve through arbitration their disputes with investors from other Member States through arbitration. Nor is there any EU law rule that prevents an arbitral tribunal to apply EU law to resolve such a dispute.

Having determined the above, the Arbitral Tribunal does not have to resolve the arguments of the parties concerning Article 16 of the ECT. In fact, this rule would be only relevant in the event of an inconsistency between the ECT and EU law. The Tribunal is aware of the conclusion that was reached on this matter by the tribunal in *Electrabel v. Hungary*, according to which '*from whatever perspective the relationship between the ECT and EU Law is examined, the Tribunal concludes that EU law would prevail over the ECT in case of any material inconsistency*'. *However, as we will see in the following paragraphs, in the present case there is no contradiction whatsoever between the ECT and EU law.*[727]

The tribunal thus focused on the alleged incompatibility of the ECT with EU law, rather than on the language in Article 16, which refers to provisions which are 'more favorable to the Investor or Investment'. The tribunal then went on to explain that Article 344 of the TFEU—which had been the main focus of respondents' arguments in this respect—did not apply to investor-state arbitration, and that, therefore, the issue of incompatibility of the ECT with EU law did not arise.[728]

In *Isolux v. Spain*,[729] the respondent made essentially the same arguments concerning the alleged lack of jurisdiction of the arbitral tribunal. The respondent argued that the ECT did not apply to intra-EU investments. In so doing, it referred to the alleged implied disconnection clause and to the effect of Article 344 of the TFEU. The tribunal rejected respondent's arguments, essentially, following the reasoning of the tribunal in *Charanne v. Spain*.[730]

The question of a disconnection clause also came up in *Blusun v. Italy*[731] in the context of respondent's argument that the ECT did not apply to relations inter se of EU Member State. The tribunal first noted that there was no carve out in the ECT, which excluded issues arising between Member States.[732] Italy argued that an implicit disconnection clause should be read into the ECT, referring to the *travaux préparatoires*. The tribunal noted that it is not permissible to rely on *travaux préparatoires* when the terms of the treaty are clear. It also observed that a disconnection clause had been proposed during the ECT negotiations, but was rejected which in the tribunal's view seemed to point against reading a disconnection clause into the ECT.[733]

Italy also argued that agreements subsequently entered into by Member States—such as the Treaty of Nice and the Treaty of Lisbon—have implicitly repealed the earlier ECT based on the *lex posterior* rule in Article 30 of the Vienna Convention. Italy also argued that Article 26 of the ECT was incompatible with Article 344 of the TFEU.

[727] Ibid. at paras. 438–9 (footnoted omitted). [728] Ibid., at paras. 440–7.
[729] See note 94, *supra*. [730] *Isolux v. Spain*, at paras. 621–60.
[731] See note 153, *supra*. [732] *Blusun v. Italy*, at para. 280. [733] Ibid. at para. 280 (item 4).

The arbitral tribunal concluded that the ECT had not subsequently been modified or superseded by later EU legislation.[734]

In *Eiser v. Spain*,[735] the respondent again raised a jurisdictional objection to the effect that Article 26 of the ECT did not give the tribunal jurisdiction to try claimant's claim. Starting with the ordinary meaning of the wording of Article 26, the tribunal concluded that it had jurisdiction. Spain argued, however, that the ECT contained an implicit exception. In Spain's view, Article 26 was subject to an unstated exception banning any claims by Investors of EU Member States against an EU Member State which is a Contracting Party. In addressing this argument, the tribunal said the following:

> Treaty law and practice provide familiar mechanisms for treaty makers wishing to limit or exclude application of particular provisions in particular situations. These were known and used in the ECT's texts, including by the predecessor to the European Union and its member countries. The treaty includes multiple limiting decisions and understandings, such as those providing that the treaty concerning Spitsbergen prevails over inconsistent provisions of the ECT in case of a conflict and limiting the scope of the treaty to 'Economic Activities in the Energy Sector'. In like vein, the European Communities and the Russian Federation agreed that trade in nuclear materials should be regulated by separate bilateral arrangements. Yet the EEC sought no similar clarifying provisions regarding what Respondent now contends is a major exclusion in the ECT's coverage. Respondent contends that no such express exclusion was included in the ECT because, for reasons analyzed below, it was obviously not required. The Tribunal is not persuaded.[736]

The tribunal then went on to interpret Article 26. In conclusion, the tribunal noted:

> Respondent's argument from Article 26(6) thus seeks to introduce a major, if unwritten, exception into the coverage of the ECT on the back of a somewhat intricate argument regarding choice of law. The Tribunal does not agree that the drafters of the ECT either intended or accomplished this result.
>
> The Tribunal's jurisdiction is derived from the express terms of the ECT, a binding treaty under international law. The Tribunal is not an institution of the European legal order, and is not subject to the requirements of that legal order. However, the Tribunal need not address the possible consequences that might arise in case of a conflict between its role under the ECT and the European legal order, because no such conflict has been shown to exist. Here, as in *Charanne*:
>
> [. . .] [T]his case does not entail any assessment with regards to the validity of community acts or decisions adopted by European Union organs. Additionally, it does not concern in any way allegations by the European Union that EU law has been violated, nor claims against such organization. In this arbitration there is not an argument according to which the content of the disputed provisions [...] is contrary to EU law.[737]

Respondent also relied on Article 344 of the TFEU. The tribunal concluded—like other tribunals before it,[738] that Article 344 was not applicable, since the dispute was not between EU Member States, nor did it address the allocation of competences between the EU and its members.[739]

In *Novernergia v. Spain*,[740] the tribunal briefly discussed respondent's arguments that the ECT included an implicit disconnection clause. The tribunal did not explicitly refer to Article 16, but concluded that there is no implicit disconnection clause and also that

[734] Ibid., at paras. 285–91. [735] See note 100, *supra.*
[736] *Eiser v. Spain*, at para. 187 (footnotes excluded).
[737] Ibid., at paras. 198–9 (footnotes excluded). [738] See p. 302 *et seq.*, *supra.*
[739] Ibid., at para. 204. [740] See note 100, *supra.*

there is no support for respondent's argument as to the primacy of EU law, based on Article 25 of the ECT, or otherwise.[741]

In *Masdar v. Spain*,[742] the claimant in response to Spain's argument with respect to the primacy of EU law relied on Article 16 of the ECT. The tribunal noted that claimant had, based on Article 16, availed itself of the more favourable investor-provisions in Article 26 of the ECT over any conflicting provisions in the EU treaties.[743]

A similar conclusion was drawn by the tribunal in *Greentech v. Italy*.[744] There Italy had relied on Article16 in an attempt to show an intention to preclude the application of Article 26 to intra-EU disputes. The tribunal, quoting claimant with approval, concluded that 'Article 16 cannot be used to deny a benefit that the ECT affords to investors'.[745]

In *Vattenfall v. Germany*,[746] the tribunal noted that Article 16 is a simpler and clearer answer to the jurisdictional challenge based on the intra-EU disputes argument.[747] The tribunal concluded that the terms of Article 16 make clear that it would be prohibited for a Contracting Party 'to construe the EU treaties so as to derogate from an Investor's right to dispute resolution under Article 26 ECT, to the extent that they are understood to concern the same subject matter.'[748]

H. Article 17: Denial of Benefits

Each Contracting Party reserves the right to deny the advantages of this Part to:

(1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organised; or
(2) an Investment, if the denying Contracting Party establishes that such Investment is an Investment of an Investor of a third state with or as to which the denying Contracting Party:
(a) does not maintain a diplomatic relationship; or
(b) adopts or maintains measures that:
(i) prohibit transactions with Investors of that state; or
(ii) would be violated or circumvented if the benefits of this Part were accorded to Investors of that state or to their Investments.

Outline

[741] *Novenergia v. Spain*, at paras. 454–63.
[742] See note 129, *supra.* [743] *Masdar v. Spain*, at para. 332. [744] See note 162, *supra.*
[745] *Greentech v. Italy*, at para. 332.
[746] *Vattenfall AB; Vattenfall GMBH; Vattenfall Europe Nuclear Energy GMBH; Kernkraftwerk Krümmel GMBH & CO. OHG; Kernkraftwerk Brunsbüttel GMBH & Co. OHG v. Federal Republic of Germany*, Decision on the Achmea Issue, dated 31 August 2018.
[747] *Vattenfall v. Germany*, at para. 192. [748] Ibid., at para. 195.

I. Introduction

Article 17 is the last article in Part III of the ECT dealing with Investment Promotion and Protection. In general terms, this provision corresponds to denial of benefits clauses found in many BITs. Such clauses are designed to exclude from the protection of a treaty nationals of a third State which through so-called mailbox or shell companies seek to benefit from provisions that the State parties to the treaty in question did not intend to extend to them. A denial of benefits clause can generally be defined as a right of a State to deny the benefits of an investment protection treaty to an investor with insufficient economic connection with the State on whose nationality it relies.

Article 17 thus restricts the benefits of Part III of the ECT to certain categories of legal entities or Investments of Investors.

As explained above,[749] the primary purpose of the Energy Charter Treaty is set out in Article 2, i.e. to establish a legal framework to promote long-term co-operation in the energy field. The Contracting Parties undertake to create stable, favourable and transparent conditions for Investors of other Member States, including standards of protection in Part III of the ECT. In order to keep those substantive advantages and the treaty protection to Investors of the Member States only, the provisions of the ECT can be invoked only by qualified Investors (as defined in Article 1(7) ECT) in respect to their Investments pursuant to Article 1(6) ECT.[750]

Another barrier to the ECT's protection is Article 17 ECT, the so-called denial of benefits clause.

It allows the host State to deny the substantive protection to Investment that are either (i) made through a company which is owned or controlled by nationals of a non-Member State (article 17(1) ECT), or (ii) made by an Investor from a third State with which the host State does not maintain normal political or economic relationships (article 17(2) ECT).

The interpretation of Article 17 ECT raises several issues as to its meaning and its effect. These issues include whether Article 17 is a matter of jurisdiction or of the merits of a dispute, whether it applies to alleged violations of the ECT that took place before the denial was exercised, as well as the meaning of 'substantial business activities'. So far, these questions have been answered in a rather consistent way by those ECT tribunals which have had to deal with objections under Article 17.[751]

Generally speaking, denial of benefits clauses in investment treaties are designed to exclude from a treaty's protection nationals of third states who, through so-called mailbox or shell companies, seek to benefit from provisions that the State parties to the treaty did not intend to give them. In other words, a denial of benefits clause can be defined as a right of the State to deny the benefits of an investment treaty to a company that does not

[749] See p. 142 *et seq.*, *supra.*
[750] See p. 67 *et seq.*, *supra.* for commentary on Article 1(6) and pages p. 132 *et seq.*, *supra.*, for commentary on Article 1(7).
[751] See p. 327 *et seq.*, *infra.*

have an economic connection to the State on whose nationality it relies. The economic connection would typically consist in control by nationals of the State party to the treaty in question, or in substantial business activities in the State.[752]

Whilst there are differences between the ECT's Article 17 and other investment protection treaties, they all share the primary purpose to prevent so-called treaty shopping, that is – nationals of third States attempting to benefit from the provision of an investment protection treaty. Third country nationals are thus prevented from enjoying the benefits of a treaty, when their home States have not accepted any of the obligations under the treaty in question. The right of a State to deny the benefits permits it to maintain a degree of reciprocity with regard to these benefits. Denial of benefits clauses also generally allow to counter balance the effect of broad definitions of 'investment' and 'investors'. Addressing Article 17 of the ECT, the tribunal in *AMTO v. Ukraine* explained that:

> Article 17 can be read together with the definition of 'Investor' in Article 1(7) as establishing two classes of Investors of a Contracting Party for the purposes of the ECT. The first class comprises Investors with an indefeasible right to investment protection under the ECT. This class includes nationals of another Contracting Party—whether natural persons or juridical entities- except for those nationals falling within the second class.
>
> The second class comprises Investors that have a defeasible right to investment protection under the ECT, because the host State of the investment has the power to divest the Investor of this right. In this second class are legal entities that satisfy the nationality requirement by reason of incorporation but are owned or controlled by nationals of a third state in a manner potentially unacceptable to the host State. Such foreign ownership or control is potentially unacceptable where it involves a State with which the Host State does not maintain normal diplomatic or economic relationships, or where it is not accompanied by substantial business activity in the state of incorporation.
>
> As the purpose of the ECT is to establish a legal framework 'in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits...' then the potential exclusion of foreign owned entities from ECT investment protection under Article 17 is readily comprehensible. 'Long term economic cooperation', 'complementarities' or 'mutual benefits' are unlikely to materialise for the host State with a State that serves as a nationality of convenience devoid of economic substance for an investment vehicle, or a State with which it does not enjoy normal diplomatic or economic relations.[753]

In practice, States usually invoke the denial-of-benefits clauses once an investor has raised claims against the host State in an international investment arbitration.

The first denial of benefits clause seems to have appeared in the Treaties of Friendship, Commerce and Navigation concluded by the United States of America after 1945. Before 1945, embryos of denial of benefits clauses can be found, for example, in the *Treaty of Friendship, Commerce and Navigation, with Final Protocol between the United States of America and Siam*, signed on 13 November 1937. Its Article 1(8) provides that '*neither High Contracting Party shall be required by anything in this paragraph to grant application for any such right or privilege [exploration and exploitation of mineral resources] if at any time such application is presented the grating of all similar applications shall have been suspended or discontinued*.'[754]

[752] Dolzer and Schreuer, Principles of International Investment Law (2008), 55; OECD, *International Investment Law: Understanding Concepts and Tracking Innovations*, 2008.

[753] *Limited Liability Company Amto v. Ukraine*, Award of 26 March 2008, paragraph 61.

[754] Mistelis and Baltag, 'Denial of Benefits and Article 17 of the Energy Charter Treaty', Penn State Law Review, 2009, 1304.

Subsequently, denial of benefits clauses were introduced in many modern bilateral and multilateral investment treaties, such as the ones concluded by the United States with China in 1945, or with Thailand in 1966.[755] In an early commentary on the U.S. BITs, it is mentioned that the purpose of the denial of benefits clause is to 'allow either party to determine whether to extend treaty benefits when involvement by nationals of ether party is relatively minor.'[756]

Although the United States was the first State to include such clauses in their BIT's, the denial of benefits clauses are found today in many investment treaties. A denial of benefits clause is also found in Article 1113 NAFTA, and serves the same two purposes as other such clauses: *first*, to deny benefits to entities with which the contracting States have no diplomatic relations, or upon which they are applying economic sanctions; *secondly*, to deny benefits to enterprises with no substantial activity in the contracting State.

The denial of benefits clause in the ECT was included at the proposal of the United States delegation.[757] This proposal was later amended and included in the ECT Draft of 15 March 1993.[758]

The language of the Draft is essentially the same as in the US proposal, with one interesting difference: the US proposal refers to 'the advantages of this agreement'—thus presumably intending to cover all provisions of the treaty—whereas the Draft refers to 'the advantages of this Part', this reference being to Part III of the ECT setting forth the substantive protections under the ECT.

II. Each Contracting Party reserves the right to deny …

This language raises several questions: (a) *what* must a Contracting Party do to 'reserve the right to deny'?; (b) *when* and *how* may a Contracting Party invoke the denial of benefits clause; and (c) what is the *effect* of exercising the right to deny benefits.

(a) The question as to *what*—if anything—a Contracting Party must do can be answered only if two other questions are first answered, *viz*., (i) is Article 17 triggered automatically if the substantive requirements set out therein are met; and (ii), if it is not triggered automatically, what conditions must be fulfilled by a Contracting Party to be able to rely on Article 17?

In *Plama v. Bulgaria*,[759] the tribunal took the view that the Contracting Party must *exercise* the right which it has 'reserved' in the first sentence of Article 17, and that a Contracting Party may choose to exercise the right, or not. The tribunal stated:

> In the Tribunal's view, the existence of a 'right' is distinct from the exercise of that right. For example, a party may have a contractual right to refer a claim to arbitration; but there can be no arbitration unless and until that right is exercised. In the same way, a Contracting Party has a right under Article 17(1) ECT to deny a covered investor the advantages under Part III; but it is not required to exercise that right; and it may never do so. The language of Article 17(1) is unambiguous;

[755] *Treaty of Friendship, Commerce and Navigation between the United States of America and the Republic of China*, signed on 4 November 1946, in American Journal of International Law, 48, Article XXVI(5), 1949, and *Thailand-U.S. Treaty of amity and Economic Relations*, signed on 29 May 1966, in International Legal Materials, Article XII(1)(f), 1966, 876, 884.

[756] Gann, 'The U.S. Bilateral Investment Treaty Program', Standford Journal of International Law, Volume 21, 1985, 373, 379–80.

[757] U.S. Proposal dated 19 March 1992.

[758] Article 19, ECT Draft dated 15 March 1993, first version, 23/93 CONF 50.

[759] *Plama Consortium Limited v. Republic of Bulgaria*, Award 27 August 2008.

and that meaning is consistent with the different state practices of the ECT's Contracting States under different bilateral investment treaties: certain of them applying a generous approach to legal entities incorporated in a state with no significant business presence there (such as the Netherlands) and certain others applying a more restrictive approach (such as the USA). The ECT is a multilateral treaty with Article 17(1) drafted in permissive terms, not surprisingly, in order to accommodate these different state practices.[760]

The tribunals in the *Yukos* cases[761] reached the same conclusion based on similar reasons. The Russian Federation had argued that denial of benefits was an automatic right once the conditions of Article 17 were met. The tribunals did not agree. They explained:

> Article 17(1) does not deny *simpliciter* the advantages of Part III of the ECT—as it easily could have been worded to do—to a legal entity if the citizens or nationals of a third state own or control such entity and if that entity has no substantial business in the Contracting Party in which it is organized. It rather 'reserves the right' of each Contracting Party to deny the advantages of that Part to such an entity. The Contracting Party must exercise the right.[762]

The same approach was taken by the tribunal in *Liman v. Kazakhstan*,[763] where the parties seem to have agreed that a Contracting Party must expressly invoke the denial of benefits clause. The tribunal agreed, and said:

> This is the only interpretation that can be drawn from the wording that the host state reserves the rights to deny the advantages of this. To reserve a right, it has to be exercised in an explicit way.[764]

The tribunal in *Khan Resources v. Mongolia*[765] adopted the same reasoning. It held:

> The ordinary meaning of the verb 'to reserve' suggests that the right to deny the benefits of the Treaty is being kept by the Contracting Party, to be exercised in the future. Had Article 17 been intended to deny benefits automatically it could have been phrased to do so. A formulation such as: 'the advantages of part III of the ECT shall be denied to' would have made such meaning plain. This leads the tribunal to conclude that the Contracting Party's right to deny the benefits of Part III of the ECT must be exercised actively.[766]

In *Stati et al v. Kazakhstan*[767] the tribunal took the same approach and said:

> Art. 17 ECT only applies if a state invoked that provision to deny benefits to an investor before a dispute otherwise arose. Since Kazakhstan did not exercise this right, Art. 17 ECT is completely irrelevant to this case.[768]

Whilst the ECT tribunals referred to above clearly take the view that Article 17 is not triggered automatically, there are two early ECT awards where the tribunals seem to have assumed that it is automatically applicable, if the substantive requirements set out in the provision are met.

In *Petrobart v. Kyrgyzstan*,[769] the tribunal did not deal in detail with Article 17. It rejected its application based on the facts presented to the tribunal, which did not establish that 'Petrobart is a company owned or controlled by citizens or nationals of a State other than the United Kingdom and that Petrobart has no substantial business in the United Kingdom.'[770]

[760] *Plama v. Bulgaria,* at para. 155.
[761] See note 580, *supra.*
[762] *Yukos* cases at para. 455.
[763] See note 568, *supra.*
[764] *Liman v. Kazakhstan*, at para. 224.
[765] See note 335, *supra.*
[766] *Khan Resources v. Mongolia*, at para. 419.
[767] See note 56, *supra.*
[768] *Stati et al v. Kazakhstan,* at para. 716.
[769] See note 557, *supra.*
[770] *Petrobart v. Kyrgyzstan*, at para. 63.

The tribunal reached this conclusion without discussing whether Kyrgyzstan was under any obligation first to exercise the right, which it had reserved to itself under Article 17. The conclusion was based on the failure to establish that the substantive requirements for its application had been met.

The tribunal in *AMTO v. Ukraine*[771] took a similar approach. In its interpretation, once the substantive requirements for its application are met, Article 17 applies automatically to bar entities, which only have a formal link to a State from the protection offered by the ECT.[772]

Some commentators have questioned the distinction made by ECT tribunals between the right to deny the advantages of Part III and the exercise of the right, suggesting that the words 'reserve the right to deny' should be understood as 'may deny'.[773] This would make for an automatic application of Article 17 of the ECT, provided that the substantive requirements set out therein are met.

b) On the assumption that a Contracting Party must exercise the right to deny benefits under Article 17, the question arises as to *how* and *when* this right is to be exercised.

The text of the provision is silent on both points. The corresponding provision in the NAFTA, however—Article 1113—is explicit with respect to the manner in which denial of benefits is to take place by requiring prior written notification. Article 1113 reads:

Article 1113: Denial of Benefits

1. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such Party and to investments of such investor if investors of a non-Party own or control the enterprise and the denying Party:
   (a) does not maintain diplomatic relations with the non-Party; or
   (b) adopts or maintains measures with respect to the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.
2. Subject to prior notification and consultation in accordance with Articles 1803 (Notification and Provision of Information) and 2006 (Consultations), a Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such Party and to investments of such investors if investors of a non-Party own or control the enterprise and the enterprise has no substantial business activities in the territory of the Party under whose law it is constituted or organized.

In *Plama v. Bulgaria*,[774] the tribunal concluded that denial of benefits must be exercised in a public manner. The tribunal said:

The exercise would necessarily be associated with publicity or other notice so as to become reasonably available to investors and their advisers. To this end, a general declaration in a Contracting State's official gazette could suffice; or a statutory provision in a Contracting State's investment or other laws; or even an exchange of letters with a particular investor or class of investors. Given that in practice an investor must distinguish between Contracting States with different state practices, it is not unreasonable or impractical to interpret Article 17(1) as requiring that a Contracting State must exercise its right before applying it to an investor and be seen to have done so. By itself, Article 17(1) ECT is at best only half a notice; without further reasonable notice of its exercise by the host

[771] See note 753, *supra.* [772] See p. 326, *supra.*

[773] Roe and Happold, *op. cit.*, at 84; cf. also Hamuda, La Clause relative á l'Exclusion des Advantages (Denials and Benefits Clause) Dans le Jurisprudence Arbitrale Récente en Matière D'Investissement: Réflexions Sur Les Affaires Amto et Yukos, Doutrine International (2012) 56–7.

[774] See note 759, *supra.*

state, its terms tell the investor little; and for all practical purposes, something more is needed. The Tribunal was referred to Article 1113(2) NAFTA as an example of a term providing for the denial of benefits which provides for a form of prior notification and consultation; and whilst the wording is materially different from Article 17(1) ECT, this term does suggest that the Tribunal's interpretation is not unreasonable as a practical matter.[775]

The respondent had exercised its right under Article 17(1) on 18 March 2003 in a letter to ICSID's Acting Secretary-General. This was more than four years after the claimant made the investment in Bulgaria. This was not sufficient in the view of the tribunal.

In the *Yukos* cases,[776] the Russian Federation argued that it had fulfilled any notification requirement that might be deemed to exist under the ECT through the 1994 Agreement On Partnership and Co-operation between the European Union and the Russian Federation. Article 30(h) of that agreement denies benefits to companies incorporated in an EU Member State that do not have their principal place of business or central administration in such State and whose operations do not have a real and continuous link with the economy of one of the EU Member States. When the agreement was ratified it was published in the Russian Federation's Official Gazette and in the official gazettes of the EU Member States.

The tribunal did not accept this line of reasoning, primarily based on the view that the ECT and the 1994 Agreement were independent of each other.

The tribunal said:

> The P&C Agreement makes no reference to the ECT and the ECT makes no reference to it. They cover some common ground, and the P&C Agreement does require that benefiting companies have their principal place of business in and possess a real and continuous link with the economy of an EU State. But the lack of any reference to the ECT in the P&C Agreement and the lack of any reference to the P&C Agreement in the ECT defeats reliance upon Article 30(h) of the P&C Agreement as constituting the required exercise of a right under Article 17(1) of the ECT.[777]

In *Khan Resources v. Mongolia*,[778] the tribunal accepted that Mongolia had exercised the right under Article 17 by raising an objection to the jurisdiction of the tribunal. The tribunal explained:

> Once it is found that the Article 17(1) right must be actively exercised, the question arises of whether in the present case Mongolia has in fact exercised its right. While Mongolia does not clearly point to a moment when it exercised its right to deny the benefits of Part III of the Treaty to Khan Netherlands, the Tribunal accepts the implication of Mongolia's argument that in raising this objection to the Tribunal's jurisdiction, Mongolia is in fact exercising its right under Article 17(1).[779]

The tribunal in *Khan Resources v. Mongolia* then went on to raise the question of *when* the right under Article 17 must be exercises. The specific question addressed by the tribunal was whether Article 17(1) could be applied with respect to a specific investor after the investor in question had commenced arbitration against the host State under the ECT. The tribunal answered this question in the negative, and explained:

> A good faith interpretation does not permit the Tribunal to choose a construction of Article 17 that would allow host states to lure investors by ostensibly extending to them the protections of the

[775] *Plama v. Bulgaria*, at para. 157. [776] See note 580, *supra.*
[777] *Yukos* cases, at para. 457. [778] See note 335, *supra.*
[779] *Khan Resources v. Mongolia*, at para. 158.

ECT, to then deny these protections when the investor attempts to invoke them in international arbitration.[780]

In *Plama v. Bulgaria* the tribunal noted that 'a Contracting State must exercise its right before applying it to an investor and be seen to have done so.'[781] In referring to Article 1113(2) of the NAFTA the tribunal seems to have suggested that some form of prior notification and consultation was necessary.[782]

The tribunal seems to have accepted that the right under Article 17 had been exercised on 18 March 2003, which, as the tribunal pointed out, was four years after the claimant made its investment,[783] but after commencement of the arbitration. The request for arbitration was filed on 24 December 2002[784] and registered by ICSID on 19 August 2003.[785]

In *Stati et al v. Kazakhstan*[786] the tribunal noted that 'Article 17 only applies if a State invoked that provision to deny benefits to an investor before a dispute otherwise arose.'[787]

Also in *Masdar v. Spain*,[788] the tribunal took the view that it is required to give affirmative notice before exercising the right to deny benefits.[789]

Commentators have raised critical voices with respect to the interpretation of Article 17 in *Plama v. Bulgaria* and in the *Yukos* cases. The criticism concerns the requirement of a prior notification of investors by a Contracting Party before exercising the right to deny benefits under Article 17. It is said that this interpretation by the tribunals in question is not in conformity with the provisions of Article 31 of the Vienna Convention,[790] essentially since the ordinary meaning of the words used in Article 17(1) cannot be understood as requiring prior notification.[791]

(c) The question as to what *effect* an exercise of the right to deny benefits has essentially turns on whether it is retroactive or prospective.

The first ECT tribunal to address this question was the tribunal in *Plama v. Bulgaria*.[792] Relying on the purpose of the ECT and the legitimate expectations of investors, the tribunal rejected any retroactive effect of Article 17 of the ECT. The tribunal initially noted that the language of Article 17(1) was not clear on this point, and that, therefore the tribunal needed to interpret the provision based on Article 31 of the Vienna Convention. The tribunal explained its conclusion in the following way:

> The covered investor enjoys the advantages of Part III unless the host state exercises its right under Article 17(1) ECT; and a putative covered investor has legitimate expectations of such advantages until that right's exercise. A putative investor therefore requires reasonable notice before making any investment in the host state whether or not that host state has exercised its right under Article 17(1) ECT. At that stage, the putative investor can so plan its business affairs to come within or without the criteria there specified, as it chooses. It can also plan not to make any investment at all or to make it elsewhere. After an investment is made in the host state, the 'hostage-factor' is introduced; the covered investor's choices are accordingly more limited; and the investor is correspondingly more vulnerable to the host state's exercise of its right under Article 17(1) ECT. At this time, therefore, the covered investor needs at least the same protection as it enjoyed as a putative investor able to plan its investment. The ECT's express 'purpose' under Article 2 ECT is the establishment

[780] Ibid., at para. 429.
[781] *Plama Consortium Limited v. Republic of Bulgaria*, Award 27 August 2008. [782] Ibid.
[783] *Plama v. Bulgaria*, at para. 158. [784] Ibid., at para. 1. [785] Ibid., at para. 7.
[786] See note 56, *supra.* [787] *Stati et al v. Kazakstan*, at para. 716.
[788] See note 129, *supra.* [789] *Masdar v. Spain*, at paras. 234–5. [790] See p. 27 *et seq.*, *supra.*
[791] See e.g. Roe and Happold, *op.cit.*, at 86–7; Baltag, *op. cit.,* at 155–7; Jagush & Sinclair, 'Denial of Advantages under Article 17(1)', in Coop and Riberiro (eds) Investment Protection and Energy Charter Treaty (2008) 35–40.
[792] *Plama Consortium Limited v. Republic of Bulgaria*, Award 27 August 2008.

of '... a legal framework in order to promote long-term co-operation in the energy field ... in accordance with the objectives and principles of the Charter'. It is not easy to see how any retrospective effect is consistent with this 'long-term' purpose.

In the Tribunal's view, therefore, the object and purpose of the ECT suggest that the right's exercise should not have retrospective effect. A putative investor, properly informed and advised of the potential effect of Article 17(1), could adjust its plans accordingly prior to making its investment. If, however, the right's exercise had retrospective effect, the consequences for the investor would be serious. The investor could not plan in the 'long term' for such an effect (if at all); and indeed such an unexercised right could lure putative investors with legitimate expectations only to have those expectations made retrospectively false at a much later date. Moreover, in the present case, the Respondent asserts a retrospective effect from a very late date, even after the Claimant's Request for Arbitration and the accrual of the Claimant's causes of action under Part III ECT.[793]

The tribunals in the *Yukos* cases[794] came to the same conclusion:

To treat denial as retrospective would, in the light of the ECT's 'Purpose', as set out in Article 2 of the Treaty ('The Treaty establishes a legal framework in order to promote long-term cooperation in the energy field . . .') be incompatible 'with the objectives and principles of the Charter.' Paramount among those objectives and principles is 'Promotion, Protection and Treatment of Investments' as specified by the terms of Article 10 of the Treaty. Retrospective application of a denial of rights would be inconsistent with such promotion and protection and constitute treatment at odds with those terms.[795]

The same reasoning was relied on by the tribunal in *Liman v. Kazakhstan*:

With regard to the question of whether the right under Article 17(1) of the ECT can only be exercised prospectively, the Tribunal considers that the above mentioned notification requirement—on which the Parties agree—can only lead to the conclusion that the notification has prospective but no retroactive effect. Accepting the option of a retroactive notification would not be compatible with the object and purpose of the ECT, which the Tribunal has to take into account according to Article 31(1) of the VCLT, and which the ECT, in its Article 2, expressly identifies as 'to promote long-term co-operation in the energy field'. Such long-term co-operation requires, and it also follows from the principle of legal certainty, that an investor must be able to rely on the advantages under the ECT, as long as the host state has not explicitly invoked the right to deny such advantages. Therefore, the Tribunal finds that Article 17(1) of the ECT does not have retroactive effect.[796]

In *Khan Resources v. Mongolia*,[797] the tribunal noted that, whilst Mongolia had exercised its right under Article 17, it must be done prior to commencement of arbitration proceedings. Otherwise, the investor 'would find itself in a highly unpredictable situation. This lack of certainty would impede the investors' ability to evaluate whether or not to make an investment in any particular State. This would be contrary to the Treaty's object and purpose.'[798]

In *Masdar v. Spain*,[799] the tribunal noted that it would 'contradict the text and the purposes of the ECT to say that a Contracting State may deny benefits retrospectively, after an investment has been made and a dispute has arisen'.[800]

Commentators have questioned whether the reliance by tribunals on Article 2 of the ECT necessarily leads to the conclusion that the effect of Article 17(1) can only be

[793] *Plama v. Bulgaria*, at paras. 161–2.
[794] See note 50, *supra.*
[795] *Yukos* cases, at para. 458.
[796] *Liman v. Kazakhstan*, at para. 426.
[797] See note 335, *supra.*
[798] *Khan Resources v. Mongolia*, at para. 426. See also *Stati et al v. Kazakhstan*, at para. 717.
[799] See note 129, *supra.*
[800] *Masdar v. Spain*, at para. 239.

prospective. It has been suggested that it could be argued that the 'long-term cooperation' referred to in Article 2 could benefit from a retrospective effect of Article 17(1) in that it could encourage early disclosure by investors of ownership, nationality and citizenship.[801]

III. … the advantages of this Part to:

'This Part' refers to Part III of the ECT. Part III bears the heading 'Investment Promotion and Protection'. It deals with the substantive standards of protection under the ECT. The fact that Article 17 is found in Part III of the ECT has required ECT tribunals to deal with the relationship between Article 17 and the arbitration provision in Article 26 of the ECT, which is found in Part V of the ECT.

It is worthwhile noting that during the negotiations leading to the ECT a proposal was made to exclude disputes relating to Article 17(2) from the arbitration provisions in Articles 26 and 27 ECT.[802] This proposal was not included in the final text.

ECT tribunals which have been confronted with the question of whether Article 17 is a jurisdictional issue, or belongs to the merits of the case, have all concluded that the denial of benefits clause is an issue of the merits of a dispute and does not affect the jurisdiction of a tribunal. This notwithstanding, the tribunals have dealt with this issue in a jurisdictional decision, or jurisdictional award. This is explained by the fact that in these cases the respondent State has raised the applicability of Article 17 as a preliminary issue, and the tribunals have dealt with it accordingly.

In *Petrobart v. Kyrgyzstan*,[803] the tribunal did not expressly rule on the question of whether Article 17 is a matter of jurisdiction, or belongs to the merits of the dispute. It simply held, based on the facts of the case, that the conditions for its application were not met.[804]

In *Amto v. Ukraine*,[805] the respondent argued that the question whether it had duly exercised its rights under Article 17 was not arbitrable and that the State was the sole judge of whether Article 17 applied or not.

The tribunal rejected this argument. It concluded that the State's exercise of its right to deny advantages is an aspect of the dispute submitted to arbitration by the claimant and is within the jurisdiction of an arbitral tribunal. The tribunal explained:

> A dispute regarding an obligation includes a dispute relating to the existence of an obligation ... The state might assert 'rights', 'powers', 'privileges or 'immunities to deny, annul or evade an obligation, but the legal description of the objection does not detach it from the Claimant's assertion of the existence and breach of an obligation. The Respondent's exercise of its 'right' to deny is an aspect of the dispute submitted to arbitration by the Claimant, and within the jurisdiction of this Arbitral Tribunal.[806]

In *Plama v. Bulgaria*,[807] respondent argued that the tribunal lacked jurisdiction to try the merits of the dispute, because there was no consent to arbitration. The respondent took the view that all the requirements for denial of benefits in Article 17(1) were fulfilled.

[801] Chalker, Making the Energy Charter Treaty Too Investor Friendly; *Plama Consortium Limited v. the Republic of Bulgaria, Transnational Dispute Management Journal (no. 5 (2006)*; see also Roe and Happold, *op. cit.*, t84-86.

[802] Letter from Craig Bamberger—Chairman of the Legal Sub-Group—to Lise Weis and Leif Ervik, dated 21 March 1994.

[803] See note 557, *supra.*

[804] *Petrobart v. Kyrgyzstan*, at p. 63.

[805] See note 753, *supra.*

[806] *Amto v. Ukraine*, at para. 60.

[807] See note 759, *supra.*

That being the case, the respondent argued, the claimants enjoyed no benefits under Part III of the ECT, and consequently, the respondent had no obligation under Part III in relation to the claimant. Therefore, the consent to arbitration could not concern an alleged breach of Part III obligation, as required under Article 26(1) of the ECT.[808]

If the tribunal had found that Article 17(1) was to be automatically applied if the substantive requirements were met,[809] as argued by the respondent, the claim would probably have been dismissed for lack of jurisdiction, since the parties to the dispute would not have entered into a valid arbitration agreement.[810]

The tribunal did not, however, squarely address this argument raised by the respondent. It focused on another argument put forward by the respondent, *viz.*, that Article 17 was not limited to benefits under Part III of the ECT, but also included all advantages *relating* to Part III, such as the right to invoke arbitration under Article 26(1) of the ECT.

In rejecting this argument, the tribunal started out by interpreting the express terms of Article 17. It concluded:

> From these terms, interpreted in good faith in accordance with their ordinary contextual meaning, the denial applies only to advantages under Part III. It would therefore require a gross manipulation of the language to make it refer to Article 26 in Part V of the ECT.[811]

The tribunal went on to explain the importance of Article 26 in this context:

> This limited exclusion from Part III for a covered investor, dependent on certain specific criteria, requires a procedure to resolve a dispute as to whether that exclusion applies in any particular case; and the object and purpose of the ECT, in the Tribunal's view, clearly requires Article 26 to be unaffected by the operation of Article 17(1).[812]

The tribunal went on further to explain its conclusion against the background of the object and purpose of the ECT. The tribunal said the following:

> In the Tribunal's view, the contrary approach would clearly not accord with the ECT's object and purpose. Unlike most modern investment treaties, Article 17(1) does not operate as a denial of all benefits to a covered investor under the treaty but is expressly limited to a denial of the advantages of Part III of the ECT. A Contracting State can only deny these advantages if Article 17(1)'s specific criteria are satisfied; and it cannot validly exercise its right of denial otherwise. A disputed question of its valid exercise may arise, raising issues of treaty interpretation, other legal issues and issues of fact, particularly as regards the first and second limbs of Article 17(1) ECT. It is notorious that issues as to citizenship, nationality, ownership, control and the scope and location of business activities can raise wide-ranging, complex and highly controversial disputes, as in the present case. In the absence of Article 26 as a remedy available to the covered investor (as the Respondent contends), how are such disputes to be determined between the host state and the covered investor, given that such determination is crucial to both? According to the Respondent, there is no remedy available to a covered investor under the ECT at all: it has no advantages under the ECT at all; it has no rights under Article 26 to amicable negotiations or international arbitration; and any attempt to initiate arbitration before ICSID will be met with a demand by the host state that the request for arbitration should not be registered under Article 36(3) of the ICSID Convention (as the Respondent contended in its letter dated 4 March 2003, cited above). Towards the covered

[808] For a commentary on Article 26, see p. 414 *et seq. infra.*

[809] See discussion at p. 327 *et seq.*, *supra*; most ECT tribunals have concluded that Article 17(1) is not automatically applicable.

[810] See p. 414 *et seq.*, infra, for discussion on how arbitration agreements are entered into in the context of investment treaty arbitration.

[811] *Plama v. Bulgaria*, at para. 147. [812] Ibid., at para. 148.

investor, under the Respondent's case, the Contracting State invoking the application of Article 17(1) is the judge in its own cause. That is a license for injustice; and it treats a covered investor as if it were not covered under the ECT at all. It is not tempered, as the Respondent's counsel tentatively suggested at the September hearing, by the possibility that the Contracting State might choose, in its discretion, to extend in a friendly but wholly voluntary way any or all of the advantages of Part III during amicable negotiations with the aggrieved investor [D1.151ff]. [813]

In the *Yukos* cases,[814] the tribunal took the same approach as the tribunal in *Plama v. Bulgaria*. In commenting on the arguments presented by the parties, the tribunals in the *Yukos* cases noted that the arguments were not on point in so far as they were deemed to address the question of the jurisdiction of the tribunal. It then went on to say:

> That is because Article 17 specifies—as does the title of that Article—that it concerns denial of the advantages of 'this Part,' i.e., Part III of the ECT. Provision for dispute settlement under the ECT is not found in 'this Part' but in Part V of the Treaty. Whether or not Claimant is entitled to the advantages of Part III is a question not of jurisdiction but of the merits. Since Article 17 relates not to the ECT as a whole, or to Part V, but exclusively to Part III, its interpretation for that reason cannot determine whether the Tribunal has jurisdiction to entertain the claims of Claimant.[815]

The tribunals in *Liman v. Kazakhstan*,[816] *Khan Resources v. Mongolia*,[817] and *Stati et al v. Kazakhstan*,[818] have all taken the same approach as previous ECT tribunals.

IV. 1) a legal entity …

Article 17(1) excludes legal entities from the benefits of Part III of the ECT, provided that the legal entity in question is owned or controlled by citizens or nationals of a third State.

Legal entity is not a defined term under the ECT. It is a widely accepted principle that the legal status of an enterprise, organization etc. is determined by the law of the country pursuant to which the enterprises, organization, etc. has been established. This approach is confirmed in Article 1(7) of the ECT where 'Investor' is defined.[819] An investor of a Contracting Party is, *inter alia*, defined as a company or other organization organized in accordance with the law applicable in that Contracting Party.

It is worthwhile noting that the definition in Article 1(7) does not add any requirements with respect to the nationality of shareholders, the origin of investment capital, or the nationality of directors, or management.[820]

V. … if citizens or nationals …

Article 17(1) limits the effect of the provision to citizens and nationals thus excluding permanent residents of third States. The definition of 'Investor' in Article 1(7) does, however, include natural persons having a permanent residency.[821]

VI. … of a third state …

'Third state' is not a defined term under the ECT. There seems to be wide acceptance that the words in this context refer to a non-contracting party. In *Amto v. Ukraine*,[822] the tribunal said:

[813] Ibid., at para. 149. [814] See note 580, *supra.* [815] *Yukos* cases, at para. 441.
[816] See note 568, at para. 259. [817] See note 335, at para. 411.
[818] See note 56, at para. 716. [819] See p. 132 *et seq.*, *supra.* [820] Ibid.
[821] For commentary on Article 1(7), see p. 133 *et seq.*, *supra*, including the concepts of nationality and citizenship.
[822] See note 753, *supra.*

Third state is not defined in the ECT, but is used in Article 1(7) in contradistinction to 'Contracting Party', which suggests that a third state is any state that is not a Contracting Party to the ECT.[823]

An early draft of the ECT refers to 'non-signatory' instead of 'third state' in the context of the denial of benefits clause.[824]

In the *Yukos* cases,[825] the Russian Federation argued that the term 'third state' is used in the ECT in such a manner that it does not exclude the possibility that a third State may be a Contracting Party or a signatory. In doing so, the Russian Federation referred to Article 1(7) of the ECT defining Investor. The provision stipulates that Investor means, '(b) with respect to a 'third state' a natural person, company, or other organization which fulfils, *mutatis mutandis*, the conditions specified in subparagraph (a) for a Contracting Party'.[826]

The Russian Federation also relied on Article 7(10)(a)(i) defining 'transit' and using the words 'so long as either the other state or the third state is a Contracting Party.'[827]

The tribunal did not agree with these arguments. It said:

> The Treaty clearly distinguishes between a Contracting Party (and a signatory), on the one hand, and a third State, which is a non-Contracting Party, on the other. The Tribunal agrees with Claimant that, on their face, several provisions distinguish between a Contracting Party and third State (for example, Articles (1)(7), 10(3) and 10(7), and 17) and that there is no equation in the ECT between a Contracting Party and a third State. This conclusion is further supported by the travaux préparatoires, which demonstrate that the term 'third state' was substituted for the term 'non-Contracting Party'.
>
> The transit provision of Article 7(10)(a)(i) is clearly distinguishable. That provision defines 'transit' as (i) the 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;
>
> In this particular context, the term 'third state' is used simply to designate the third of the three States necessarily involved in the transit relationship, and not a category of States distinct from Contracting Parties. The French version of the Treaty uses the term 'troisième Etat' in Article 7(10)(a)(i), but 'Etat tiers' elsewhere in the Treaty, clearly supporting the distinct meaning of the term in the different contexts.[828]

In *Libananco Holdings v. Turkey*,[829] the tribunal analyzed this issue in detail, reaching the same conclusion as the tribunals in the *Yukos* cases. The tribunal had the benefit of a written testimony of Mr. Craig Bamberger, who had been closely involved in all aspects of the drafting process leading to the final text of the ECT. Based on this testimony, the tribunal established four principal points:

(a) The term 'third state' appears in numerous Articles of the ECT, viz. Articles 1(7)(b), 7(10)(a)(i), 9(1), 10(3), 10(7), 12(1), and in Article 17 itself.
(b) As the negotiations entered their final phase, the uniform usage in all of these provisions (other than Article 7) was the phrase 'state that is not a Contracting Party'.

[823] *Amto v. Ukraine*, at para. 62. [824] ECT Draft dated 15 March 1993.
[825] See note 580, *supra.* [826] *Yukos* cases, at para. 540–1.
[827] For commentary on Article 7, see p. 177 *et seq.*, *supra.* [828] *Yukos* cases, at para. 543–4.
[829] *Libananco Holdings Co. Limited. v. Republic of Turkey*, Award dated 2 September 2011.

(c) This phrase was then replaced, at the very final stages, by the term 'third state,' but this was a purely technical drafting operation undertaken by the Secretariat on the recommendation of the Legal Sub-Group, and was not intended to bring about any change of meaning.
(d) Article 7 of the ECT was negotiated separately from Article 17, and under the aegis of a different Conference committee. No specific process was set in train, in the rushed final days of the Conference, to ensure an overall concordance of texts, or in particular to compare or reconcile the usage in Article 7 with that in other provisions, or vice versa.[830]

Against this background, the tribunal interpreted the term 'third state' based on the principles of treaty interpretation laid down in the Vienna Convention.[831]

The tribunal said, *inter alia*, the following:

The Tribunal is satisfied that 'third state' has a well recognised ordinary meaning in treaty law. As appears from Section 4 of the VCLT (entitled 'TREATIES AND THIRD STATES'), the expression means simply 'state not party to the treaty in question', which is indeed the only way in which one can give meaning to the 'General rule regarding third States' enunciated in Article 34 of the VCLT, or to the particular rules laid down in Articles 35–7, or to the saving clause contained in Article 38. This reading corresponds exactly to what (according to the evidence of Mr. Bamberger) transpired in the closing stages of the Conference on the ECT, when the crystal-clear phrase 'state that is not a Contracting Party' was replaced by 'third state'. Had the change not been made, there would have been no room for argument on the question. But the Tribunal is not persuaded that the blanket drafting change in all of the Articles in which the longer version occurred was intended to—or had the effect of—changing the sense of these provisions as a matter of 'ordinary meaning'. If any confirmation of this were needed, it can be found by looking at the uses of this term in the ECT 'in their context', as the VCLT requires. Without performing this analysis in detail, the Tribunal can content itself with observing that, in all of the cases listed above (with the exception of Articles 7 and 17), the reference to a 'third state' is juxtaposed immediately alongside a reference to 'a Contracting Party' or 'the Contracting Parties', in such a way as to leave no room for doubt that the two situations were meant to indicate mutually exclusive alternatives. The Tribunal regards that as powerful confirmation that the term 'third state' is used in the ECT in its normal sense. The wording of Article 17 on its own may offer, by contrast, no strong contextual evidence of the same kind, but in its place we have Mr. Bamberger's account that the Article had been worded 'state that is not a Contracting Party' until the final stages, when the wording was altered together with the same phrase in other articles.

Does it make any difference to this clear picture that Article 7 explicitly provides that a 'third state' can be a Contracting Party? In the Tribunal's view, it does not. This view does not depend in its entirety on Mr. Bamberger's evidence referred to in paragraph 552(d) above, although the Tribunal observes that Mr. Bamberger's evidence would be directly relevant if there were to exist any ambiguity that might be resolved by reference to the preparatory work. But in truth there is no ambiguity in Article 7 itself, the terms of which admit only one possibility, namely that in this Article a 'third state' can be a Contracting State, because that is what the definition in paragraph (10)(a)(i) says expressly. Once again, moreover, it is the context that explains the usage, since in this particular case, where the subject of the treaty provision is transit, there is by definition a first state (the state of origin) and a second state (the state whose territory is being transited), so that the state of destination becomes, in an ordinary linguistic sense, a 'third' state – but in circumstances in which it would make no sense to apply the treaty to the carriage unless the 'third' state were itself a Contracting Party. However the clinching argument is in any case, as the Tribunal sees matters, the explicit indication in the chapeau

[830] *Libananco v. Turkey*, at para. 552. [831] See p. 25 *et seq.*, *supra.*

to Article 7(10) that the two definitions which follow are '[f]or the purposes of this Article, which automatically excludes the export of either of those two definitions to other Articles, Article 17 included.[832]

VII. … own or control such entity …

The concepts of ownership and control play a central role in Article 17. Yet the provision does not define these two concepts. Determining ownership is usually less complicated than determining whether there is control of an entity. Understanding No. 3 addresses the question of control for purposes of defining 'Investment' under Article 1(6) of the ECT. [833] This notwithstanding, tribunals have sought guidance from Understanding No. 3 also when interpreting Article 17.

It is to be noted that the provision refers to ownership *or* control. Consequently, the requirements are not cumulative, but are alternative.

In *Plama v. Bulgaria*,[834] the tribunal explained that in its view 'ownership includes indirect and beneficial ownership; and control includes control in fact, including an ability to exercise substantial influence over the legal entity's management, operation and the selection of members of its board of directors or any other managing body'.[835]

In that case the parties agreed on the interpretation of Article 17(1) in this respect, but disagreed on the facts. The tribunal took the view that deciding this issue at the jurisdictional stage was too intertwined with the merits of the case. It therefore reserved the decision for a later stage of the proceedings.[836]

In *Amto v. Ukraine*,[837] the tribunal came to the conclusion that the claimant was wholly owned by a holding company incorporated in Liechtenstein. The holding company was in turn owned by a foundation with its registered office in Liechtenstein. Claimant stated that the ultimate beneficiaries of the foundation were Russian citizens. The tribunal concluded that Amto was controlled by Russian citizens, a finding which raised the issue of whether the Russian Federation was a 'third state' within the meaning of Article 17(1).[838] In the end, the tribunal did not need to rule on this issue, since it found that Amto had substantial business activities in Latvia.[839]

In the *Yukos* cases,[840] the tribunals noted that respondent had not exercised its right under Article 17, which therefore could not be applied.[841] This finding notwithstanding, the tribunal went on to discuss in detail the substantive provisions of Article 17(1), including the questions of ownership and control.

As the chart set out below illustrates, the ownership structure of claimants in the *Yukos* cases was complicated.[842]

[832] *Libananco v. Turkey*, at paras. 553–4 (footnotes omitted).
[833] For commentary on Article 1(6), see p. 105 *et seq.*, *supra.*
[834] See note 759, *supra.*
[835] *Plama v. Bulgaria*, at para. 170.
[836] Ibid., at para. 178.
[837] See note 753, *supra.*
[838] *Amto v. Ukraine*, at para. 66.
[839] Ibid., at para. 70.
[840] See note 580, *supra.*
[841] *Yukos* cases, at para. 458.
[842] This chart was an appendix to the Interim Award on Jurisdiction an Admissibility.

* The Southern Cross Trust is a declaration of trust constituted on April 26, 2005 by the appointment of the GML shares previously held in the Pavo Trust of which Khodorkovsky was the settlor. The Southern Cross Trust has no Protector.

The tribunal found that the claimants were owned by GML Limited (previously group Menatep Limited), a company registered in Gibraltar. The shares of GML were held by seven trusts created in Guernsey. After having analyzed the trust engagements,[843] the tribunal concluded that GML was controlled by one of the trusts holding a 52.3% share in GML. Since both the controlling trust and GML were UK nationals by virtue of declarations of the UK making Gibraltar and Guernsey covered territories under the ECT, they were found not to be 'nationals of a third state'.[844]

VIII … and …

Article 17(1) sets out two requirements for a Contracting Party to be able to deny advantages under Part III of the ECT. *First*, a legal entity must be owned or controlled by citizens or nationals of a third State. *Secondly*, that legal entity must have no substantive business activity in the Area of the Controlling Party in which it is organized.

The word 'and' suggests that the two requirements are cumulative, rather than alternative.

The tribunal in *Plama v. Bulgaria*[845] observed: 'The tribunal attaches significance to the word 'and' linking both limits of Article 17(1), thereby requiring both to be satisfied.'[846]

Whilst the tribunal in *Amto v. Ukraine*[847] did not directly address this issue, it is clear from its reasoning that it viewed the two requirements in article 17(1) as cumulative. When discussing the issue of ownership and control, the tribunal concluded that Amto was controlled by a Russian national, which gave rise to the question whether Russia was a 'third state' within the meaning of Article 17(1). The tribunal then went on to say:

> However, the tribunal's finding on the second precondition in Article 17(1), relating to substantial business activity in Latvia, means the tribunal does not need to determine this question.[848]

When discussing the issue of substantial business activities, the tribunal prefaced this discussion by saying:

> The application of Article 17(1) ECT in this case also requires that AMTO has substantial business activities in the country in which it is organized, i.e. in Latvia.[849]

The tribunal in the *Yukos* cases[850] have taken the same view. After having quoted relevant parts of Article 17(1) and underlined the word 'and', the tribunals said:

> It is apparent from the wording of Article 17(1) that two additional cumulative substantive conditions must be met before the 'denial-of-benefits' clause can be exercised in respect of any particular legal entity. First, such legal entity must be owned or controlled by citizens or nationals of a third State; second, the legal entity must have no substantial business activities in the place in which it is organized.[851]

IX. … if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized; or …

The central words here are *substantial business activities*. There is no definition in the ECT of this term. Nor does the treaty provide guidelines as to how to determine whether a legal entity is engaged in 'substantial business activities'. This is primarily a factual issue

[843] *Yukos* cases at paras 499–535.
[844] Ibid., at para. 536. See p. 335 *et seq.*, *supra* for a discussion of the concept of 'third state'.
[845] See note 759, *supra.* [846] *Plama v. Bulgaria*, at para. 143. [847] See note 753, *supra.*
[848] *Amto v. Ukraine*, at para. 67. [849] Ibid., at para. 68. [850] See note 580, *supra.*
[851] *Yukos* cases, at para. 460.

which tribunals will need to determine based on the facts and circumstances of each individual case.

The reference to *business activities* will include activities and measures in the normal course of business such as buying and selling products or services, entering into contracts concerning the business area in question, holding shareholders' meetings, and carrying out management of the business. Business activities would also include paying taxes and fees relating to the business activity.

In *Petrobart v. Kyrgyzstan*,[852] the tribunal did not deal with this in detail. It accepted the information provided by Petrobart that it was managed by Pemed Ltd, a company registered in England, with its principal office in London. This company handled many of Petrobart's strategic and administrative matters. The tribunal concluded: 'Petrobart therefore has substantial business activities in the Area of a Contracting Party, i.e. the United Kingdom, in the meaning of Article 17 of the Treaty'.[853]

In *Amto v. Ukraine*,[854] the tribunal approached the term 'substantial business activities' in the following way:

> The ECT does not contain a definition of 'substantial', nor does the Final Act of the European Energy Charter Conference that would serve as guidance for interpretation. As stated above, the purpose of Article 17(1) is to exclude from ECT protection investors which have adopted a nationality of convenience. Accordingly, 'substantial' in this context means 'of substance, and not merely of form'. It does not mean 'large', and the materiality not the magnitude of the business activity is the decisive question. In the present case, the Tribunal is satisfied that the Claimant has substantial business activity in Latvia, on the basis of its investment related activities conducted from premises in Latvia, and involving the employment of a small but permanent staff.[855]

The tribunal based this conclusion on the following documents submitted by Amto: a report from a local law firm; a tax certificate from the State Revenue Service in Riga; a statement from the company's landlord; and a bank statement from a Latvian bank.[856]

The tribunal in *Amto v. Ukraine* thus emphasized the materiality of the business activity rather than the quantitative aspects of it. In addition, the term 'substantial' suggests that the business activity in question must be of a certain duration, and that therefore temporary business activities are not relevant in this context.

In *Plama v. Bulgaria*,[857] the claimant, Plama, admitted that it did not have any substantial business activities in Cyprus. The tribunal did therefore not rule on this issue, but added the following:

> It is clear to the tribunal that the claimant has never had any substantial business activities in Cyprus; and contrary to the Claimant's pleading, this shortfall cannot be made good with business activities undertaken by an associated but different legal entity, Plama Holding Limited ('PHL'), even where PHL owns or controls the claimant. In the tribunal's view, the second limb of Article 17(1) is satisfied and applies to the present case.[858]

The tribunal in *Masdar v. Spain*,[859] endorsed the approach suggested in *Amto v. Ukraine*. In evaluating the evidence presented to it, the tribunal concluded that 'the unchallenged evidence adduced by Claimant, notably as to its standing as a holding company with substantial international assets under its control … and the similarly unchallenged evidence

[852] See note 557, *supra*. [853] *Petrobart v. Kyrgyzstan*, at p. 63. [854] See note 753, *supra*.
[855] *Amto v. Ukraine*, at para. 69. [856] Ibid., at para. 68. [857] See note 759, *supra*.
[858] *Plama v. Bulgaria*, at para. 167. [859] See note 129, *supra*.

of Mr. Al Ramahi, is persuasive of the time, extent and materiality of the business conducted by Claimant in the Netherlands'.[860]

X. (2) an Investment, if the denying Contracting Party establishes that …

Investment is a defined term in Article 1(6) of the ECT.[861]

The burden of proof is on the denying Contracting Party. It will thus have to establish that there are no diplomatic relations or that certain kinds of measures are adopted or maintained.

In *Amto v. Ukraine*,[862] the tribunal noted the following when discussing the Article 17:

> There are important differences in drafting between Article 17(1) and 17(2). In particular, Article 17(2) places the burden of proof to establish the facts necessary to exercise this power on the State Party, while Article 17(1) is expressed in a neutral manner in respect of the burden of proof.[863]

When discussing the retrospective or prospective effect of Article 17(1),[864] the tribunal in *Plama v. Bulgaria*[865] observed with respect to Article 17(2):

> … likewise Article 17(2) suggests only a prospective effect to a denial of advantages (' … if the denying Contracting Party establishes … ' etc.).[866]

XI. … such Investment is an Investment of an Investor of a third state with or as to which the denying Contracting Party:

The denying Contracting Party must prove that the Investor is from a third state, i.e. a non-Contracting Party.[867] The definition of Investor of a third State in Article 1(7)(b) of the ECT was introduced because the need was felt to define Investor not only in relation to a Contracting Party, but also with respect to 'third states'.[868] The ECT does not, however, have any definition of 'third state', even though the words are within quotation marks and found in Article 1 of the ECT, which is the definitions section of the treaty.

XII. (a) does not maintain a diplomatic relationship; or …

The only ECT award where Article 17(2) has been relied on is *Libananco v. Turkey*.[869] The respondent relied on this provision because it viewed *Libananco* as a national of Cyprus, a State with which Turkey has no diplomatic relations.

The tribunal did not agree with this argument. It said:

> The only substantial argument remaining is the one from effet utile, on which the Respondent, placed greater and greater reliance as the arbitration proceeded. The essence of the argument is that the purpose and effect of Article 17(2) is to deny benefits ('advantages', in the treaty text), so that the provision would make no sense unless those benefits were in principle available, from which it must follow (so the argument continues) that 'third state' must be capable of including Treaty Parties, since otherwise 'an Investment of an Investor of a third state' would not enjoy Part III benefits in the first place.
>
> The Tribunal does not find this argument convincing. One might begin by pointing out that, under the Respondent's construction, the picture contains no 'third' state at all (in the numerical

[860] *Masdar v. Spain*, at para. 254.
[861] For a commentary on Investment, see p. 67 *et seq.*, *supra.*
[862] See note 753, *supra.*
[863] *Amto v. Ukraine*, at para. 63.
[864] See p. 327 *et seq.*, *supra.*
[865] See note 759, *supra.*
[866] *Plama v. Bulgaria*, at para. 159.
[867] See discussion at p. 335 *et seq.*, *supra*.
[868] Memorandum of Craig Bamberger, dated 27 May 1993.
[869] See note 829, *supra.*

sense). More substantively, though, both 'Investor' and 'Investment' are capitalized in the wording of Article 17(2), so indicating that they are used as terms of art defined as in Article 1. And the definition of 'Investor' in Article 1(7) is deliberately drawn so as to allow for third state Investors. The clear probability must therefore be that Article 17(2) had in mind a quite different eventuality from the one posited by the Respondent, namely one in which the 'Investment' itself is made—in a direct sense—from within the circle of the Contracting Parties, but the ultimate beneficial owner or controller of the 'Investment' (the 'Investor') belongs to a 'third state' as envisaged in Article 1(7). That would then make sense of the difference in phraseology as between paragraphs (1) and (2)34, with its requirement under paragraph (2) that the denying Contracting Party has to 'establish' the ultimate third state nature of the Investor/Investment in order to be entitled to deny him/it the advantages of Part III of the ECT. This seems to the Tribunal to be the natural reading of Article 17, and it finds in fact some confirmation in the account in Mr. Bamberger's witness statement.[870]

XIII. (b) adopts or maintains measures that:

(i) prohibit transactions with Investors of that state; or
(ii) would be violated or circumvented if the benefits of this Part were accorded to Investors of that state or to their Investments.

The measures contemplated here include various forms of trade and financial sanctions adopted by the Contracting Party in relation to the third State in question. Such sanctions could be ordered by the UN Security Council or by the European Union.

Article 17(2) allows a Contracting Party to maintain and pursue its political objectives in relation to Non-Contracting Parties.

XIV. Burden of Proof

Article 17(2) clearly places the burden of proof to establish the facts necessary to exercise the right on the denying Contracting Party.

Article 17(1) is less clear. The latter's wording is rather neutral, which has raised questions in some cases.[871] Which party must prove that the requirements of Article 17 are met? Does it follow the general recognized Roman principle *incumbit probatio qui dicit, non qui negat*, meaning that the burden of proof initially rests on the party who makes an assertion?

The tribunal in *Amto v. Ukraine*[872] observed:

> The burden of proof of an allegation in international arbitration rests on the party advancing the allegation, in accordance with the maxim onus probandi actori incumbit. In application of this principle, a claimant has the burden to prove that it satisfies the definition of an Investor so as to be entitled to the Part III protections and the right to arbitrate disputes in Article 26. On the same basis, the claimant would be expected to have the burden of proof that it controls, directly or indirectly, an Investment for which protection is sought, and this is a fact explicitly stated in Understanding 3 to the Final Act. However, when a respondent alleges that the claimant is of the class of Investors only entitled to defeasible protection, so that the respondent can exercise its power to deny, then the burden passes to the respondent to prove the factual prerequisites of Article 17 on which it relies. Article 17(2) adopts exactly this approach but, as already mentioned, Article 17(1) is neutral on the question of burden of proof.[873]

The tribunal in *Amto v. Ukraine* thus recognized that it may be difficult in practice for the respondent to demonstrate who owns and controls an investor, especially in cases

[870] *Libananco v. Turkey*, at paras. 555–6.
[871] See e.g. *Amto v. Ukraine*, para. 63.
[872] See note 753, *supra.*
[873] *Amto v. Ukraine*, at para. 64.

where ownership and control might involve a number of entities in different jurisdictions. Moreover, a claimant usually has already access to its own business records and could easily present evidence to establish those activities, whereas such information might not be accessible to the respondent. Nevertheless, the tribunal considered that the easy access of the claimant to this information was not sufficient to justify a modification of the normal rules regarding the burden of proof. In the view of the tribunal, the respondent must thus prove that the requirements of Article 17(1) are met.

The fact that the claimant has easy access to the information in question could support a duty to disclose evidence, such that a respondent or a tribunal could request disclosure of specific documents from the claimant, in cases where the information is not otherwise accessible. The tribunal further noted that '*negative interferences might be drawn against the claimant for a failure to provide the requested documents or information. Alternatively […] the respondent might seek to exploit the paucity or ambiguity of the evidence relating to the claimant's business activities to argue these activities have no substance, thereby effectively compelling the Claimant to supplement this evidence, or defend its limitations*'[874]

In *Liman Caspian v. Kazakhstan*,[875] the tribunal recalled the general principle that the burden of proof lies with the claimant to establish the facts on which the claim is based. It also recalled that exceptions on which the respondent relied in its defense made the burden shift. Thus, the tribunal reached the conclusion that the denial of advantages pursuant to Article 17(1) ECT is a situation in which the burden of proof shifts to the respondent.[876]

In *Plama v. Bulgaria*, the claimant argued that it was up to the respondent to prove that Article 17(1) ECT applied factually to the dispute. By contrast, the respondent argued that '*although it might have borne the burden initially in asserting Article 17(1), the burden subsequently shifted to the Claimant to show that its ownership and control has never been held by a national of a third state, being an approach consistent with ECT.*'[877] Respondent contended that the burden shifted to the party which is in exclusive control of the relevant evidence i.e. the claimant, as it alone could produce the relevant documentation and testimony required to resolve disputed factual issues over its own ownership and control.

The tribunal in *Plama v. Bulgaria* adopted the test proffered by Judge Higgins, in her separate opinion in the *Oil Platforms* case,[878] citing the *Mavrommatis* case.[879] In the latter, the Permanent Court of International Justice held that in the absence of any test set forth in the treaty or in the rules governing the Court itself, the Court was '*at liberty to adopt the principle which it considers best calculated to ensure the administration of justice, most suited to procedure before an international tribunal and most in conformity with the fundamental principle of international law*.'[880]

Judge Higgins continued:

> The Court should … see if, on the facts as alleged by [Claimant], the Respondent's action complained of might violate the Treaty articles (§33) … Nothing in this approach puts at risk the obligation of the Court to keep separate the jurisdictional and merits phases … and to protect the integrity of the proceedings on the merits … what is for the merits and which remains pristine and

[874] A*mto v. Ukraine,* at para. 65. [875] See note 568, *supra.*
[876] *Liman Caspian Oil v. Kazakhstan*, at para. 164. [877] *Plama v. Bulgaria*, at para. 166.
[878] *Islamic Republic of Iran v. United States of America (Oil Platforms Case)*, ICJ Reports, 1996, 803, 810.
[879] *Mavrommatis Palestine Concessions*, Judgment No. 2, 1924, P.C.I.J, Series A, 16.
[880] *Plama v. Bulgaria*, paragraph 118; Dissenting Opinion of Judge Higgins in *Oil Platforms Case*, paragraph 28.

untouched by this approach to the jurisdictional issue) is to determine what exactly the facts are, whether as finally determined they do sustain a violation of … [the treaty] and if so, whether there is a defence to that violation … In short, it is at the merits that one sees 'whether there really has been a breach'.[881]

ECT tribunals have all come to the conclusion that the burden of proof rests on the Contracting Party which wants to deny the right and protection of an Investor of the ECT. Some commentators have suggested that: '*Placing the onus of proof under Article 17(1) upon the claimant would be equivalent to an a priori presumption that an investor is not entitled to the benefits under the Energy Charter Treaty, thus granting the host states a license to arbitrarily deny the substantive advantages under the ECT to foreign investors*'.[882]

[881] Dissenting Opinion of Judge Higgins in *Oil Platforms Case*, paragraph 34.

[882] Gadelshina, 'Burden of proof under the 'denial-of-benefits' clause of the Energy Charter Treaty: actori incumbit onus probandi?', Journal of International Arbitration (2012) 284.